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**Enforcing Compliance or Privileging Unaccountability?
The Efficacy and Dangers of Deferred Prosecutions in the
Corporate Sector**

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September 2012

CLMR RESEARCH PAPER SERIES

WORKING PAPER NO. 12-3

ENFORCING COMPLIANCE OR PRIVILEGING UNACCOUNTABILITY? THE EFFICACY AND DANGERS OF DEFERRED PROSECUTIONS IN THE CORPORATE SECTOR

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The difficulties associated with managing and surviving a hostile operating environment has weakened commitment to ethical operating standards. In a major survey Ernst & Young notes that the marked increase in corporate tolerance for unethical practice coincides with what its terms an extremely aggressive enforcement environment. That environment is far from uniform, notwithstanding global commitment to the OECD Convention on Anti-Bribery and Corruption. The United States remains, by far, the most influential jurisdiction in prosecuting economic crime, notably through the application of deferred prosecution agreements. Now the United Kingdom intends to transplant the approach, with refinements, to address the lack of judicial oversight. It remains, however, unclear whether the refinement will necessarily either address the accountability deficit or prove more efficacious in ensuring more substantive compliance. The paper evaluates the strengths and pitfalls of negotiated prosecution and assesses the dangers of using creative enforcement to combat economic crime.

A Introduction

The global economic downturn has significantly increased the pressures on major corporations. Profit margins have been squeezed. Increased competition, decreased demand and the perennial pressure to meet or exceed earnings forecasts add to the bottom line pressures on corporate boards. In such a difficult operating environment, capacity to retain market share while upholding commitment to ethical standards is exceptionally problematic. The 2012 Ernst & Young Annual Global Fraud Survey paints an exceptionally bleak picture.¹ It describes how a debilitating nexus between a challenging economic outlook and 'institutional fatigue' inhibits capacity to deal with a pervasive and growing problem. Hard times, it concludes, strain ethical standards.

The increased corporate tolerance comes at a time of increased external prosecutorial scrutiny. The determination to 'root out global corruption' is most notable in the United States, where fines linked to deferred prosecution agreements are running at record levels.² These agreements, which amount to extra-judicial contracts, significantly enhance the bargaining power of prosecutorial agencies. The flexing of regulatory and legal muscle is also apparent in the United Kingdom, where the Government is consulting on the transplantation of the deferred prosecution as the primary means to combat the scourge of economic crime. The primary stated justification is the capacity of the mechanism to enforce behavioral change. In particular, the consultation paper highlights how efficacious deployment of external monitors through deferred prosecutions can be in evaluating ongoing performance. Three additional tactical and strategic advantages are also canvassed. First, it can reduce the time it takes to complete complex investigations. Second, and if appropriate, corporate exit from particular high-risk activities or markets can be built in. Third, significant revenue can accrue to the Treasury, therefore adding to

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¹ Ernst and Young, *Growing Beyond, A Place for Integrity* (New York, 2012).

² Brandon Garrett, 'Globalized Corporate Prosecutions' (2011) 97 *Virginia Law Review* 1776 (noting the Department of Justice's expansive definition of enforcement, i.e. to 'root out global corruption' at 1776-77).

the sovereign balance sheet as well as to the prosecutorial armory.³ Although the proposals are subject to review in a consultation process, the Government has already signaled its strong support for the introduction of the legislation.⁴ It has also committed to reviewing whether sentencing guidelines can be strengthened to increase custodial and financial penalties.⁵

The commitment to what Ernst and Young describe as ‘an exceptionally aggressive enforcement environment’ is, however, far from uniform. In both the academic and practitioner communities, the expansion of prosecutorial authority is greeted with markedly different responses on either side of the Atlantic.⁶ In part this can be traced to substantial variation in enforcement priorities and available defenses. The United Kingdom’s *Bribery Act* (2010), for example, closely tracks the United States’ *Foreign Corrupt Practices Act* (1977) in its definition of what constitutes an offence. It departs substantially, however, in that corporate liability can be reduced if ‘adequate procedures’ are in place.⁷ In part it also reflects the prior catastrophic failure of the Serious Fraud Office in dealing with economic crime.⁸ This has led to an under-estimation of the risks associated with providing prosecutorial agencies (unfettered) power to broker settlements in circumstances where operating environments are informed by illegal or unethical payments.

The debate has relevance far beyond either jurisdiction. Irrespective of whether or not they are domiciled in either United States or the United Kingdom, foreign corporations face enhanced

³ Ministry of Justice, *Deferred Prosecution Agreements* Cm 8348 (HM Government, London, 2012) available online at: <https://consult.justice.gov.uk/digital-communications/deferred-prosecution-agreements>.

⁴ George Parker and Caroline Binham, ‘Legal Skills Can Boost Economy, Says Clarke,’ *Financial Times*, 6 December 2011 (in which the Justice Secretary, Ken Clarke, is quoted as saying that ‘it’s a piece of legislation which I will be very supportive of’), available online at: <http://www.ft.com/intl/cms/s/0/9c02f658-201e-11e1-8662-00144feabdc0.html#axzz1x8yWEP8b>.

⁵ Caroline Binham, ‘Garnier Eyes US Style Fines and Bargains,’ *Financial Times*, 28 September 2011 (noting the ‘Americanization of the UK economic prosecutors toolbox’ also reduces possibility of forum shopping between jurisdictions), available online at <http://www.ft.com/intl/cms/s/0/4d86d088-e9f7-11e0-b997-00144feab49a.html#axzz1x8yWEP8b>; see also Jacqueline Bonneau, ‘Combating Foreign Bribery: Legislative Reform in the United Kingdom and Prospects for Global Enforcement’ (2011) 49 *Columbia Journal of Transnational Law* 365 (

⁶ There is a marked contrast between opposition in the United States to its application and the sanguine response, to date of the major United Kingdom based law firms. For the United States, see James Copland, *The Shadowy Regulatory State* (New York: Manhattan Institute, 2012); Mike Koehler, ‘The Façade of FCPA Enforcement’ (2010) 41 *Georgetown Journal of International Law* 907 (outlining concern that misuse could lead to ‘global façade of enforcement’ and citing the example of the United Kingdom). For the United Kingdom, see Clifford Chance, ‘UK Government Unveils Plans for Deferred Prosecution Agreements,’ 18 May 2012 (noting that ‘although the involvement of judges means that no guarantees are possible, the enactment of a dedicated framework for negotiated settlements in the UK is likely to provide organizations considering engaging with prosecutors with additional comfort that indications given by the SFO that action will stop short of immediate criminal prosecution are likely to materialize.’ at 3) available at http://www.cliffordchance.com/publicationviews/publications/2012/05/uk_government_unveilsplansfordeferred.html.

⁷ *Bribery Act* (2010), ch. 23, s. 7(2); see also Ministry of Justice, *The Bribery Act 2010 Guidance* (HM Government: London, March 2011) available at <http://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf>; for background to the Act, see Peter Yeoh, ‘The UK Bribery Act 2010: Contents and Implications (2011) 19 *Journal of Financial Crime* 37; F. Joseph Warin, Charles Falconer and Michael Diamont, ‘The British are Coming! Britain Changes its Law on Foreign Bribery and Joins the International Fight Against Corruption’ (2010) 46 *Texas International Law Journal* 1.

⁸ The SFO had previously signaled its enthusiasm for applying the deferred prosecution but had not enrolled the support of either the political establishment of the judiciary, see Barry Rider, ‘The End of a Chapter’ (2011) 18 *Journal of Financial Crime* 3 (noting that as a consequence, ‘the experiment was almost bound to fail, given the political issues surrounding the Bribery Act 2010 and in particular the concern of business and the city’), available online at <http://www.emeraldinsight.com/journals.htm?issn=1359-0790&volume=18&issue=3&articleid=1939475&show=html&PHPSESSID=tp0dsqle1f2i9nbmiphkiev1f0>; see also Yeoh, above n 7.

litigation risk if they have operations within or pass financing through these jurisdictions. The enforcement net is progressively widening. Multinational corporations must adopt a much more considered approach to what constitutes effective compliance, irrespective of whether domestic enforcement is either apparent or robust. Australian prosecutions for breaches of the Organization for Economic Cooperation and Development Anti-Bribery Convention,⁹ for example, have been noticeable for their absence.¹⁰ Given the fact that the Ernst & Young survey explicitly states that the major threat to compliance with the OECD convention emanates from operations within the high growth Asian region, this raises a series of profound questions. Whether the absence of prosecution reflects higher governance standards, lower oversight or an inadequate range of enforcement tools remains very much open to debate? If the latter, should Australia introduce or further recalibrate the deferred prosecution mechanism? And what specific measures could or should Australian corporations take to minimize litigation risk without exiting one of the most vibrant if challenging markets in the world.

The paper examines the benefits and pitfalls of using the deferred prosecution mechanism to combat economic crime. It highlights the scope of its actual and proposed application. It assesses whether enhanced prosecutorial flexibility enhances or inhibits the capacity to enforce behavioral change. Finally, it evaluates whether the trade-off is – or can be made – subject to effective oversight. The paper is structured as follows. Section B outlines the growing scale of and tolerance for economic corruption as outlined in the Ernst & Young Survey. Section C explores how and why the deferred prosecution has become the enforcement tool of choice in the United States, with particular reference to breaches of the *Foreign Corrupt Practices Act* (1977). Section D evaluates the accountability deficiencies associated with its application, both in terms of over-enforcement and under-enforcement. Section E evaluates the proposed extension of the mechanism in the United Kingdom and assesses the extent to which the refinements address the accountability deficit. Section F evaluates the extent to which the efficacy of the Australian regime would be improved by engaging in a similar transplantation exercise. Section G concludes.

B The Corruption Nexus

The 12th Ernst & Young Global Fraud Survey is one of the most detailed snapshots of the bribery and corruption challenges facing multinational corporations. The survey is drawn from a sample of 1700 senior executives, including Chief Financial Officers and senior executives running the legal, compliance and internal audit function across 43 different countries.¹¹ One of

⁹ *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* (OECD: Paris, 1997). Article 1 of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (“OECD Convention”) requires member states to:

...establish that it is a criminal offense under its law for any person to intentionally offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.

Member states are also required to undertake the necessary measures to establish that:

...complicity in, including incitement, aiding and abetting, or authorization of an act of bribery of a foreign official shall be a criminal offense.

Article 5 of the OECD Convention requires that investigation and prosecution of matters of foreign bribery:

...not be influenced by considerations of natural economic interest, the potential effect upon relations with another State or the identity of the natural or legal persons involved.

In 2009, the OECD Convention was updated to include recommendations on bribery related tax measures.

¹⁰ See David Hume and Geoff Healy, ‘Bribery and Corruption: Key Issues for Australian Corporations Operating Overseas’ (2011) *University of New South Wales Law Journal* 747 at 784 (noting that the ‘tide of enforcement is rising’).

¹¹ Ernst & Young, above n 1 at 29.

the most 'troubling' findings is what Ernst & Young terms a growing widespread acceptance of unethical business practices (e.g. 64percent of respondents believe that the incidence of compliance failure has increased because of the downturn). The trend is particularly apparent in East Asia (e.g. 60percent of respondents in Indonesia suggested it was acceptable to make cash payments to secure new contracts; 36percent of respondents in Vietnam suggested it was permissible to misstate financial accounts). The decline in ethical commitment is traced to a lack of training, and, more significantly, to mixed messages from senior management on the importance of compliance to Anti-Bribery and Corruption Policies (ABACP). As Ernst & Young conclude, if action is not taken to hold offenders to account stated commitment to high standards remains an exercise in symbolism. It is also an exceptionally risky strategy given the global rise in enforcement. The accompanying analysis concludes that companies need to 'properly balance the priorities of growth and ethical business conduct, while seizing opportunities in these highly adverse economic conditions'.

While many of the executives surveyed reported having sophisticated compliance systems in place, these were not subject to ongoing external testing. Only 33percent reported using external law firms or consultants to provide assurance. In a significant finding, 54percent of Chief Financial Officers surveyed had not taken ABACP training, while 52percent of all respondents reported that the board was not sufficiently aware of operating risk.¹² As well as specific local conditions, board's needed to be cognizant of corporate acquisitions, unless gaps between controls and compliance programs in each entity are identified and procedures put in place are rectified.¹³ On an ongoing basis, however, the overriding identified risk - and resulting legal exposure - focused on how a corporation manages the (legacy and ongoing) relationship with third parties.

According to Ernst & Young, 'many companies are failing to adopt even the most basic controls to manage these third-party relationships' (e.g. only 59percent use an approved supplier database; 56percent conduct background checking system; 50percent do not check the ownership structure of the third-party as part of routine due diligence; 55percent do not have either audit rights or check audit procedures with the third-party entity).¹⁴ This constitutes, according to the global professional advisory firm, a 'real problem' precisely because third party due diligence is 'increasingly expected' by the Department of Justice in the United States as well as the United Kingdom.¹⁵ Disturbingly, 15percent of the CFO respondents report unawareness that the company can be held liable for the actions of third-party agents.¹⁶ Ignorance is not, however, a defence when it comes to prosecution for violations of the *Bribery Act* (2010) or the incredibly malleable application by the Department of Justice of its analogue in the United States, the *Foreign Corrupt Practices Act* (1977).

As noted above, the survey's evidence of increased tolerance for unethical practice comes despite a significant increase in regulatory scrutiny. This is described by Ernst & Young as an 'aggressive enforcement environment.'¹⁷ The Department of Justice in the United States has secured record fine levels for the prosecution of offences linked to FCPA violations.¹⁸ Moreover, a significant strengthening of the incentives for corporate whistle blowing, linked to the introduction of a bounty system under the *Wall Street Reform and Consumer Protection Act of 2010* ('Dodd-Frank),

¹² Ibid, at 6.

¹³ Ibid, at 11.

¹⁴ Ibid, at 9.

¹⁵ Ibid, at 9; see also Ministry of Justice, above n 5, paragraphs 37-43.

¹⁶ Ibid, at 13.

¹⁷ Ibid, at 1.

¹⁸ See Garrett above n 2.

adds to the risk.¹⁹ These reforms, which have applicability far beyond the FCPA arena, necessitate that corporations demonstrate that they have effective systems in place to police deviance. The problem facing corporations is that the definition of what constitutes an effective compliance program is itself constantly shifting. Moreover, the compliance program is itself of variable use in defending a corporate liability action.

In the United Kingdom, for example, guidance issued by the Ministry of Justice suggests adequate procedures can constitute a defence.²⁰ Defendants must demonstrate, however, that operating risk – including sector, region, reliance on intermediaries, use of corporate hospitality – have been taken into consideration in the design and ongoing monitoring of compliance programs. The corporation must demonstrate that it has conducted effective due diligence of all associated personnel. It must demonstrate that communication and training is in place and that commitment to the policy is warranted through, for example, external engagement with the media and practitioners. In sharp contrast, however, in the United States the parameters of adequate compliance are not defined in the FCPA legislation itself (or in concrete guidance).²¹ Certainty cannot be assured through application of case law precedent. Rather it is informed by prosecutorial imperatives.²² The result is that what constitutes compliance means solely what prosecutors say it means. The primary battleground on which this debate is fought (and intentions ascertained) is in the negotiations over whether and on what terms a prosecutor is prepared to countenance a deferred prosecution.

These pre-trial diversion agreements force corporations to accept a partial reading of the record that corresponds to the worldview of the prosecutorial agency and prohibits questioning in return for a deferral of application of prosecution. Notwithstanding the criticism that its use has contributed to the emergence of a ‘shadow regulatory state’²³ breed over-compliance and reflects an extra-judicial contract,²⁴ the deferred prosecution has emerged as one of the most potent weapons in the prosecutorial armory. The Ernst & Young report is likely only to strengthen resolve at the Department of Justice headquarters on Pennsylvania Avenue and in London, where the United Kingdom government has been long pressed to follow the United States

¹⁹ *Wall Street Reform and Consumer Protection Act of 2010* (Dodd-Frank), s. 922 (authorizing the Securities and Exchange Commission to institute an awards scheme for those who provide material information leading to a successful aging of a fine in excess of \$1,000,000 to receive a payment of between 10-30percent); see also Securities and Exchange Commission, *Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934* (Washington, D.C., 25 May 2011), which holds that the level of the award can increase if the information had been initially provided to internal corporate compliance: at 5. The SEC has also established a whistleblower website to promote the scheme, see <http://www.sec.gov/whistleblower>. For discussion of the practical and conceptual

²⁰ See Ministry of Justice, above n 5.

²¹ The Department of Justice, does, however, routinely publish the terms of compliance programs, which serve a broader demonstration effect. See for example, *United States of America v Panalpina World Transport (Holding) Ltd* Deferred Prosecution Agreement (Department of Justice, Washington, D.C., 4 November 2010) Attachment C, 1-7 (Panalpina is mandated to ‘develop compliance standards and procedures, including internal controls, ethics, and compliance programs on the basis of a risk assessment addressing the individual circumstances of the Company, in particular the foreign bribery risks facing the Company, including, but not limited to, its geographical organization, interactions with various types and levels of government officials, industrial sectors of operation, involvement in joint venture arrangements, importance of licenses and permits in the company's operations, degree of governmental oversight and inspection, and volume and importance of goods and personnel clearing through customs and immigration’: at C3), available online at <http://www.justice.gov/criminal/fraud/fcpa/cases/panalpina-world/11-04-10panalpina-world-dpa.pdf>.

²² See Evidence to the United States Senate Sub-Committee on Crime and Drugs, ‘Examining Enforcement of the Foreign Corrupt Practices Act, 30 November 2010 (A. Weissman) 5-6 (Mr Weissman, a former head of the Corporate Crime Taskforce, argued that under FCPA prosecutorial imperatives, the existence of a compliance program reduces the culpability scoring in determining level of pecuniary penalty rather than offering a defence).

²³ Copland, above n 3.

²⁴ Koehler, above n 3.

example in using creative enforcement to add to prosecutorial capacity.²⁵

The Ministry of Justice has now embarked on a consultation process designed to introduce the deferred prosecution. Indeed the use of external monitors to secure ongoing compliance was explicitly referred to by the Solicitor General, Edward Garnier, as the singular attraction of the mechanism, which, he claimed would provide a more effective way of ‘dealing with criminality without causing collateral damage.’²⁶ It is, however, a mechanism that is exceptionally susceptible to abuse. Yet it is also a mechanism that is now proposed for extension of application in the United Kingdom, without credible restraining forces to protect either the corporation or the prosecutorial agency from the legitimacy and authority risk. Evidence from the United States suggests this is highly likely. In the following section the nature of that risk to both corporations and prosecutorial authority is traced through an analysis of the expanded use of the deferred prosecution. The benefits and pitfalls are then evaluated in Sections C and D, while Section E examines the extent to which the UK proposals deal adequately with the risk.

C Tackling Creative Compliance Through Creative Enforcement

The accounting and conflicts of interest scandals at the turn of the millennium rekindled interest in the use of creative enforcement to deal with economic crime, broadly defined. The primary mechanism developed was the deferred prosecution, which had been used to stunning effect by the New York State Attorney General, Eliot Spitzer to force both executive regime change and substantive compliance recalibration.²⁷ Following his innovative use, the mechanism increasingly formed part of the prosecutorial toolbox, although the rising scale of financial penalties can obfuscate as much as illuminate.²⁸ At its core, the mechanism involves an extra-judicial contract between the prosecutorial authority and a corporation. In return for a commitment to enter into a series of undertakings, the severity of which is dependent on prosecutorial acumen, the corporation can secure a deferral of charges or a non-prosecution agreement. The policy was originally applied to juvenile offenders as an alternative to custodial sentences and the longer-term effects of having a criminal conviction.²⁹ It was first used in the corporate sector in 1994, with the prosecution of Prudential Securities. From the outset its capacity to ensure rehabilitation, the stated goal, was questionable. It has since found application in a range of sectors (see Figure 1), with the Department of Justice the primary, although not sole agency recognizing its potential utility.

[INSERT FIGURE 1 HERE]

²⁵ See, for example, Nancy Boswell, Letter to the Editor, ‘SFO Can Learn From US Approach to Corruption,’ *Financial Times*, 7 July 2008 (the author, Chief Executive of Transparency International’s US chapter, argues that when properly applied DPA’s are an effective adjunct to full prosecution) available at: <http://www.ft.com/intl/cms/s/0/21ea2326-4bc1-11dd-a490-000077b07658.html#axzz1wnbQTu00>.

²⁶ Caroline Binham, ‘Plans Revealed for US-Style Plea Bargains,’ *Financial Times*, 28 September 2011, available at: <http://www.ft.com/intl/cms/s/0/3ed306d2-e9e9-11e0-a149-00144feab49a.html#axzz1wnbQTu00>.

²⁷ Justin O’Brien, ‘The Politics of Enforcement, Eliot Spitzer, State-Federal Relations and the Redesign of Financial Regulation’ (2005) 35 *Publius The Journal of Federalism* 439.

²⁸ See Drury Stevenson and Nicholas Wagoner, ‘FCPA Sanctions: Too Big Too Debar’ (2011) 80 *Fordham Law Review* 775 at 778 (Arguing that ‘with zero risk of debarment and minimal risk of detection, companies have little incentive to comply with the FCPA when the fines imposed make up a fraction of the profit generated from foreign business procured through bribery’).

²⁹ For summary, see Justin O’Brien, *Engineering a Financial Bloodbath* (2009) 48-56; see also Justin O’Brien, *Redesigning Financial Regulation* (2007) 123-169; for assessment of the Department of Justice’s usage, see Government Accountability Office, *Corporate Crime: Preliminary Observations on DOJ’s Use and Oversight of Deferred Prosecution Agreements and Non-Prosecution Agreements* (Washington, D.C., June 25, 2009).

Figure 1: Total Frequency of Deferred Prosecution Agreements by Crime Type (1992 – 2012)

Figure 1 depicts that, over time, almost half of all deferred prosecution agreements relate to three types of crime. 31 per cent relate to matters arising under the FCPA, 16 per cent relate to cases of mail and wire fraud and 9 percent relate to matters arising under the *Medicare and Medicaid Patient Protection Act of 1987* (“Anti-Kickback Statute”).³⁰ This pattern is mirrored in the use of non-prosecution agreements, where 22 percent relate to matters arising under the FCPA, 9 percent relate to mail and wire fraud and 20 per cent relate to drug misbranding and antitrust violations.

The rapid expansion over time (see Figure 2) can be traced to a debate within the Department of Justice, in particular, on how to deal with the collateral damage associated with charging a corporation with a criminal offense.³¹ From the beginning it was also clear that the rationale fed into a wider narrative concerning the systemic failures in US corporate governance. As Larry Thompson, the Deputy Attorney General put it in 2003 the framework was designed to ‘address the efficacy of the corporate governance mechanisms in place within a corporation to ensure that these measures are truly effective rather than mere paper programs.’³² Nine specific factors were to be taken into consideration:

- (i) The nature and seriousness of the offence;
- (ii) The pervasiveness of wrongdoing including the complicity of corporate management;
- (iii) The corporation’s history of similar conduct;
- (iv) Its disclosure of wrongdoing;
- (v) Its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection;
- (vi) The existence and adequacy of the corporation’s compliance program; the corporation’s remedial actions (which includes the implementation of an effective corporate compliance program or attempts to improve an existing one, the replacement of management, the extent to which those involved were either disciplined or fired, willingness to pay restitution and to cooperate with relevant government agencies);
- (vii) An evaluation of the collateral consequences;
- (viii) The adequacy of the prosecution of individuals responsible for the corporation’s malfeasance; and
- (ix) The adequacy of remedies such as civil or regulatory enforcement action.³³

³⁰ Medicare and Medicaid Patient Protection Act of 1987, as amended, 42 U.S.C. §1320a-7b.

³¹ See Larry Thompson, ‘Principles of Federal Prosecution of Business Organizations,’ US Department of Justice (Washington, D.C., 20 January 2003), hereinafter *The Thompson Memo*.

³² Ibid. See also *Business Week*, ‘Q and A with Manhattan DA Robert Morgenthau,’ 23 December 2002 (in which the veteran prosecutor, then aged 83, argued: ‘I think we’re seeing now is that the system of corporate governance, of checks and balances, has really broken down. In the past, you had a guy acting largely on his own. Now, you’ve got a lot of people involved, and that’s the lawyers, accountants, executives, the board of directors. The kindest thing you can say is they have all been asleep at the wheel. Regulators have to take some of the blame for not analyzing what’s going on. The whole system seems to have broken down. That’s what I think is most disturbing.’) Available online at: http://www.businessweek.com/magazine/content/02_51/b3813011.htm. Morgenthau, who retired in 2009 following 34 years in service retains a sense of anger and frustration at corporate practice, see Robert Morgenthau, ‘Those Islands Aren’t Just a Shelter From Taxes,’ *New York Times*, 5 May 2012, SR8 (noting that offshore accounts at the heart of the Madoff and Stanford Ponzi scandals were difficult to detect, with regulators becoming aware of the network through ‘whistleblowers, cooperators and serendipity’).

³³ *The Thompson Memo*, above n 33.

The exceptionally broad parameters significantly enhance prosecutorial discretionary power to determine what is the public interest in charging a corporation or whether that interest is advanced by agreeing to a non-prosecution or deferred prosecution. Concern over the separation of power has limited judicial oversight.

[INSERT FIGURE 2 HERE]

Figure 2: Total Frequency of Deferred Prosecution Agreements (1992 – 2012)

Figure 2 shows that prior to the Department of Justice updating its guidance on corporate prosecutions through the Thompson Memo in 2003, deferred prosecution agreements were rarely pursued. Federal prosecutors trying to evaluate the appropriateness of deferred prosecution agreements were largely “left to their own discretion, with few if any applicable standards upon which to rely.”³⁴ The Thompson Memo provided a framework within which to evaluate corporate conduct and instructed federal prosecutors to consider deferred prosecution agreements and non-prosecution agreements in appropriate circumstances.³⁵ From 2003, the number of deferred prosecution agreements has consistently increased, driven by sector-specific crises such as the collapse of Arthur Andersen (accounting fraud), the US Senate investigations into the UN Oil for Food Programme (bribery and corruption), and, more generally the political environment arising in connection with the financial downturn of 2008.

The emphasis on collateral damage derived from the implosion of the accounting firm Arthur Andersen in 2002, which was subject to criminal prosecution over its alleged role in the Enron scandal. Although Andersen had been offered but declined a deferred prosecution (and the guilty verdict was overturned on appeal³⁶), the decision to prosecute led to the destruction of a storied brand and the loss of thousands of jobs. Thereinafter the Department of Justice, while emboldened by the higher prosecutorial penalties mandated in the *Wall Street Reform and Public Company Oversight Act of 2002* (“Sarbanes-Oxley”), determined that justice be tempered by pragmatism.³⁷ It has proved to be an exceptionally lucrative business for the Department of Justice (see Figure 3), most notably in its application to alleged violations of the *Foreign Corrupt Practices Act of 1977*³⁸ (“FCPA”), with the use of deferred prosecutions increasing centralized within the Fraud Section (see Figure 4).³⁹

[INSERT FIGURE 3 HERE]

Figure 3: Total Fines by the Department of Justice - Fraud (1992 – 2012)

Figure 3 depicts the exponential rise in fines obtained by the Department of Justice, Fraud Division over time, driven in part by the far-reaching jurisdictional arm of the FCPA. In 2010, a

³⁴ F. Joseph Warin and Jason C. Schwartz, ‘Deferred Prosecutions: The Need for Specialized Guidelines for Corporate Defendants’ (1997), 23 *Journal of Corporate Law* 121 at 127.

³⁵ *The Thompson Memo*, above n 33.

³⁶ *Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005)

³⁷ Justin O’Brien, *Wall Street on Trial* (2003) 283 (quoting a senior Department of Justice prosecutorial manager that ‘there is no benefit to be accrued by the government gaining control of a busted company:’ at 283).

³⁸ As amended, 15 U.S.C. §§ 78dd-1, et seq. For overview of the Act and its application, see Robert Tarun, *The Foreign Corrupt Practices Act Handbook* (2012).

³⁹ The Department of Justice is responsible for all criminal enforcement and for civil enforcement of the anti-bribery provisions with respect to domestic concerns and foreign companies and nationals. The SEC is responsible for civil enforcement of the anti-bribery provisions with respect to issuers.

record breaking \$830 million was collected, 80 percent of which was attributable to four cases: Daimler A.G. (\$93.6 million), Technip S.A. (\$240 million), Snamprogetti Netherlands (\$240 million), and Alcatel-Lucent (\$92 million), each of which relate to matters arising under the FCPA. In 2011, the Fraud Division collected approximately \$303 million, 72 per cent of which related to a single FCPA matter against JGC (\$218 million). The Department of Justice has also received significant fines relating to non-prosecution agreements, collecting \$150 million on one false claims matter in 2010⁴⁰ and \$376 million from two antitrust matters in 2011.⁴¹

[INSERT FIGURE 4 HERE]

Figure 4: Deferred Prosecution Agreements by Region (1992 – 2012)

The Department of Justice – Fraud Division is responsible for all criminal enforcement and for civil enforcement of the anti-bribery provisions of the FCPA with respect to domestic concerns and foreign companies and nationals. 31 per cent of all deferred prosecution agreements relate to FCPA matters, and as such Figure 4 shows that 38 per cent of all deferred prosecution agreements are entered into by the Department of Justice – Fraud Division.

The FCPA, which dates back to the bribery scandals at Lockheed, was enacted for the purpose of making it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business. Since 1977, the anti-bribery provisions of the FCPA have applied to all U.S. persons and certain foreign issuers of securities. With the enactment of the *International Anti-Bribery and Fair Competition Act 1998*, the anti-bribery provisions of the FCPA now also apply to foreign firms and persons who cause, directly or through agents, an act in furtherance of such a corrupt payment to take place within the territory of the United States. The FCPA has extraordinary extraterritorial reach. It potentially applies to any individual, corporation, director, employee or agent, whose actions satisfy at least one criterion of the acts' following three subsets:

- Practices by 'Domestic Concerns' – being any individual who is a citizen, national or resident of the US, or any corporation, partnership, sole proprietorship or other business organization or trust, which has the US as its principal place of business;
- Practices by 'Issuers' – being any corporation have issued securities registered in the US, or any corporation that is required by the SEC to file periodic reports; and
- Persons other than Issuers or Domestic Concerns - any person other than an issuer or domestic concern that whilst in the territory of the US, makes such an act, promise or offer.

The Department of Justice has moved progressively through a series of sectors in furthering its stated strategic goal of rooting out global corruption. In 2009 a senior official noted that the Department was 'intensely focused on rooting out foreign bribery' in the pharmaceutical industry.⁴² Many of these foreign pharmaceutical companies are located in countries that are known to pose greater FCPA risks, including China, India, Russia, Italy, Argentina, and Israel.⁴³ The Department has also brought cases recently against companies in the telecommunications,⁴⁴ oil and gas services,⁴⁵ engineering⁴⁶ and the entertainment industries.⁴⁷ A close examination of the

⁴⁰ Forest Laboratories.

⁴¹ JP Morgan and Wachovia.

⁴² See Lanny Breuer, Assistant Attorney General of the Criminal Division, Department of Justice, Keynote *Address at the Tenth Annual Pharmaceutical Regulatory and Compliance Congress and Best Practices Forum* (12 November 2009).

⁴³ See Mauro M. Wolfe, *Does the US Government Have Limitless Jurisdiction Enforcing the FCPA?*

⁴⁴ See *United States v. Siemens*, No 08-cr-00367 (DDC 12 December 2008).

⁴⁵ *SEC v. NATCO Group, Inc.* No. 10-cv-0098 (S D Tex.)

⁴⁶ *United States v. Warwick*, No. 09-cr-449 (E D Va)

use of deferred prosecutions demonstrates, however, that there are base tactical as well as laudable strategic calculations at play.

There is a lack of coherence in how fines are determined, the level of discount applicable for cooperation and whether independent monitors are mandated (both significant drivers for extension to the United Kingdom). While the mechanism has amassed significant bounty for the exchequer, the fines has not been passed back to the victims of the offence, either through direct transfer to the countries where such illegalities have curtailed or stunted development or for the building of capacity building. Nation-building, has it would appear, defined limits depending on where an agency sits on the Washington Beltway.⁴⁸ Equally, notwithstanding the high-flown rhetoric, there is a marked deviation in the application of the mechanism, in particular in cases where the decision is made to impose an external monitor (Figure 5).

[INSERT FIGURE 5 HERE]

Figure 5: Frequency of Independent Monitor Appointment (1992 – 2012)

Figure 5 illustrates the frequency with which an external monitor was appointed as part of the deferred prosecution agreement. Independent monitors have been appointed to a wide variety of crime types over time. The useage peaked in 2007, and has since lost favor. While the appointment of independent monitors is subject to prosecutorial discretion, if the corporation had an effective compliance program in place, corporate monitors would not be required.⁴⁹ Since 2007, the decrease in the appointment of independent monitors has coincided with an increase in the requirement to install a compliance program as a term of the deferred prosecution agreement.

While the attraction of the mechanism to the prosecutor is clear, it is less immediately apparent why readily apparent why corporations choose to settle. In part, this is understandable. Corruption allegations are notoriously difficult to defend on reputational grounds. In part, corporations have in the past tended to settle rather than contest allegations in cases in which the Department of Justice has either provided an incentive to cooperate through not demanding the appointment of an external monitor or applying a significant sentencing discount (see Figure 6).

[INSERT FIGURE 6 HERE]

Figure 6: Percent Discount in Fine Levied From United States Sentencing Guidelines Minimum

Figure 6 depicts percentage discount received by the accused from the minimum fine recommended by the United States Sentencing Guidelines (“USSG”). To date, of the 73 deferred prosecution agreements entered into where fines were levied, only 20 have included calculations of the penalty based on the USSG. For economic crimes, the USSG directs⁵⁰ the Court to adopt a mathematical structure where the fine range is a function of the seriousness of

⁴⁷ United States v. Green, No. 08-cr-59 (CD Cal.)

⁴⁸ OLIVIA FIND THE LETTER FROM NIGERIANS AND RESPONSE FROM SEC.

⁴⁹ See Christopher M. Matthews, *Fraud Chief: Effective Compliance Programs can Prevent Monitors*, Main Justice: Politics, Policy and the Law (2010), available at <http://www.mainjustice.com/2010/05/24/fraud-section-chief-effective-compliance-programs-can-prevent-monitors/> (quoting the Criminal Fraud Section Chief, Denis McInerney: “If you have already established an excellent compliance program, then it will be less likely that we’ll install a compliance monitor, which can come at some cost to the company.”).

⁵⁰ USSG §8C2.1.

the crime⁵¹ and the culpability of the organisation.⁵²

The Court then has discretion to make upward or downward adjustments to the fine range based on aggravating⁵³ or mitigating circumstances.⁵⁴ 16 of the Of the 20 deferred prosecution agreements where fine calculations were disclosed, 16 received discounts, 12 of which were at least a 20 per cent reduction from the USSG minimum. What the foregoing analysis makes clear is that there is a remarkable lack of consistency in the application of the measure. To make matters worse the manner in which these prosecutions have been handled call into question the Department of Justice's standing as a model litigant. It also suggests that misuse and disproportionate power can call into question the legitimacy of the office, bringing into disrepute the authority of the legal system.

D Mapping the Accountability Deficit

The negotiated prosecution offers a range of benefits to the prosecutor. First individual executives are made amenable to the court, thereby serving the public policy imperative of individual accountability. Second, the corporation is forced to ensure that control deficiencies highlighted by the investigation are adequately addressed. Third, the prosecutorial agency is given explicit operational veto over implementation of remedial reform through the requirement that the corporation appoint an external monitor. Fourth, as noted above, the mechanism provides a source of revenue to the Department of Justice and the Securities and Exchange Commission, which receives the proceeds from fines or settlements that companies pay it in connection with violations, or alleged violations, of the FCPA.

For the corporation, the deferral also offers (at surface level) a range of potential benefits. First, it is shielded from ongoing legal uncertainty and negative publicity, of particular relevance if the corporation is public-facing (i.e. it has exposure to fickle consumer markets). Second, it offers an opportunity for the corporation to *ex post* revitalize its compliance program and embed within organizational structure mechanisms to ensure warranted commitment to stated values.⁵⁵ The emphasis on cooperation masks disproportionate prosecutorial leverage throughout the process. Prosecutors not only investigate potential crime (often with the complicity of the corporation in order to avoid prosecution) but also adjudicate on guilt and degree of penalty. The agency determines whether to offer deferral and scopes the extent of internal change required and degree of external oversight.⁵⁶ Furthermore the prosecuting agency alone (or in tandem with

⁵¹ Through calculation of the total offense level and the base fine. The Court refers to the Guidelines to determine the total offense level and then converts it to a base fine, through the greater of the statutory fine or the pecuniary gain to (or loss caused by) the organization from the offense. USSG §8C2.4(a).

⁵² Through calculation of a culpability score determined through an enumerated list of aggravating and mitigating factors.

⁵³ USSG §§ 8C4.2, 4.3, 4.4, 4.5, 4.6.

⁵⁴ USSG § 8C4.10.

⁵⁵ The primary emphasis on the deferred prosecution is the capacity to rehabilitate, see Peter Henning, 'Corporate Criminal Liability and the Potential for Rehabilitation' (2009) 46 *American Criminal Law Review* 1417 at 1428 ('The use of the criminal law should be directed primarily towards enabling the corporation to reform itself'). This ideal is, however, not observed in practice, see Kurt Eichenwald, *Serpent on the Rock* (New York: Harper Business, 1995; 2nd Edition, New York: Broadway Books) xiii-ix (in which the then New York Times reporter quotes a senior executive as saying the agreement to end an investigation into an \$8 billion securities fraud through the payment of \$330m into a restitution fund was a cost of doing business and that the firm had done nothing wrong); see also Stevenson and Wagoner, above n29.

⁵⁶ Brandon Garrett, 'Structural Reform Prosecution' (2007) 93 *Virginia Law Review* 853 at 913. The issues have been thrown into stark relief by judicial criticism of the Securities and Exchange Commission use of settlement agreements in relation to the financial crisis. A federal court in Manhattan has rejected a proposed \$225 million settlement between Citigroup and the Securities and Exchange Commission, on the grounds that it was neither fair

chosen monitor) determines whether a breach has taken place. Crucially, the entire negotiation takes place outside the formal judicial arena, with a waiver of client attorney privilege while not demanded implicitly required.⁵⁷ The extent to which this has called into question the standing of the Department of Justice has been evident in a number of high-profile failures.

The early emphasis on accounting, tax and securities fraud securities fraud and with it more aggressive restrictions, was subject to a further calibration in 2006 following overreach in the prosecution of individual tax partners at KPMG. The prosecution was found by a federal judge to be unconstitutional precisely because the accused partners, who had been following corporate policy, were denied ongoing legal representation at KPMG's expense under the terms of a settlement agreement that included the appointment of an external monitor, the payment of a \$415 million fine and a commitment to exit the individual high net worth tax planning market. For Justice Kaplan, the Department of Justice had been at best economical in its representations to the court and its claim that the legal fee issue was made without 'coercion' and 'bullying' tactics could 'be justified only by tortured definitions of those terms.'⁵⁸ The decision, which was upheld on appeal, significantly reduced prosecutorial discretion in this one area.⁵⁹ The problem is that the aggression is not confined to capacity of individuals to secure representation.

When cases have gone to trial the capacity of prosecutors to act as model litigants has not been shown in a favorable light. In a Central California District Court last December, Justice A. Howard Matz, found that the Department of Justice had overstepped the boundary of acceptable conduct in the prosecution of senior executives from the Lindsey Manufacturing Company. They had been accused of bribing two high-ranking employees of an electric utility company wholly owned by the Mexican government through payments made to an intermediary. Lurid testimony showed how these payments had funded the purchase of a Ferrari, a yacht and American Express bills. The problem for the prosecutors is that the framing constituted itself a framing. The ruling striking down the charges is instructive:

It is with deep regret that this Court is compelled to find that the Government team allowed a key FBI agent to testify untruthfully before the grand jury, inserted material falsehoods into

nor reasonable no in the public interest. Judge Jed Rakoff argued that the failure to secure an admission of wrongdoing from a corporation he described as a 'recidivist; offender had privileged the 'façade of enforcement,' see *Securities and Exchange Commission v Citigroup Global Markets Inc* 11 Civ. 07387 (JSR) (28 November 2011). The SEC has appealed the decision not to endorse the settlement suggesting that it introduced a new standard that limited regulatory capacity, see Securities and Exchange Commission, 'Enforcement Director Statement on Citigroup Case' (Press Release, Washington, D.C., 15 December 2011).

⁵⁷ See Christopher Wray, 'Remarks to the ABA White Collar Luncheon Club' (Speech delivered at American Bar Association, Washington, D.C., 25 February 2005; see also Christopher Wray and R. Hur, 'Corporate Criminal Prosecution in the Post-Enron World' (2006) 43 *American Criminal Law Review* 1095; for sustained criticism by the former US Attorney who first introduced the measure in the deferred prosecution agreement with Prudential Securities in 1992, see 'Interview with Mary Jo White' (2005) 19 *Corporate Crime Reporter* 48 at 11; for background to Prudential case, see Eichawald, above n56.

⁵⁸ *USA v Jeffrey Stein et al* S1 05 Crim.0888 (LAK) 27 June 2006 at 81; for media commentary, see Editorial, 'A Conspiracy Theory Debunked,' Wall Street Journal, 20 December 2008, A 14 (describing the prosecution as 'a regrettable and abusive episode' deriving from an 'Alice-in-Wonderland logic'); for impact on enforcement generally see Justin O'Brien, 'Accounting and Accountability Failure: The Impact of the Kaplan Ruling on Corporate Enforcement' (2006) 1 *Compliance and Regulatory Journal* 28.

⁵⁹ *United States v. Stein*, 541 F.3d 130 (2d Cir. 2008); see, generally Christopher McNamara, 'How the Decisions in Favor of the Stein Thirteen Will Effect the Litigation of Corporate Crime and Department of Justice Policies and Expand the Sixth Amendment Right to Counsel (2009/2010) 78 *Fordham Law Review* 933; Sarah Ribstein, 'Right to Counsel Denied: Corporate Criminal Prosecutions, Attorney Fee Arrangements and the Sixth Amendment' (2008-2009) 58 *Duke Law Journal* 857 at 861 (noting that the original phrasing of the Thompson Memo has been progressively eliminated from prosecutorial decision-making); for current application of guidelines, see Mark Filip, 'Memorandum: Principles of Federal Prosecution of Business Organizations' (Department of Justice: Washington D.C., 28 August 2008), available at <http://www.justice.gov/dag/readingroom/dag-memo-08282008.pdf>.

affidavits submitted to magistrate judges in support of applications for search warrants and seizure warrants, improperly reviewed e-mail communications between one Defendant and her lawyer, recklessly failed to comply with disclosure obligations, posed questions to certain witnesses in violation of the Court's rulings, engaged in questionable behavior during closing argument and even made misrepresentations to the Court.

The Government has acknowledged making many "mistakes" as it characterizes them. "Many" indeed. So many in fact, and so varied, and occurring over so lengthy a period (between 2008 and 2011) that they add up to an unusual and extreme picture of a prosecution gone badly awry. To paraphrase what former Senator Everett Dirksen supposed said, "a few mistakes here and a few mistakes there and pretty soon you're talking misconduct."⁶⁰

The misconduct extends to investigative stages. In a second high profile case, known as the 'Africa Sting' operation, the Department of Justice charged twenty-two employees of military and law enforcement agencies of conspiring to bribe government officials in West Africa. It followed an extensive undercover FBI investigation. The operation focused on luring the defendants to believe that a 20 percent commission payment to an intermediary would be used to secure a \$15m procurement order to upgrade the presidential guard, with at least half of the money going direct to the Gabonese Minister of Defence. The high profile operation led to the arrest of 21 individuals at a trade show in Las Vegas and a further individual in Miami on 18 June 2010.

The arrests and indictments had been proclaimed to be a demonstration of resolve and sophistication. The Department of Justice claimed it was the 'largest single investigation and prosecution of individuals in the history of the DOJ's enforcement of the FCPA.'⁶¹ 150 field officers were involved in the operation in the United States. In addition the Metropolitan police executed search warrants in London. The sting operation was, according to the FBI, played out 'with all the intrigue of a spy novel.'⁶² Unfortunately, for the both the Department of Justice and the FBI, there was little if anything of substance. In a rare piece of British reporting of the scandal, which led to the arrest and prosecution of a British citizen, David Painter, the mid-market tabloid *The Daily Mail*, described the sting as 'a huge, sleazy and ultimately doomed FBI operation...a deadly weapon in their arsenal against corruption but the biggest investigation of its type in DOJ-FBI history brought only humiliation, controversy and complete legal defeat.'⁶³ David Painter, who lost his business and accrued millions of dollars in legal fees, is quoted as saying 'with the complicity of the DOJ and FBI, I was told this deal had been approved by the US State Department.'⁶⁴ Richard Bistrong then husband of Nancy Soderberg, a former United States ambassador to the United Nations, was instrumental in pitching the deal, adding to its authenticity. The Department of Justice was forced, eventually, to file a motion to dismiss with prejudice. In accepting the argument, following a second trial, Judge Richan Leon found that the federal prosecutors were susceptible to pursuing a 'very, very aggressive conspiracy theory that was pushing its already generous elasticity to its outer limits. Of course in the second trial that

⁶⁰ *USA v Enrique Faustino Aguilar Noreiga et al* CR10-01031 (A)-AHM (1 December 2011) 2, 5. For commentary on the case and its implications, see Alison Frankel, 'What FCPA Defendants Can Learn From the Blockbuster Lindsay Win,' Thomson Reuters, 12 February 2011.

⁶¹ Department of Justice, 'Twenty-Two Executives and Employees of Military and Law Enforcement Products Companies Charged in Foreign Bribery Scheme' (Press Release, 19 January 2010). Available at <http://www.justice.gov/opa/pr/2010/January/10-crm-048.html>.

⁶² Federal Bureau of Investigation, 'Corporate Corruption—A Historic Takedown' (Press Release, Washington, D.C., Jan. 26, 2010), available online at http://www.fbi.gov/news/stories/2010/january/fcpa_012610

⁶³ Sarah Oliver, 'The Vegas Sting,' *Daily Mail*, 28 May 2012, available online at: <http://www.dailymail.co.uk/news/article-2150337/The-Vegas-Sting-A-cunning-FBI-trap-ensnared-British-businessman-destroyed-life-David-Painter-completely-innocent.html>.

⁶⁴ *Ibid*.

elastic snapped in the absence of the necessary evidence to sustain it.’⁶⁵ He also castigated the Department of Justice for its handling of the discovery process, saying it constituted a degree of ‘sharp practice that had no place in a federal courtroom.’⁶⁶

It is apparent from these techniques that while the enforcement environment is, as Ernst & Young reports, ‘aggressive’ it has revealed significant tactical and strategic weaknesses. There is a significant danger that without considerable oversight that the mechanism could disrepute the legitimacy of prosecutorial agencies and the authority of the judicial system. As will be explored more fully below, the United Kingdom proposals differ from the mechanism used in the United States in that non-prosecution agreements are not to be pursued. Secondly, the proposals signal the desirability of judicial scrutiny much earlier in the process in order to address explicitly the lack of accountability.⁶⁷ Although the refinement has the capacity to enhance transparency and accountability much detail remains to be ironed out.

E The Perils of Transplantation

The difficulties associated with prosecuting white-collar and general economic crime continue to dog prosecutorial authorities in the United Kingdom. The decision by the Serious Fraud Office to discontinue an investigation into the collapse of Britain’s largest hedge fund collapse has done much to undermine already weakened confidence.⁶⁸ The decision mirrored the explanation offered by the Financial Services Authority not to prosecute those involved in the collapse of the Royal Bank of Scotland. The collapse of Royal Bank of Scotland was talismanic of poor corporate governance in the United Kingdom.⁶⁹ The foreword of the FSA’s report into the failure, penned by the organization’s chairman, Lord Adair Turner, provides the rationale for the exhaustive investigation: ‘Quite reasonably, people want to know why RBS failed. And they want to understand whether failure resulted from a level of incompetence, a lack of integrity, or dishonesty which can be subject to legal sanction.’⁷⁰ The short answer provided is that it cannot. According to the FSA, current legal frameworks in the United Kingdom make it impossible to launch proceedings that do not have a reasonable prospect of success.⁷¹ One mechanism to

⁶⁵ *United States v. Amaro Goncalves et al.* Fed. R. Crim. P. 48(a) (Feb. 21, 2012). For detail of the case, see Mike Koehler, ‘What Percentage of DOJ FCPA Losses Are Acceptable’ (2012) 90 *Criminal Law Reporter* 893 at 5 (‘If there is a common theme in the recent DOJ losses in FCPA enforcement actions, it is this: DOJ’s aggressive theories and tactics, when subjected to scrutiny, failed.’).

⁶⁶ *United States v. Amaro Goncalves et al.* Fed. R. Crim. P. 48(a) (Feb. 21, 2012).

⁶⁷ Under the UK proposals a judge would be involved in determining on whether the approach was justified in the first instance, which would be determined by a yet to be defined code of practice. This would, according to the consultation document, ensure that a ‘prosecutor is not entering into a “cosy deal” with a commercial organization “behind closed doors”, see Ministry of Justice, *Deferred Prosecution Agreements*, above n 2 at 21. Although the refinement has the capacity to enhance transparency and accountability much detail remains to be ironed out.

⁶⁸ The decision was based on the grounds that there was ‘no reasonable chance of a criminal conviction. A subsequent civil court action awarded creditors \$450m in damages, Sam Jones and Caroline Binham, ‘SFO May Face Legal Challenge on Wavering,’ *Financial Times*, 30 May 2012, available online at: <http://www.ft.com/intl/cms/s/0/5e39842c-aa3e-11e1-8b9d-00144feabdc0.html#axzz1wnbQTu00>.

⁶⁹ Royal Bank of Scotland was far from unique. Similar misjudgments were visible in many major British banks. For specific compliance failure within HBOS, see explosive memo from its former head of compliance, Paul Moore, ‘Memo to Treasury Select Committee,’ Westminster, 10 February 2009 (‘My personal experience of being on the inside as a risk and compliance manager has shown me is that, whatever the very specific, final and direct causes of the financial crisis, I strongly believe that the real underlying cause of all the problems was simply this—a total failure of all key aspects of governance. In my view and from my personal experience at HBOS, all the other specific failures stem from this one primary cause’).

⁷⁰ FSA, *The Failure of Royal Bank of Scotland* (FSA: London, 2011), 7.

⁷¹ Contrast this with the argument put forward by the former Director of Enforcement at the SEC that ‘a regulator that has a 100percent litigation success rate is not litigating enough, see Justin O’Brien, *Wall Street on Trial* (2003); for application to the fallout from the sub-prime crisis, see Justin O’Brien, ‘The Façade of Enforcement: Negotiated Prosecution, Goldman

address both sets of failings has been the proposed introduction by the United Kingdom Ministry of Justice of the deferred prosecution agreement (“UK Consultation Paper”).⁷²

The proposed model for England and Wales looks to the United States deferred prosecution agreement model for guidance. It seeks to incorporate a far greater level of judicial oversight, transparency and consistency throughout the process, ultimately requiring judicial approval before a deferred prosecution agreement can be entered into. While much of the detail relating to how and when deferred prosecution agreements will be used remains to be determined, a five-stage model is envisaged.

1. A decision by the prosecutors following investigation as to whether to offer and enter into a deferred prosecution agreement;
2. Commencement of deferred prosecution proceedings before a judge;
3. Judicial approval of the content of the deferred prosecution agreement;
4. Monitoring and action if necessary for non-compliance or breach (including prosecution); and
5. Withdrawal of prosecution in the case of full compliance.⁷³ – **Olivia please make this a nice table.**

As noted above, deferred prosecution agreements do not have a statutory basis in the United States, instead relying upon the United States Attorney’s Manual, *Principles of Federal Prosecution of Business Organisations*, which sets out the circumstances in which it is appropriate to enter into a deferred prosecution agreement and the factors to consider when investigating, charging, and discussing an agreement with respect to corporate crimes.⁷⁴ The UK Consultation Paper calls for the deployment of similar factors⁷⁵ noting that the Director of Public Prosecutions and the Director of the Serious Fraud Office should publish a Code of Practice setting out the factors prosecutors should take into account in deciding whether to enter into a deferred prosecution agreement.⁷⁶ Although not yet written, the practical impact of any Code of Practice raises the question of whether the procedures place significant limits on prosecutorial discretion. The UK Consultation Paper notes that any decision to enter into a deferred prosecution agreement for offenses under the *Bribery Act 2010* (UK) (“Bribery Act”) “must be taken by the DPP or Director of SFO personally”.⁷⁷ By contrast, in the United States, there is no requirement for the Attorney-General to determine whether deferred prosecution agreements are appropriate for violations of the FCPA.

Perhaps the biggest departure from the United States model is the proposal for early judicial intervention. Once a prosecutor has made a decision in principle that a deferred prosecution is likely to be suitable and appropriate, initial proceedings would commence before the Crown Court.⁷⁸ At the initial proceedings, the Court would be presented with an outline of the basic agreed facts, a draft indictment or charge-sheet, the proposed conditions of the deferred prosecution agreement and an outline of the areas still being considered. The Court would

Sachs and the Politics of Blame’ in S. Will and S. Handelman (eds.) *How They Got Away With It: Lessons from the Financial Crisis* (2012), forthcoming.

⁷² Ministry of Justice ‘Consultation on a new enforcement tool to deal with economic crime committed by commercial organisations: deferred prosecution agreements’ (May 2012), available online at: <https://consult.justice.gov.uk/digital-communications/deferred-prosecution-agreements> [UK Consultation Paper]

⁷³ UK Consultation Paper, §89, p. 24

⁷⁴ US Department of Justice, *Principles of Federal Prosecution of Business Organisations*, §9-28.300(A), pp. 3-4.

⁷⁵ UK Consultation Paper, §92, p. 25.

⁷⁶ UK Consultation Paper, §92, p. 24.

⁷⁷ UK Consultation Paper, §93, p. 24.

⁷⁸ UK Consultation Paper, §104, p. 26.

consider whether the proposed deferred prosecution agreement was in the interests of justice based on the facts of presented and that the proposed terms were “...fair, reasonable and proportionate.”⁷⁹

In the United States, the presiding judge is not involved in the negotiation of the terms of the deferred prosecution agreement, where the analogous standard with respect to settlement agreements proposed by the Securities and Exchange Commission is whether the agreement is “...fair, reasonable, adequate, and in the public interest,” although such a broad mandate has, as we have seen, recently caused significant judicial and academic controversy.⁸⁰ Judicial approval is also required for the final agreement. The hearing for this purpose would start in private to allow the agreed deferred prosecution agreement terms to be presented to the judge and allow discussion and resolution of any final issues.⁸¹ The Court would then determine if the final deferred prosecution agreement was “...fair, reasonable and proportionate.” If so, it would be approved in open court to ensure openness and transparency. The upside of the United Kingdom approach is that an indication could be obtained at the initial hearing as to whether or not the Court considers the deferred prosecution agreement to be appropriate in principle. This preliminary hurdle may avoid some of the issues that are currently arising in the United States as to what is deemed to be in the ‘public interest’ and also provide an opportunity for the court to question the prosecutorial methods deployed in presenting the case. At the same time, however, the same factors that convince a corporation to accept an agreement – a desire to settle in order to avoid ongoing reputational risk or avoid public exposure of compliance failure – may also inhibit willingness to challenge.

The second area in which the United Kingdom model attempts to differ from the United States template is in the emphasis on transparency and consistency. The UK Consultation Paper suggests the use of specific guidelines that would provide “more detailed starting points or ranges for financial penalties and perhaps other conditions.”⁸² This approach appears to be replicating the ranges, categories and starting points for deferred prosecution agreement penalties and conditions that the sentencing guidelines do.⁸³ However, the Court is given permission to stray from the guidelines, if the “interests of justice” demand.⁸⁴ In contrast, the United States doesn’t publish guidelines as to the terms that might compose a deferred prosecution agreement, which is left to the total discretion of the prosecutor.

F Corruption and Enforcement: Does Australia Have a Problem?

The past two years has seen sweeping changes to the global economic crime regulatory infrastructure with the launch of the UK Bribery Act (2010), tougher penalties and sanctions under the Australian Criminal Code and an increase in prosecutions under the US Foreign Corrupt Practices Act (“*FCPA*”). Despite these changes, Australia’s enforcement of foreign bribery and corruption under the OECD Convention has remained stagnant since its enactment in 1999. Has this tepid enforcement environment arisen because Australia is ‘corruption free’ or because it lacks either the political will or enforcement tools?

⁷⁹ UK Consultation Paper, §108, p. 27.

⁸⁰ See comments by Judge Jed S. Rakoff criticising this procedure in *SEC v. Vitesse Semiconductor Corp.* No. 10 Civ. 9239 (JSR); *SEC v. Bank of America* No. 9 Civ. 6829 (JSR), 10 Civ. 0215 (JSR); *SEC v. Citigroup*. See generally, Garrett, n 56 above and accompanying text.

⁸¹ UK Consultation Paper, §112, p. 28.

⁸² UK Consultation Paper, §99, p. 26.

⁸³ UK Consultation Paper, §102, p. 26.

⁸⁴ UK Consultation Paper, §103, p. 26.

Transparency International (“TI”), an international NGO that works to combat corruption, prepares annual Corruption Perception Indexes (“CPI”) designed to measure the extent to which public sector corruption is perceived to exist in approximately 178 countries around the world. Each country is ranked on a scale from 10 (very clean) down to 0 (highly corrupt). Although Australia is ranked in the 2011 CPI as “very clean” with a score of 8.8,⁸⁵ a number of Australia’s largest trading partners, particularly in the Asia-Pacific region, rank very low.⁸⁶ This corresponds to the Ernst & Young survey of 1700 ranking chief executive officers and heads of legal, audit and compliance highlighted in Section A above. It is therefore highly improbable that Australian corporations are not regularly exposed to at least the possibility of foreign corruption and bribery. Indeed, the failure to manage this process was underscored in the highly publicized *Inquiry into Certain Australian Companies in Relation to the UN Oil-For-Food Programme* (2006).⁸⁷ Despite the knowledge and likelihood of foreign bribery in the Australian market, when compared to jurisdictions such as the US and the UK, the absence of prosecutions or investigations is a cause for concern and suggests a serious deficiency in the currently regulatory framework.

TI has prepared annual independent progress reports on enforcement of the OECD Convention since 2005. In its 2011 progress report (“*TI Progress Report*”), seven countries were classified as having active enforcement (Denmark, Germany, Italy, Norway, Switzerland, UK and US), nine as having moderate enforcement and 21, including Australia, as having little or no enforcement.⁸⁸ The TI Progress Report indicates that at the time of publication, Australia had no prosecutions, 1 civil action and 3 investigations in relation to foreign bribery. TI argues that key inadequacies in the Australian model relate to: inadequacies in the legal framework, which amounts to an effective lack of criminal liability for corporations; inadequacies in the enforcement system - TI suggests that the lack of enforcement to date may be indicative that successful prosecution is unfeasible under the present system; inadequate whistleblower protection; and a lack of specialist skills such as forensic skills needed to investigate such matters.⁸⁹

The Criminal Code Amendment (Bribery of Foreign Officials) Act 1999 (Cth) (“*Act*”) commenced on 17 December 1999 and the OECD Convention came into force in Australia on the same date. The Act inserted a new Division into the Criminal Code Act 1995 (Cth) (“*Criminal Code*”) to criminalize the bribery of foreign public officials. Australia’s foreign bribery laws are contained in Division 70 of the Criminal Code and are extremely broad. While the term ‘bribery’ is not specifically defined within Division 70, nor within the Criminal Code generally, the elements of the offense can be drawn from within Section 70.2 which prohibits bribery of foreign public officials for the purpose of obtaining business or an undue business advantage.

The offence applies to conduct in Australia or on board an Australian ship or aircraft and to conduct outside Australia, where the person committing the offence is an Australian citizen, a resident of Australia, or an Australian company. Penalties for breaching the provisions are substantial. In broad terms there are two defenses: that the benefit was permitted or required by written law; or that the payment was a facilitation payment. A payment is a facilitation payment, and therefore does not amount to unlawful bribery, if: the value of the benefit is minor; the person’s conduct was engaged in for the sole or dominant purpose of expediting or securing the

⁸⁵ Results of the Transparency International 2011 CPI Index: <http://cpi.transparency.org/cpi2011/results/>

⁸⁶ Id.

⁸⁷ See <http://www.oilforfoodinquiry.gov.au/>.

⁸⁸ F. Heilmann, G. Dell & K. McCarthy, *Progress Report 2011: Enforcement of the OECD Anti-Bribery Convention*, Transparency International, p. 4.

http://www.transparency.org/whatwedo/pub/progress_report_2011_enforcement_of_the_oecd_anti_bribery_convention

⁸⁹ See Progress Report 2011, p 17.

performance of a routine government action of a minor nature; and as soon as practicable afterwards, the person made a record of the conduct.

The first Australian Prosecution for foreign bribery was initiated on 1 July 2011, when the Australian Federal Police (“AFP”) charged two Australian companies - Securrency International Pty Ltd (“Securrency”) and Note Printing Australia Limited (“NPA”) - and six Victorian individuals with bribery of foreign public officials under sections 11.5(1) and 70.2(1) of the Criminal Code Act 1995.⁹⁰ A seventh individual was charged by the AFP on 10 August 2011.⁹¹ The charges relate to bribes allegedly paid to public officials in Indonesia, Malaysia and Vietnam between 1999 and 2005, the allegations being that senior managers from Securrency and NPA used international sales agents to bribe foreign public officials to secure bank note contracts. Securrency and NPA plead guilty to three charges each of conspiracy to bribe foreign public officials in October 2011, and have been ordered to pay penalties of \$19.8m and \$1.8m respectively under the Proceeds of Crime Act. The companies were scheduled to be sentenced for the offences in the Victorian Supreme Court in December 2011. The individuals facing charges were due to appear before the Melbourne Magistrates Court the same month. To date, no outcomes have been reported.⁹² The AFP referred the matter to ASIC for consideration and on 12 March 2012, ASIC released a media release which stated “...in line with its normal practice, ASIC has reviewed this material from the AFP for possible directors’ duty breaches of the Corporations Act and has decided not to proceed to a formal investigation.”⁹³

The upside is that the successful cases against Securrency and NPA demonstrate that prosecution is possible under the current Australian legislative framework. As both companies pled guilty, the offence has not been tested to the extent it would have been if the companies had contested the charges. However, the fact that both companies pled guilty indicates that they had reached a conclusion that the offence could be made out by the Commonwealth Director of Public Prosecutions (“CDPP”). Despite this ‘success’, Australia’s two public investigations share one commonality – a long and costly path. The inquiries into the UN Oil-For-Food Programme resulted in an initial independent inquiry, a subsequent inquiry (the Cole Inquiry) and the formation of a joint task force between the AFP, ASIC and the Victorian Police. The result was that no criminal prosecutions eventuated, with the AFP and Victorian Police both discontinuing their investigations in 2009 and ASIC dropping its criminal charges in 2010.⁹⁴ As of July 2011, ASIC was still pursuing civil penalty proceedings against the 6 former senior officers of AWB for breaches of the Corporations Act.⁹⁵ Despite this, the prosecution of Securrency and NPA has had some positive spillover effects. On 14 February 2012, Leighton Holdings became the first big Australian company to admit publicly that it had alerted the federal police to a possible breach of anti-bribery laws. It comes as several large public companies are understood to have given the federal police information implicating themselves in possible foreign bribery offences after internal audits. The audits were prompted by the corruption scandal involving Securrency and

⁹⁰ AFP, *Foreign Bribery Charges Laid in Australia*, media release, 1 July 2011 <http://www.afp.gov.au/media-centre/news/afp/2011/july/foreign-bribery-charges-laid-in-australia.aspx>

⁹¹ AFP, *Further Charges Laid in Foreign Bribery Investigation*, media release, 10 August 2011 <http://www.afp.gov.au/media-centre/news/afp/2011/august/further-charges-laid-in-foreign-bribery-investigation.aspx>

⁹² See Barker, Note 4.

⁹³ <http://www.asic.gov.au/asic/asic.nsf/byheadline/12-47AD+Statement+on+Securrency+International+and+Note+Printing+Australia>

⁹⁴ <http://www.businessspectator.com.au/bs.nsf/Article/ASIC-drops-criminal-charges-against-AWB-execs-repo-pd20100604-63Q5U?OpenDocument>

⁹⁵ <http://www.brisbanetimes.com.au/business/watchdog-too-slow-on-awb-20110717-1hk05.html>

NPA.⁹⁶

So how can Australia pull its head out of the sand and learn from the robust enforcement of economic crime in the US and UK? First, there is little transparency as to how the AFP targets and resolves cases. Implementation of a website similar to the US Department of Justice,⁹⁷ which contains basic information on the regulations, guidance notes, regulatory guides, and links to cases and investigations would be a step in the right direction. Second, similar to the specialized investigative unit at the SEC, the development of specialized teams at the AFP to investigate foreign bribery and complex corporate fraud will ensure that adequate resources are dedicated to sufficiently identify, investigate and prosecute cases. Third, recognition that effective prosecution is dependent on commitment and cooperation and exchange of information between regulatory agencies. Although ‘informal’ arrangements currently exist between agencies, formalized agreements which set out investigation and intelligence gathering techniques is imperative. Fourth, direction and support for ASIC and the CDPP to investigate and prosecute corporate officers and directors for both criminal and civil breaches of the Corporations Act. Fifth, a loophole may currently exist for organizations whose employees or agents commit offences, with no direct input from the organization. Legislative amendments consistent with Section 7 of the UK Bribery Act, requiring organizations to actively prevent bribery by their employees and agents, could resolve this problem, i.e. codes of conduct, due diligence standards. Finally, there is currently no legislative or regulatory requirement that positively requires an individual or corporation to report knowledge of foreign bribery having been committed. Given the CPI rating of Australia’s trading partners, it would suggest that more instances of bribery occur than are actually being reported.

However, in response to criticism that Australia had not been effectively implementing its obligations under the OECD Convention, the *Crimes Legislation Amendment (Serious and Organised Crime) Act (No. 2) 2010 (Cth)* came into effect in February 2010 which includes substantially higher penalties, including stiff jail sentences for the bribery of Commonwealth or foreign public officials. The offence is now punishable by up to 10 years imprisonment, a fine of up to 10 000 penalty units (currently \$1.1 million) or both for an individual. For a corporation, the maximum penalty is the greater of 100 000 penalty units (currently \$11 million) or three times the value of the benefit obtained by the corporation (where it can be ascertained) or ten per cent of the annual turnover of the corporation (where the benefit obtained cannot be determined).

The Australian Federal Police (“AFP”) and the Commonwealth Director of Public Prosecutions (“CDPP”) are responsible for the investigation and prosecution of foreign bribery offenses, respectively. To the extent that a foreign bribery allegation occurs within a regulated entity, the AFP may refer the matters to other agencies that can potentially prosecute civil and administrative matters and investigate criminal conduct, including: the Australian Securities and Investments Commission (“ASIC”) for cases involving consumer credit activities, the integrity of financial markets and the provision of financial services; the Australian Prudential Regulation Authority (“APRA”) for cases involving regulation of banks and superannuation funds, financial reporting by insurers and disqualification of persons in senior roles in a supervised institution; or the Australian Taxation Office (“ATO”) for tax related offenses.

The AFP evaluates matters referred to it in accordance with its *Case Categorisation and Prioritisation Model* (“CCPM”), including consideration of the incident type, its impact on Australian society,

⁹⁶ R. Baker, *Leighton Alerts Police to Investigate Possible Foreign Bribes*, Sydney Morning Herald, 14 February 2011 <http://www.smh.com.au/business/leighton-alerts-police-to-investigate-possible-foreign-bribes-20120213-1t2c3.html>

⁹⁷ <http://www.justice.gov/criminal/fraud/fcpa/cases/2012.html>

its priority for the AFP and the referrer and the resources required.⁹⁸ Foreign and domestic bribery are included in the second highest of four categories under the ‘impact’ element and obligations under international treaties in the second highest of four under the ‘priority’ element of the CCPM. The CDPP’s decisions about whether to institute or continue proceedings are made in accordance with the *Prosecution Policy of the Commonwealth*.⁹⁹ While the policy sets out matters to be considered in such decisions, it does not give higher priority to any particular types of offences.

⁹⁸ AFP, *Case Categorisation and Prioritisation Model*, AFP, May 2010, <http://www.afp.gov.au/~media/afp/pdf/c/ccpm-may-2010-pdf.ashx>

⁹⁹ CDPP, *Prosecution Policy of the Commonwealth: Guidelines for the making of decisions in the prosecution process*, CDPP, <http://www.cdpp.gov.au/Publications/ProsecutionPolicy/ProsecutionPolicy.pdf>