# Did Tesco Act Too Hastily in Entering Into DPA Negotiations? (Serious Fraud Office v Tesco Stores Ltd)

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**What is the background to this DPA and why is it only now being published?**

On 29 October 2014, the SFO opened an investigation into Tesco Stores Ltd in relation to a suspected offence of false accounting, contrary to section 17 of the Theft Act 1968.

The SFO alleged that between February and September 2014, Tesco Stores dishonestly falsified digital accounting records and statutory interim accounts, which resulted in an announcement by Tesco Stores' parent company, Tesco plc, of estimated profits in the six months leading up to 23 August 2014 of around £1.1bn. According to the allegation, this represented an overstatement of over £250m.

In April 2017, the UK High Court approved a DPA reached between Tesco Stores and the SFO. This was the fourth DPA concluded in the UK since their introduction in February 2014.

Parallel to the SFO's negotiations with Tesco Stores over the DPA, the SFO investigated and charged (in September 2016) three former Tesco employees with false accounting and fraud by abuse of position, linked to the allegations with which the DPA was concerned.

At the time of the DPA judgment, the prosecution of these three individuals was ongoing. The DPA statement of facts clearly implicates these individuals in wrongdoing. Accordingly, publication of the DPA and the statement of facts prior to the conclusion of proceedings against the individuals would have prejudiced their prospects of a fair trial by jury.

In December 2018, the Court of Appeal confirmed a Crown Court ruling that two of the three had no case to answer and the jury was instructed to return verdicts of not guilty. Following this, in January 2019, the SFO offered no evidence against the third individual and he was acquitted.

**What are the practical considerations for companies considering DPAs which flow from this judgment?**

The balance of power in DPA negotiations lies firmly in favour of the prosecutors. Companies must wait to be invited before such negotiations can begin, though this does not preclude companies from making the right noises about being open to the process.

Companies remain on the back foot throughout and it is clear that successful negotiations will require painful choices to be made. It is important to demonstrate full co-operation from the start, which may entail:

- self-reporting;
- changes of leadership;
- the disclosure of privileged material;
- invitation of external auditors; and
- the restructuring of internal reporting lines.

DPAs may also require companies to give up the option of conducting an internal investigation, leaving this in the hands of investigators who are unlikely to conduct the investigation with the formulation of potential defences in mind.

As the decision in Serious Fraud Office v Tesco Stores Ltd indicates, it is difficult to reconcile these expediencies with the fact that DPA negotiations do not entail an admission of guilt.

That said, the case demonstrates that prosecutors are not always right, and their investigations will not always reach the correct conclusion, to the detriment of companies and individuals. It is to be hoped that this case will allow companies to persuade investigators that co-operation should not preclude the right to conduct an internal investigation and to mount a defence should that investigation fail to demonstrate liability to the criminal standard of proof.

**What are the key differences between this DPA and those that precede it?**

The Tesco DPA shares many features with its three predecessors. Each DPA places significant weight on the cooperation of the company under investigation and emphasises the benefits of self-reporting to prosecutors. The Tesco DPA also finds common ground with others in that changes in leadership encouraged the court in its confidence that the company was turning over a new leaf. Likewise, the financial penalties, though different in scale, were arrived at by the same application of the appropriate sentencing guidelines.

What sets the Tesco DPA apart from the others is the nature of the charges in the draft indictment. The previous three DPAs addressed conduct deemed contrary to the Bribery Act 2010 (BA 2010), specifically the failure to prevent bribery under BA 2010, s 7. The draft indictment in the Tesco DPA contained a Theft Act charge, which assigns liability to the company through the 'identification principle' rather than through its failure to prevent the misconduct of persons associated with the company.

Liability for the failure to prevent misconduct is not currently available for false accounting or fraud offences. This makes the prosecution of companies for these offences more difficult as it requires the attribution of criminal misconduct to a 'controlling mind' of the company, which has proven difficult in the prosecution of large companies.

This difficulty, coupled with the acquittal of the individuals in this case, has led some commentators, with the benefit of hindsight, to question whether Tesco acted too hastily in entering into DPA

negotiations.

This exposes the catch-22 faced by companies invited by the SFO to negotiate—those investigated regarding offences that rely on the identification principle may consider they face a low prospect of conviction, but their failure to engage early on in negotiations will be seen as uncooperative and may lead to the offer of negotiations being withdrawn. Accordingly, companies may consider the risk of a criminal conviction, which entails the prospect of a long, expensive and reputationally damaging investigation and trial process, is not worth taking, no matter how remote that risk may be. The discounts in financial penalties that have been afforded companies demonstrating full co-operation, 50% in the case of Rolls Royce, make the risk of contesting the case even less palatable.

Negotiation despite the low possibility of conviction may be an acceptable outcome for companies but this can come at a high price for individuals. One further feature that makes the Tesco DPA stand apart from those that came before is that it is the first to name publicly the individuals whose alleged wrongdoing underpins the DPA. This difference is made starker by their eventual acquittals. These acquittals might encourage more scrutiny over the decision to name individuals implicated in misconduct that is accepted by the company before the individuals have been found to have committed that conduct by a criminal court.

Sir Brian Leveson, who has presided over each of the four DPAs negotiated to date, Lisa Osofsky, director of SFO, and Robert Buckland, the Solicitor General, have all expressed their support for the expansion of failure to prevent offences into fraud and false accounting offences. A consultation for its expansion took place in 2017. Were it brought into law, it would make the prosecution of companies for fraud offences an easier proposition for the SFO and further encourage companies to negotiate DPAs.

**What does the judgment indicate about what will render a DPA acceptable/in the interests of justice?**

Before it can approve a DPA negotiated between two parties, the Crown Court must be satisfied that doing so is in the interests of justice and that the terms agreed are fair, reasonable and proportionate.

In its assessment of the interests of justice, the court first considers the seriousness of the offence —the more serious the offence, the less likely a DPA will be approved. At least that is the theory. In this case, the court highlighted:

- the damage caused to the market and public confidence in it;
- the leading role played by senior management at Tesco Stores in “organised and planned misconduct, involving other employees through the application of pressure”;
- a course of conduct that continued “over a number of years”;
- a culture of pressuring finance and accounting functions to deliver to budget, “including through illegitimate methods”; and
- the failure of senior managers “aware of the unlawful activity” to take opportunities to alert the relevant internal functions as well as their efforts to conceal it from external auditors.

Counterbalancing the seriousness of the offence, the court in Tesco identified several features that weighed in favour of granting a DPA. These features are common across some or all of the three previous DPAs and give an indication of the factors most likely to influence the SFO sand the court in the negotiation and approval of a DPA.

Most importantly, the court emphasised Tesco's "unreserved and enduring" co-operation, which is a factor that will be afforded considerable weight when that co-operation is prompt and proactive.

Further significant influencing factors included:

- the instruction of internal and external auditors;
- the company's decision to dismiss four senior employees implicated in misconduct;
- changes of leadership at Tesco Stores and Tesco plc;
- simplification of reporting lines;
- the launch of an externally-run whistle-blowing service; and
- the adverse impact of a criminal conviction on Tesco Stores, Tesco plc, shareholders and the wider UK supermarket and food industry.

This last factor also featured prominently in the Rolls Royce DPA and will be of little comfort to smaller businesses that could receive less protection from the court because they are not of sufficient importance to Great Britain plc.

**What did the judge say in the 22 January 2019 judgment about the court's jurisdiction with regards to a DPA and why is this important?**

Following the conclusion of proceedings against the three Tesco employees, restrictions were lifted against the publication of the statement of facts in the case (" the Statement"). The Statement is a summary agreed between the parties to the DPA and contained the admission by Tesco Stores that it had engaged in "dishonest falsification" of its results.

The Statement directly implicates, by name, three individuals in the senior leadership team that "were aware of and dishonestly perpetuated the misstatement…thereby falsifying or concurring in the falsification of accounts".

Given the resounding result of the proceedings in favour of these individuals, their legal teams sought the redaction of the Statement to remove information that ascribed to the individuals criminal conduct of which they had been found not to be guilty, or else to provide an addendum acknowledging this fact. Their submission was more emphatic in this case as the case brought by the SFO was so weak that none of the defendants was required to put forward a defence.

In a brief judgment delivered on 22 January 2019, Sir Brian Leveson, the presiding judge over the original DPA, stated he was in no doubt that he had "no jurisdiction now to alter or modify either the terms of the DPA or its supporting statement of facts".

Sir Brian Leveson also observed that the wording of the DPA made clear that "the DPA (and thus the statement of facts) related only to the potential criminal liability of Tesco Stores Ltd" and not the liability of any individual. That is true, but it ignores the fact that the statement contains in essence, a

list of acts and omissions made by the individuals that amount to criminal conduct by them as controlling minds of the company. From a lay perspective, even if not from a strictly legal one, the High Court's approval of the DPA amounts to tacit acceptance or approval of those facts as accurate.

DPAs are negotiated between companies and prosecutors necessarily without the input of any individuals implicated by the facts. The Statement represents information agreed between the two parties to provide a basis upon which the court can make a judgment. From a legal standpoint, there is no room for the intervention of a third party who is not involved in those proceedings. The problem in this case is that these individuals were involved in linked proceedings and the result of those linked proceedings contradicted the assertions made against them in the DPA.

The consequence for individuals in these circumstances is that there is ample room for them to be thrown under the bus without a right of reply. At the same time, companies may be encouraged to pin the blame on individuals whose subsequent dismissal can be used as evidence of co-operation and remediation to present to the SFO.

This highlights a tactical dilemma for companies whose interests, if the case were contested in court, may be better protected by aligning themselves with the defence of their employees, rather than depicting them as bad apples in an otherwise blameless organisation.

The fact that the three individuals were cleared of wrongdoing may give companies approached in the future to enter into DPA negotiations some pause for thought as to the extent to which they should prioritise co-operation over contestation of the allegations insofar as they might conflict.

The DPA scheme places great emphasis on the extent and timing of co-operation by companies, which incentivises them to engage in what amounts to a settlement process, perhaps to the exclusion of fully considering whether they have a case to answer. Whether or not that was the case for Tesco, companies might consider it commercially expedient to avoid the cost and uncertainty of the trial process in favour of a short, sharp shock that may prove easier to swallow for shareholders. While companies may be able to absorb the financial and reputational damage of what amounts to admissions of criminal conduct, the same is not true for the individuals who may be implicated by those admissions.

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