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Working Group on Bribery in International Business Transactions (CIME)

CORPORATE LIABILITY RULES IN THE COMMON LAW JURISDICTIONS OF AUSTRALIA, CANADA, ENGLAND AND WALES, NEW ZEALAND AND THE UNITED STATES

This document has been prepared by Celia Wells, Professor of law at the University of Wales, Cardiff (UK) for the Working Group consultation on "The Responsibility of Legal Persons" to be held in Paris on 4 October 2000 from 9.30 - 12.30.

Delegates wishing to comment or raise questions on the issues addressed or on related aspects are invited to submit these to the Secretariat in preparation for the consultation. Comments or questions received before 25 September will be forwarded to the authors in anticipation of the meeting.

Ms. Nicola Ehlermann-Cache, DAF/DIR (Tel: 33.1.45.24.17.48, Fax: 33.1.44.30.63.07, e-mail: nicola.ehlermann-cache@oecd.org)

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Or. Eng.

CRIMINAL RESPONSIBILITY OF LEGAL PERSONS IN COMMON LAW JURISDICTIONS

Working Group on Bribery in International Business Transactions

1. Introduction

1.1. Corporations are legally deemed to be single entities, distinct and separate from all the individuals who compose them. Legal personality means that corporations can sue and be sued, hold property, conduct transactions and, where jurisdictions so allow, incur criminal liability in their own name and on their own account.

1.2. Corporate liability for crime has appeared on the agenda in many jurisdictions and at the level of international bodies such as the Council of Europe,[1] the European Union and the OECD itself.

1.3. This paper deals with legal principles in the common law jurisdictions of England and Wales,[2] the United States, Australia, Canada and New Zealand. The United States and Australia have both federal and state criminal laws. Different corporate liability rules apply at the federal and state levels. Canada, New Zealand and UK have only one criminal jurisdiction.

1.4. The relevant law for present purposes, that is corruption offences, is federal law in both US and Australia. These jurisdictions also have the broadest corporate liability standards. Those in Canada, New Zealand and the UK are relatively narrow.

2. Attributing liability to legal persons

2.1. The range of solutions, both actual and potential, to the problem of attributing responsibility to a corporation varies according to the area of law concerned. Corporate law primarily regulates the corporation's relationship with its own 'members', in contrast to those legal duties and responsibilities which regulate its relationship with outsiders. Many of those external duties and responsibilities apply equally to individuals and to incorporated bodies. The civil law of obligations – contract, tort, restitution - applies to corporations as it does to individuals. How responsibility is to be attributed to the corporation in these areas has been regarded as relatively unproblematic, largely because those areas of law do not rely on a notion of fault, or where they do (as in the tort of negligence, for example), it is an objectively assessed fault liability.

3. Theoretical considerations

3.1. Despite a long history of endowing certain organisations with separate legal personality, there has been an increasingly lively debate as to its theoretical basis. Are corporations merely, and nothing more than, collections of individuals, as the 'nominalist' view would hold, or does the corporation have an existence and meaning as well as a legal personality of its own, as the 'realist' view contends?

3.2. Particularly in relation to criminal law, with its reliance on moral fault, there is still a struggle between the nominalists and the realists, a struggle which affects the rules by which responsibility is attributed. Since, in the nominalist view, the corporation does not exist apart from its members, any blameworthiness or responsibility can only derive from the culpability of an individual employee. That still leaves to be decided whether the corporation will be responsible for all of its employees or only for some of them. For the realist, on the other hand, the corporation does

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1 Recommendation No R (88).

2 Which for ease of exposition I will refer to (inaccurately) as the UK.

represent something beyond the individuals comprising it and this opens up completely different avenues for attribution.

4. Criminal law and legal persons

4.1. It is in criminal law that many of the difficult questions arise as to how a legal entity such as a corporation can be held responsible. Criminal law is pre-eminently concerned with standards of behaviour enforced, not through compensation, but through a system of state punishment negotiated via standards of fault such as intention, knowledge and subjective recklessness. Whether and how that system should be applied to corporations thus attracts more controversy than does the ascription of civil liabilities.

4.2. There is a further type of criminal law, however. Unlike laws against murder, assault and theft, for example, which apply universally to all persons of sound mind, there are schemes created specifically to regulate areas of business activity. Trading standards laws, health and safety laws, and environmental protection laws all fit this category. These regulatory schemes share some characteristics of the criminal law- such as utilising the criminal procedural and penalty structure- yet in other ways are quite different, and are certainly perceived as distinct, from mainstream criminal law. Those differences are often reflected in the rules relating to corporate responsibility. It can be noted that jurisdictions which do not recognise corporate criminal liability (or have not until very recently), such as many in continental Europe, avoided the difficulties which might otherwise have arisen in regulating business enterprise by establishing a stream of administrative regulation. These regulatory schemes, despite their different classification, actually share many of the characteristics of regulatory criminal law.

4.3. Common law jurisdictions do not commonly have a code of criminal law or procedure but general principles, in relation both to the minimum fault element in criminal offences, and to corporate liability, have developed. These may be overridden by particular statutes.

4.4. As explained further below, determining the type of offence and the type of fault element in any particular offence is a crucial factor in establishing the standard of corporate liability for criminal offences in the UK.

4.5. Criminal laws tend to be eclectic in their use of fault terms. Key features in criminal culpability are the subjective mental states of intention, knowledge and recklessness. In some offences, the prosecution may be required to prove that the defendant herself realised that her actions would inevitably lead to a particular result, (intention); or that she herself was aware of particular circumstances, (knowledge). The threshold for many offences is lower than this, requiring proof that she herself was aware that her actions might have that result or that a circumstance might exist (recklessness). Although many systems also utilise objective fault terms such as negligence (that the defendant's behaviour fell short of that expected of a reasonable person even though she had not adverted to the relevant risk), and even discard the need for a mental state altogether in some cases (usually dubbed strict liability), the underlying basis for distributing different fault elements is not always explicit.

4.6. It should be noted that the form in which corruption offences are drafted in relation to the mental or culpability element will have a bearing on the scope of corporate liability. In other words, corporate liability is derivative from or piggy-backed on the underlying specific offence definition.

4.7. The form of corruption offences differs between jurisdictions although intentionality in some form is generally required. [3]

[3] Australia Criminal Code Act 1995, s 70.2.1.c 'with the intention of influencing'; Canada: Corruption of Foreign Public Officials Act 1998, s. 3(1) 'in order to obtain or retain an advantage in business'; US-

5. Attribution of responsibility in common law jurisdictions

5.1. In general, three different theories for attributing blame to corporations compete for attention. The first is based on the agency principle whereby the company is liable for the wrongful acts of all its employees. United States federal law employs a principle of this type, *respondeat superior*, while English law limits the application of vicarious liability to certain regulatory offences. The second theory of blame attribution, which English law utilises for all other offences, identifies a limited layer of senior officers within the company as its 'brains' and renders the company liable only for their culpable transgressions, not for those of other workers. The third locates corporate blame in the procedures, operating systems or culture of a company. Company culture theory is deployed in the Australian Criminal Code Act, and is proposed in relation to a corporate homicide offence in the UK.[4]

5.2. The first two theories have in common that they seek in different ways to equate corporate culpability with that of an individual and both are therefore derivative forms of liability. Further, the second version adopts an anthropomorphic vision of company decision-making. The third theory, on the other hand, exploits the dissimilarities between individual human beings and group entities.

6. Vicarious Liability

6.1. In civil (as opposed to criminal) law, an employer or principal is liable for many of the acts of any employee or agent. Criminal law has generally accepted this avenue of blame attribution in a limited range of strict liability offences. A full-scale vicarious liability principle is endorsed in South Africa as well as in the federal law of the United States, thus confirming that there is no difficulty in applying the vicarious principle to offences both of strict liability and of subjective knowledge. Under the English binary scheme, vicarious principles apply to certain regulatory offences only.

6.2. Vicarious liability, a doctrine transplanted from civil law which grew out of the development of the liability of a master (employer) for his servant (employee), facilitated the development of both the civil and criminal liability of corporations. The vicarious principle applied only to some statutory offences in the regulatory field and, by 1900, a number of regulatory provisions were construed as applying to corporations.

6.3. Whether a criminal prohibition could be applied to a corporation in this way was a matter of interpreting the object of the statute. In general, the process of judicial interpretation of the statutory object led to corporate liability being imposed only for regulatory offences, especially those offences which did not require proof of *mens rea* or a mental element. While the general principle that a company can be prosecuted for a criminal offence has long been accepted, the question whether a *particular* statute imposes such liability and whether the vicarious or identification doctrine will apply, is rarely if ever spelled out, and the process of interpretation is thus on-going.

Foreign Corrupt Practices Act 1977/1998 'corruptly' requires intention to induce recipient to misuse his/her official position. UK current law is less explicit- 1906 Act: 'purposely doing an act that the law forbids as tending to corrupt'. The Government intends to introduce legislation which defines 'corruptly' more specifically- acting on a bribe or accepting a bribe 'believing it was offered corruptly', clause 8, draft Corruption Bill, Law Commission Report no 248 (1998)

4 Clause 4, draft Involuntary Homicide Bill, Law Commission Report 239 (1996)

6.4. To render a corporation vicariously liable, the employee's conduct must be within the scope of the individual's employment or authority. Vicarious liability has been criticised for including too little (in demanding that liability flow through an individual, however great the fault of the corporation), and for including too much (in blaming the corporation whenever the individual employee is at fault, even in the absence of corporate fault). This summary of the drawbacks of vicarious liability neatly encapsulates one of the major problems in any discussion of corporate responsibility- how to conceptualise 'corporate' fault. Vicarious liability attracts criticism as a mechanism for attributing fault because it is felt that there is some other way of measuring 'corporate culpability'. The key question is to identify that way.

7. **Alter Ego (identification) theory-**

7.1. It was not until the 1940s that English law contemplated a form of corporate liability which could apply to serious offences such as fraud, theft and manslaughter. One of the objections to finding corporations liable for such offences was that they required proof of a mental element of intention, recklessness or negligence. For the purposes of corporate liability for this type of offence, courts developed the *alter ego*, or identification theory, under which certain key personnel are said to act as the company (rather than on behalf of it, as is the case with vicarious liability). The underlying theory is that company employees can be divided into those who act as the 'hands' and those who represent the 'brains' of the company.

7.2. Translated into the criminal sphere, this became the basis for the identification principle, which essentially meant that a company would be liable for a serious criminal offence where one of its most senior officers had acted with the requisite fault. Expounded in the leading case of *Tesco v Nattrass* (1972), this limited the relevant personnel to those at the centre of corporate power.

7.3. The identification theory developed from a series of fraud cases and it marked the recognition of corporations as capable of committing offences which required proof of a mental element.[5]

7.4. This juridical solution to the conceptual problem of attributing a mental element to a company imagined the company's senior officers acting as, rather than on behalf of, the company. By making so much of the distinction between vicarious liability for all the company's employees and the 'direct' liability of 'the company itself', the courts ensured a limited role for corporate liability for serious non-regulatory offences. Despite the radical decision to extend to corporations liability for traditional offences, there has for a long time been a clear reluctance to give the doctrine any bite. The vast majority of corporate prosecutions are brought in magistrates' courts where sophisticated legal argument is rare. It was not until *Tesco v Nattrass*[6] that the emerging identification doctrine came before the House of Lords, which held that only those who control or manage the affairs of a company are regarded as embodying or acting as the company itself *for these purposes*.

7.5. It is likely that both the existing and proposed corruption offences in the UK would be subject to this narrow form of corporate attribution.

8. Modern holistic theories

8.1. The recent emergence of corporate responsibility as a topic of debate reflects concerns about safety of workers and of members of the public. Disasters such as rail crashes, ferry capsizes, and chemical plant explosions which can be attributed to corporate enterprise operations have led to

5 *R v ICR Haulage Ltd* (1944) 30 Criminal Appeal Reports 31

6 [1972] Appeal Cases 153.

calls for those enterprises to be prosecuted for manslaughter. They have also led to doubts about the appropriateness of the two theories of corporate responsibility hitherto recognised by legal systems.

8.2. Vicarious liability, as we have seen, is indeterminate in its sweep. It has rarely been applied to serious offences such as manslaughter. (Federal jurisdiction in Australia and US does not include homicide offences) Identification liability regards the transgressions of only a limited number of people within the company as relevant to the attribution of culpability to the company itself. The rhetoric of identification liability asserts not merely a difference of degree between the two principles. It is said that under identification theory, the errant company officer acts *as* (rather than on behalf of) the company. However, on closer scrutiny, the distinction is of less substance than at first appears. In both vicarious and identification liability, the individual company employee can be prosecuted in her own right, and in each case, the company can only be liable if fault is found in one individual. The limitations of these theories have led to a debate about more appropriate mechanisms for establishing corporate culpability, especially with regard to attempts to bring manslaughter prosecutions.[7]

8.3. The ideas considered in this section each have in common an attempt to escape from company liability derivative from the wrongdoing of one individual. In other words, they aim to capture the 'corporateness' of corporate conduct.

8.3.1. *Aggregation*: In many large organizations, task specialization means that, even amongst officers senior enough to count for alter ego purposes, one individual director will not have access to all the information on which to base a finding of knowledge or negligence. This was the case with P&O Ferries following the Zeebrugge disaster. While aggregation of pockets of knowledge from a number of individual employees has been accepted in US federal courts,[8] it has not been adopted in jurisdictions reliant on the more restrictive identification theory for knowledge-based offences. While aggregation might appear attractive, it presents two difficulties. Reliance on individual, albeit dis-aggregated, knowledge suggests an incomplete shift to 'corporateness'; and it relies on a fiction (that, if A knows p while B knows q, this allows knowledge of 'p and q' to be ascribed to the corporate person). Aggregation of knowledge is an incomplete solution. A scheme of corporate liability has to look further than individuals (atomised or aggregated) to the corporation's own structure.

8.3.2. **Systems /Culture Theory** A developing theory for attributing fault to a corporation is based on internal decision-making structures. A legislative example can be found in the Australian Criminal Code Act 1995, establishing standard principles for federal offences, outlined in para 10.4 below.

9. As the above account indicates corporate criminal liability principles are relatively immature. Developing concern about corporate responsibility has resulted in a certain degree of flux and the following sections attempt to summarise these developments. Liability for corruption offences will both affect and be affected by the settled principles which might eventually emerge from this period.

9.1.1. **Embryonic organisation theories** The recognition of the emergent doctrine of organisational or systems based liability has led to a reconsideration of *Tesco v Nattrass* even where it applies to offences requiring proof of a mental element. The main case is a decision

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7 Identification liability is confirmed as the applicable doctrine in Attorney-General's Reference No 2/1999 [2000] 3 All ER 182, CA. This decision prompted the government to implement the Law Commission's corporate killing offence which relies on the concept of 'management failure'. Above n 4.

8 *United States v Bank of New England*, 821 F.2d 844 (1st Cir.), *cert. denied*, 484 U.S. 842

of the Privy Council, *Meridian Global Funds Management Asia Ltd v Securities Commission*.[9]

9.1.2. An alleged breach of the securities legislation turned on whether the company had knowledge of the activities of its investment managers. Lord Hoffmann suggested that the directing mind model espoused in *Tesco v Nattrass* should not be regarded as the exclusive tool for attributing culpability to a company. It was relevant to examine the language of the particular statute, its content and policy. Since, in this case, the policy was to compel disclosure of a substantial security holder, the relevant knowledge should be that of the person who acquired the relevant interest.

9.1.3. What is not clear, however, is how the *Meridian* test is to be determined in relation to any particular statutory provision. One objection is that leaving the question open to inference from legislative intent presents a hostage to judicial fortune, and the case provides little by way of guidance other than reference to the purpose of the statute, a matter on which opinions will differ. Another problem is that one of the major criticisms of the identification model, particularly in its current restrictive form, is that it fails to respond to differences in company decision-making structures, not that it is insensitive to various legislative purposes. While *Meridian* could be regarded as the first step taking us closer to a new model of corporate liability, it is too early to predict the direction in which the challenge it has issued will be resolved. The incrementalism and pragmatism of the common law facilitates major shifts in direction such as that seen in *Meridian* but equally allows a quiet return to the status quo. As yet there is little evidence that the courts have grasped the theoretical underpinnings of the holistic third model of attribution.

9.1.4. A further development is the separate offence of corporate killing, based on the notion of management failure. This is unlikely to be translated to offences, such as the corruption offences, since they rely on a subjective fault element. The Law Commission's arguments are based firmly on the distinction that this homicide offence is based (unusually for serious criminal offences) on an objective culpability standard.

10. Applying the principles to the specific corruption offences

10.1. ***UK*** **-** Without specific legislation (and none appears forthcoming) the principles of corporate liability for criminal offences are likely to continue to be explored in piecemeal fashion as a matter of interpretation of specific (usually statutory) offences. Identification liability in its narrow form is likely to be applied. This means that unless the bribe is offered by a director or senior officer within the company no liability will be placed on the company itself.

10.2. ***US*** **-** federal offences have always had a much broader liability principle – *respondeat superior*. Under this the company will be liable for any employee's act within the scope of his/her employment and for the benefit of the corporation.

10.3. ***Canada*** - The Canadian Supreme Court has expanded identification liability, recognising that companies may have more than one directing mind. The essence of the test is whether the identity of the directing mind and the company coincide when the directing mind is operating in his/her assigned field of operations. The field of operations may be geographic or functional or embrace the entire operations of the company. (*Canadian Dredge and Dock Co Ltd v The Queen* (1985) 19 CCC (3d) 1 (SCC).

[9] [1995] 3 All England Law Reports 918. It should be noted that although the judicial personnel are consonant, Privy Council decisions do not have the same precedential effect as those of the House of Lords.

10.4. ***Australia*** - As with US, a corruption offence is federal and therefore governed by provisions in the Australian Criminal Code Act 1995 which contains one of the most detailed modern restatements of organisational liability. This federal statute provides that, for offences of intention, knowledge or recklessness, the "fault element must be attributed to a body corporate that expressly, tacitly or impliedly authorised or permitted the commission of the offence." (Criminal Code Act 1995 (C'th) s 12.3) Authorisation or permission can be shown in one of three ways - the first echoes the *Tesco v Nattrass* version of identification liability, and the second extends the net wider to 'high managerial agents'. The third represents a clear endorsement of an organisational or systems model, based on the idea of 'corporate culture'. 'Corporate culture' can be found in:

- an attitude, policy, rule, course of conduct or practice within the corporate body generally or in the part of the body corporate where the offence occurred.
- Evidence may be led that the company's unwritten rules tacitly authorised non-compliance or failed to create a culture of compliance.

The Australian Code has been in force less than a year and therefore interpretation of it is yet in its infancy

10.5. *Thus the US and Australia, through different routes, have much the broadest corporate liability rules. The company will be liable not just where a director (UK), or high managerial agent (Canada) acts corruptly but where any employee does so (US), or where the corporate culture encourages or condones such behaviour (Australia).*

11. Other issues

11.1. Once the basis of corporate liability for corruption offences is established other issues which need to be addressed include those of territoriality and liability for subsidiary companies, and potential interaction between these, that is the liability of a parent company for the activities of its foreign subsidiary. Discussion of these issues is beyond the scope of this paper.

11.2. Further relevant factors include the enforcement and sentencing provisions. A comparative exercise such as this needs to take account of administrative and procedural differences which are often as significant as those of substantive law.

12. SUMMARY

1. A corporation is a separate legal person subject to civil and criminal laws.
2. For a prosecution to succeed against a company two broad questions need to be addressed: is the offence one which a corporation is capable of committing and what principles will apply to impute that offence to a corporation?
3. There has been a gradual expansion in the common law of corporate criminal liability, both of the range of offences a corporation is capable of committing and in the means by which an offence is imputed. There are now very few offences which a corporation cannot commit.
4. Until recently only two mechanisms for attributing criminal fault to a corporate body have been recognised: the vicarious principle and the doctrine of identification.
5. While the general principle that a company can be prosecuted for a criminal offence has long been accepted, the question whether a particular statute imposes such liability and whether the vicarious or identification doctrine will apply, is rarely if ever spelled out.
6. It is increasingly accepted that neither the agency nor the identification models is satisfactory. Vicarious liability is both too wide (in attributing the wrongdoings of any employee to the company) and too narrow (in leaving no opportunity to explore company policies). Identification is seen as insensitive to the diversity of corporate organisation. Modern corporations are fragmented and decentralized. They do not conform to the company image prevailing at the time of Tesco v Nattrass of command and control.
7. Some jurisdictions have introduced modern liability rules (eg Australia) or are actively discussing them (Canada). Identification liability is the relevant principle in relation to corruption offences in Canada, New Zealand and UK. Canada has expanded the narrow base established in *Tesco v Nattrass*, while developments in the UK have proceeded less certainly based on a statute by statute construction rather than general principle. Australia has introduced a wide-ranging provision incorporating the concept of corporate culture. The US has a long tradition of broad liability based on the principle 'respondeat superior'.
8. The institutional arrangements for enforcement and the structure of penalties should be taken into consideration in assessing the effectiveness of corporate criminal liability rules.