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CORPORATE CRIME BRIEFING

SFO ENTERS INTO THIRD AND LARGEST DEFERRED PROSECUTION AGREEMENT

JANUARY 2017

London

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On 17 January 2017, Sir Brian Leveson QC approved the UK's third Deferred Prosecution Agreement ("**DPA**"), resulting in orders for disgorgement, penalties and costs exceeding £500 million. This is the largest DPA since their introduction in the UK in 2014. Herbert Smith Freehills' London Corporate Crime and Investigations team negotiated the first DPA with the Serious Fraud Office ("**SFO**"), which was concluded in November 2015. This latest agreement confirms their status as an important tool for the SFO in tackling financial crime, at a time when the government is consulting on measures to increase the scope for companies to incur criminal liability (see our e-bulletins on *Failure to Prevent Economic Crime* and *Failure to Prevent Facilitation of Tax Evasion*).

In this briefing, we provide an overview of the Rolls-Royce DPA, and discuss some of the emerging themes from the growing body of DPA case-law indicating the importance of what the Judge described as Rolls-Royce's "extraordinary co-operation".

DPAs

By way of background, and as set out in our briefing in relation to the second DPA, 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 (1) Rolls-Royce Plc (2) Rolls-Royce Energy Systems Inc

On 17 January, the President of the Queen's Bench Division, the Rt. Hon. Sir Brian Leveson QC (who also heard the first two DPA cases), approved a DPA agreed between the SFO and two entities now ultimately owned by Rolls-Royce Holdings plc, being Rolls-Royce plc and Rolls-Royce Energy Systems Inc (together "**Rolls-Royce**").

The DPA related to 12 counts of alleged criminal conduct which spanned eight jurisdictions and three of Rolls-Royce's business divisions for over 20 years. The offences included corporate failure to prevent bribery, conspiracy to corrupt and false accounting. Specifically, the offences include:

- agreements to make corrupt payments to agents in connection with the sale of Trent aero engines for civil aircraft in Indonesia and Thailand between 1989 and 2006;
- concealment or obfuscation of the use of intermediaries involved in its defence business in India between 2005 and 2009 when the use of intermediaries was restricted;

- an agreement to make a corrupt payment in 2006/7 to recover a list of intermediaries that had been taken by a tax inspector from Rolls-Royce in India;
- an agreement to make corrupt payments to agents in connection with the supply of gas compression equipment in Russia between January 2008 and December 2009;
- failing to prevent bribery by employees or intermediaries in conducting its energy business in Nigeria and Indonesia between the commencement of the Bribery Act 2010 and May 2013 and July 2013 respectively, with similar failures in relation to its civil business in Indonesia; and
- failure to prevent the provision by Rolls-Royce employees of inducements which constitutes bribery in its civil business in China and Malaysia between the commencement of the Bribery Act 2010 and December 2013.

The terms of the DPA (which will remain in place until at least 2021) require Rolls-Royce to:

- cooperate with the relevant authorities in all matters relating to the relevant conduct;
- disgorge the gross profit of £258,170,000 arising from the conduct;
- pay a financial penalty of £239,082,645;
- pay the costs incurred by the SFO amounting to £12,960,754; and
- complete a compliance programme following the recommendations of a review commissioned by Rolls-Royce. However, a "monitoring" obligation was not imposed.

As the conduct spans a period both prior and subsequent to the Bribery Act 2010 ("UKBA") coming into force (in July 2011) the charges were brought under old law and, in respect of the more recent conduct, under section 7 of the UKBA.

The DPA does not cover any conduct not disclosed by Rolls-Royce prior to the date of the agreement (or any future criminal conduct) and allows fresh proceedings to be initiated if it is found that Rolls-Royce provided inaccurate, misleading or incomplete information to the SFO and knew or ought to have known that it was inaccurate, misleading or incomplete.

Public interest

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

Seriousness of 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.

The first DPA (SFO v Standard Bank plc) concerned a failure to prevent bribery where it was not suggested that the Bank was complicit in the corruption alleged. The second DPA (SFO v XYZ Ltd) involved more serious misconduct both in terms of type and scale. It allegedly involved systematic offer and payment of bribes to secure contracts in foreign jurisdictions and a small but important number of XYZ Limited's employees were aware of this.

In contrast, the conduct of Roll-Royce involved the "most serious" breaches of the criminal law. In addition, Sir Brian Leveson QC found that the seriousness of the alleged conduct was aggravated by the fact that it was persistent, multi-jurisdictional, numerous, spread across Rolls-Royce's businesses, involved substantial funds and displayed careful planning.

Sir Brian Leveson QC commented that, from a seriousness perspective, it would be hard to identify cases where conduct would merit prosecution (as opposed to a DPA) more than the present case. Nonetheless, other strong countervailing public interest factors outweighed the seriousness of the conduct.

Cooperation

In both the first and second DPA cases, considerable weight was given to the fact that the companies "self-reported". In contrast, this investigation was not triggered by a self-report but rather started as a result of internet postings which raised concerns about the operation of Rolls-Royce and which led the SFO to seek information from Rolls-Royce. Nonetheless, Sir Brian Leveson QC accepted the SFO's argument that Rolls-Royce's "extraordinary" cooperation meant that he should not "distinguish between its assistance and that of those who have self-reported from the outset". Indeed, Rolls-Royce, although not self-reporting at the outset, brought to the attention of the SFO matters which it would not have been aware of without the company's cooperation.

The full, extensive and pro-active nature of Rolls-Royce's cooperation included: (i) voluntary disclosure of internal investigations, with limited waiver of privilege; (ii) providing extensive digital material to the SFO; (iii) cooperating with the SFO's requests in respect of the conduct of the internal investigation (including deferring interviews until the SFO had first completed its interview, and conducting recorded interviews where requested); (iv) reporting of findings on a rolling basis; and (v) providing all financial data requested and fully cooperating with the assessments undertaken. As at December 2016, Rolls-Royce's costs for this work, the work relating to investigations by prosecutors in other jurisdictions, the cost of the compliance review and the cost of professional advice amounted to £123,115,643.

Other factors

It was noted that Rolls-Royce had taken real and significant steps to improve its compliance policies and procedures. In particular, in 2013, Rolls-Royce commissioned an independent consultant to review its ethics and compliance procedures and to act as a "quasi-monitor" of its compliance programme.

The court noted the substantial effect of prosecution on Rolls-Royce which, in turn, would have had a wider impact for the UK and persons who were not connected to the criminal conduct (including Rolls-Royce employees and pensioners, and those in its supply chain). Although Sir Brian Leveson QC emphasised that national economic interests are irrelevant and that a company in the position of Rolls-Royce is not immune from prosecution, he considered the repurcussions to third party interests as one of the countervailing factors in the public interest test. The agreement of a DPA also avoided the significant expenditure of time and money which the SFO would have incurred in any prosecution of Rolls-Royce.

Finally, a "powerful point" in favour of the public interest was that a DPA will likely incentivise the exposure and self-reporting of wrongdoing by organisations in similar situations to Rolls-Royce.

Conclusion

Sir Brian Leveson QC found that, taking into account all of the factors above, it was unnecessary "to inflict the undeniably adverse consequences on Rolls-Royce that would flow from prosecution because of the gravity of its offending".

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 following a guilty plea. 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

The Sentencing Guideline for Corporate Offenders: Fraud, Bribery and Money Laundering ("**the Guideline**") requires the removal of all gain, as well as appropriate punishment. Accordingly, the approved DPA required disgorgement by Rolls-Royce of profit in the sum of £258,170,000.

The disgorgement in respect of the more historic conduct (where Rolls-Royce was charged with bribery) was based on the "gross profits" earned on contracts in respect of which the alleged bribes were paid. The approach to the "failure to prevent" offences under section 7 of the UKBA was more novel. In respect of these offences, it was accepted that profit made prior to the implementation of the Bribery Act 2010; and any profit made subsequent to the final alleged bribe would not be used to calculate the sum to be disgorged (with the latter limitation being a fact-specific determination based on consideration of the totality of the proposed financial orders). Accordingly, it was agreed that the total gross profit to be disgorged for the relevant conduct would be prorated by reference to the number of months post-implementation of the Bribery Act 2010 until the last payment to the intermediary, as a proportion of the total number of months during which gross profit was earned on the contract.

Financial penalty

As set out in the Guideline, the usual starting point in calculating a financial penalty is to establish the consequential "harm" from the offending. In bribery cases, harm is normally represented by the gross profit from the contract obtained, retained or sought as a result of each offence. Alternatively, where there is no gross profit, in "failure to prevent" cases the likely costs avoided by failing to put in place appropriate measures to prevent bribery will be taken into account.

Interestingly, the court followed the Sentencing Council's Definitive Guideline on Offences Taken into Consideration and Totality ("**the Totality Guideline**") which states that in cases involving multiple offending it may not be just and appropriate to calculate the aggregate sentence by adding up the sentence for each offence individually. The Totality Guideline was applied in relation to three of the 12 counts which represented "multiple offending of a similar nature being a course of conduct in one jurisdiction, using one intermediary in respect of one airline involving the same senior Rolls-Royce employees". The result was that, for example, the gross profit for three of the offences was averaged and that average was then used in penalty calculations as the harm for all three of the counts.

Having assessed the harm figure for each of the offences, the Guideline requires that the financial penalty which is calculated 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. This exercise is performed on a count by count basis. In this case the culpability multiplier was assessed at between 250% and 400% for different counts,In this case the culpability multiplier was assessed at between 250% and 400% for different counts,

Using the steps outlined above the penalty in the DPA, before discount, amounted to £478,165,290.

Discount

In accordance with section 144 of the Criminal Justice Act 2003 and the Guideline issued by the Sentencing Guidelines Council on Guilty Pleas, Sir Brian Leveson QC found a full discount of one third of the proposed penalty was appropriate. A discount of one third is the level of discount that is usually available to an individual who pleads guilty at the earliest possible opportunity.

Taking into account Rolls-Royce's "extraordinary cooperation", a further discount of 16.7% was applied, bringing the total discount of the penalty to 50%. This is consistent with the approach taken in SFO v XYZ Ltd but is not based on statutory provisions or sentencing guidelines. At the open hearing of 17 January 2017, Sir Brian Leveson QC explained that a discount of one third is applied to an individual who pleads guilty at the earliest possible opportunity because, among other things, it saves the court and prosecutor time and resources; as such, where a corporate self-reports, cooperates and 'admits' guilt at a very early point (earlier than an individual can), it follows that the amount of discount should be greater.

The discount of 50% resulted in a penalty of £239,082,645. Importantly, the discount applies only to the penalty and is not applied to the amount to be disgorged or the SFO's costs.

US/Brazilian Settlements

Settlements were also concluded in parallel with the US Department of Justice and the Brazilian authorities (with payments of $170m going to the DOJ and $25.6m to the Brazilian authorities).

Commentary

This DPA is significant not only because it involved the largest penalty ever imposed in a bribery matter in the UK, but also because it has re-emphasised the importance of self-reporting and cooperation.

Sir Brian Leveson QC provided that "incentivising self-reporting is a core purpose of DPAs and the weight it attracts depends on the totality of the information provided. In one sense, the more egregious the conduct, the greater significance of wholesale self-reporting and admission: the question is to identify the tipping point".

This case shows that even in cases of serious misconduct, the "tipping point" is heavily influenced by cooperation and self-reporting, with those factors also having an important influence on the level of discount. The case is also an interesting (and welcome) confirmation that, in an appropriate case, a DPA will be viable even where conduct is not self-reported – if there is nevertheless extensive co-operation. There had been concerns, following the Standard Bank and XYZ cases, that the bar for a DPA had been set too high, and that there would be fewer cases where, in practice, a company would be in a position to self-report itself as quickly as Standard Bank and XYZ had done. In cases of this scale, a discount of 50% will be a very important and significant incentive to corporates.

Sir Brian Leveson QC also indicated that taking into account the nature of the criminality and the difficulty of the sentencing exercise it was difficult to draw a "meaningful comparison" to what would have happened had the instant matter been before the US courts.

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