

The starting point for a fine for corporate corruption

The draft UK sentencing guidelines for companies for bribery, fraud or money-laundering offences suggest that the starting point for a fine should be a multiple of the actual or intended amount of benefit gained or loss avoided by the company as a result of the unlawful conduct.

For offences under the Bribery Act, the guidelines suggest that **gross profit** from the contract obtained or sought through the unlawful conduct is the appropriate measure of the benefit obtained. (An alternative measure for offences under section 7 of the Bribery Act is the cost avoided by failing to implement appropriate anti-bribery measures.)

Where there is no clear evidence of the benefit obtained or loss avoided by the unlawful conduct, the starting point for a fine will be based on **10% of “relevant global revenue from the product or business area to which the offence relates”**.

Each of the scenarios below includes an attempted quantification of the amount of any benefit or loss intended to be gained or avoided. The scenarios that follow are divided among three industries: construction, energy and financial services. The scenarios are followed by a discussion of whether and how the two alternative formulae for arriving at a starting point for a fine would operate and the appropriateness and fairness of such operation.

In each case, how would or should any fine be calculated, if the company’s head office in London discovers the corruption and reports it to the SFO?

Hypothetical Scenarios

Construction

A UK-listed construction company (CoCo Plc) is seeking to establish a presence in a high-corruption-risk developing country, Farland. It is seeking to win work as a main contractor on major infrastructure and rail projects (mostly for public sector clients) and some complex commercial building projects for private clients. A local company (CoCoFar) is established in Farland for these purposes, wholly-owned by CoCo Plc. The margin that CoCoFar is likely to make on successful projects would be between 3% and 5% on average, maximum 8%.

Globally, CoCo Plc’s global business includes well-established and successful rail, major infrastructure and commercial building businesses operating in a number of mature, low-corruption risk markets such as the UK, US and Western Europe. CoCo Plc’s global revenue from those businesses in those established markets is approximately £20 billion, and its average margin is 2-4%.

CoCo Plc has identified Farland as a growth market and hopes to establish, over a 5-10 year period, a 5% share of what could be a £100 billion infrastructure market.

CoCoFar encounters a number of difficulties in Farland, both when establishing its business in year 1 and in executing projects in years 2-5:

Scenario	Amount of Benefit or Loss Intended to be Gained or Avoided
<p>1. CoCoFar’s local general manager (GM) has negotiated a lease on its new office premises. He now needs to obtain a certificate from the local council’s electrical engineering department, confirming that the electricity supply is safe and can be turned on. The council engineer visits the offices, tells the GM that the air conditioning will have to be condemned, and informs him that all staff will have to go home until the problem has been rectified. Faced with a one month delay and the prospect of having a completely non-functioning office, the GM pays £500 to the engineer to “make the problem go away”.</p>	<p>a. The expected cost of installing new, compliant air conditioning; or</p> <p>b. The opportunity cost of having staff sitting largely idle at home for one month, which should be measured as the gross profit from the work undertaken or contracts obtained during the one month period when they were, in fact, working; or</p> <p>c. If there is insufficient evidence for measures a or b, presumably</p>



	<p>10% of the revenue of anything from:</p> <ol style="list-style-type: none"> 1. projects likely to be, or actually performed during, say, the first year once the office is up and running; to 2. the successful establishment of a £5 billion business. <p>However, in this scenario, using measures c1 or c2 to calculate the starting point for a fine would seem harsh as it must be assumed that those revenues have been legitimately earned. The punitive element of a fine is provided for in the draft guidelines by the application of a multiplier to the benefit obtained ('harm') figure. Therefore, targeting legitimately earned revenue at this initial stage of the calculation is disproportionate – compare the £500 paid to the engineer or the cost of new air conditioning to the £billions in revenue.</p>
<p>2. CoCoFar is considering bidding for its first contract. The client is the Rail Ministry. It is a substantial construction project. The GM has a senior contact at the Rail Ministry who is able to influence the specification for the project so that only CoCoFar can realistically qualify to do the work. He does this in return for the award of a significant sub-contract, worth more than £150,000, to a company owned by his son. As a result, CoCoFar wins the work without having to undercut any competitors.</p>	<p>a. The gross profit from the corruptly obtained contract.</p> <p>In this scenario, using a revenue figure as the basis to calculate the starting point for a fine would ignore the significant construction costs incurred and the fact that the construction project had already been delivered.</p>
<p>3. CoCoFar has completed a project (obtained entirely properly) and is submitting its application for payment of the final milestone payment due to it, representing £10 million, or 30% of the total value of the contract. The client's engineer, whose job it is to certify payment applications, refuses to certify payment, even though CoCoFar has completed all the work in accordance with the contract and followed the prescribed submission process to the letter. The client's engineer recommends a consulting firm which, for a fee of £50,000, can help get the</p>	<p>a. The cost avoided by not having to enforce the contract to recover the final milestone payment (e.g. legal costs); or</p> <p>b. The gross profit element of the corruptly obtained milestone payment; or</p> <p>c. The corruptly obtained milestone payment itself, i.e. revenue.</p>

<p>payment application through the client’s approval process. CoCoFar engages this firm, which succeeds in getting the payment application approved by the client but appears to do little or no work in exchange for its fee. CoCoFar receives the final milestone payment from the client.</p>	<p>In this scenario, CoCoFar has legitimately entered into the contract and legitimately completed the work under the contract at cost to itself. It is therefore entitled to payment of the milestone payment – i.e. it is legitimately earned revenue. Therefore, measure a is most appropriate.</p>
<p>4. Following an internal audit of CoCoFar’s Farland operations, CoCo Plc uncovers a systemic practice of making facilitation payments or other generally modest but nonetheless corrupt/unlawful payments. Such payments total at least £150,000 in the last three years and are made in a variety of situations, including:</p> <ul style="list-style-type: none"> a. Getting materials through customs b. Getting through police checkpoints c. Avoiding speeding tickets d. Postponing tax audits e. Obtaining or expediting employment visas f. Obtaining building regulation certificates for miscellaneous work or utilities at CoCoFar’s offices or employees’ residences 	<ul style="list-style-type: none"> a. To the extent the purpose of each payment can be ascertained, then it may be possible to estimate the actual benefit obtained or, more likely, the amount of loss avoided in each case. b. However, in some cases the purpose may not be ascertainable and/or a meaningful estimate may not be possible. The cost avoided by failing to implement appropriate anti-bribery measures would be the appropriate measure were the relevant offence the one under s.7 of the Bribery Act. c. Given average margin is 2-4%, applying the 10% of relevant global revenue in the relevant business area test would produce a ‘harm’ figure a number of times higher than the highest possible gross profit from the relevant contracts.
<p>5. An internal investigation reveals that, in two consecutive years, CoCoFar paid bribes averaging £5,000 to persuade a major client to pay invoices in December for work due to be performed, invoiced or paid for in the following January or February. In one case this was done in order to meet the year-end bonus target, and on the other occasion to ensure that the year-end revenue figures were “respectable”.</p>	<ul style="list-style-type: none"> a. In this case, the benefit obtained is the value of receiving payment early i.e. the interest saved or earned. (There are also benefits to management (rather than the company) in terms of bonuses and/or credibility). a. Alternatively, were this to be considered an adequate procedures failure (under s.7 Bribery Act), the cost avoided by failing to implement adequate anti-bribery measures would be the appropriate measure.

	<p>b. Again, a ‘harm’ figure calculated as 10% of global revenue in the relevant business area would be far in excess of the actual benefit obtained.</p>
<p>6. An internal audit reveals that, after CoCoFar won a large piece of work for a private client, the procurement director at the client recommended a specialist sub-contractor to CoCoFar. CoCoFar appointed the sub-contractor to perform part of the work on the project, without following its normal procurement procedures (pre-qualification of approved sub-contractors, three competitive bids etc.) and without conducting due diligence into the sub-contractor. As a result, CoCoFar did not learn that it could have appointed an alternative sub-contractor for approximately 20% less, nor did it discover that the sub-contractor was owned by the client’s procurement director.</p>	<p>a. Given the lack of intention, this may only realistically be an adequate procedures failure at CoCoFar. If so, the cost avoided by failing to implement adequate anti-bribery measures would be the appropriate measure in respect of the s.7 offence.</p>

Manufacturing

A large UK-based company (Colossus Ltd) is involved in various energy related projects both in the UK and overseas. These projects concern power generation and distribution, oil and gas, renewable energy and nuclear.

Colossus Ltd’s general strategy is to win work (either as a sub contractor or as a minority shareholder in a special purpose vehicle) on major infrastructure projects in the energy sector (mostly for public sector clients) and supply engines and spare parts to local distributors for onward sale to or incorporation into larger products for private clients. Similarly to CoCo Plc, Colossus Ltd operates on low margins of below 5%.

Colossus Ltd encounters a number of difficulties in connection with certain ongoing projects:

Scenario	Amount of Benefit or Loss Intended to be Gained or Avoided
<p>1. One of Colossus’ local subsidiaries operates a power plant in another high-corruption-risk developing country, Newmania. As a result of a technical malfunction, the plant starts emitting pollutants into the environment and jeopardising the health and safety of the local population. Colossus decides to despatch a team of UK-based field service engineers to Newmania to urgently address the issue. In order to reduce the ordinary 4-6 week period for obtaining a Newmania work permit for the engineers, the local subsidiary makes a series of small payments (of between £10 and £50) to the staff responsible for processing the permit applications. Each payment is authorised by a Colossus executive in the UK who directs that they are treated as “travel expenses” in the local subsidiary’s accounts. As a result, work permits are issued within four days and the engineers are admitted into the country to make the necessary repairs.</p>	<p>a. The immediate loss intended to be avoided is the expected cost of a delay in dealing with the problem. This may be difficult to calculate.</p> <p>b. Alternatively, in the absence of a clear intended benefit or loss to the company itself, presumably the 10% of global revenue in the relevant business area test would be triggered. Given the size and ultimate purpose of the payments this would not seem appropriate.</p> <p>In this scenario, using measure b to calculate the starting point for a fine would seem harsh as it must be assumed that those revenues have been legitimately earned. Colossus has sought to address a serious environmental issue as quickly as possible, therefore the starting point for a fine being based on</p>



	<p>10% of global revenue in such a case is wholly disproportionate. In the circumstances, it may not even be in the public interest to prosecute this case.</p>
<p>2. Colossus has a 5 per cent shareholding in a special purpose vehicle that has submitted a bid to build a new power plant for the Ministry of Electricity in Costanistan. The co-ordinator of the bid (the Project Manager) is an employee of the majority shareholder (Elainco) as well as a graduate and trustee of a prestigious university in the UK. Upon being informed by the Minister of Electricity that he would look favourably on any efforts to assist his daughter gain admission to a UK university, the Project Manager used funds of the special purpose vehicle to make a substantial donation to the University and simultaneously pressured the Board of Trustees to offer the Minister’s daughter a place. The Minister helped steer the award of the project to the special purpose vehicle.</p>	<p>a. As a 5% investor it is doubtful whether the bribes could be said to have been paid on behalf of Colossus. However, if they could then this could be considered an adequate procedure failure at Colossus, in which case the cost avoided by failing to implement adequate anti-bribery measures would be the appropriate measure, or</p> <p>b. Alternatively, Colossus’ 5% share of the gross profit from the corruptly obtained contract would seem the appropriate measure.</p> <p>As a minority shareholder of the SPV, Colossus would only be entitled to a small proportion (5%) of the SPV’s (revenues) and profits. Therefore, the relevant gross profit figure in this context ought to reflect Colossus’ minority shareholding.</p>

Trade Finance

XYZ Bank operates out of London in the trade finance market specialising in commodities sourced mostly from developing countries where corruption is prevalent. Amongst other things, it provides working capital to major international commodity firms on an unsecured basis and deal specific transactions with some underlying security in the form of the commodity in question.

Many of these transactions are very large and XYZ Bank often enters into syndicated arrangements. It does take a lead role in these arrangements as a Mandated Lead Arranger (MLA) as well as taking a subsidiary role in others.

Scenario	Amount of Benefit or Loss Intended to be Gained or Avoided
<p>1. XYZ Bank enters into agreements as MLA with 4 other banks to provide US\$2.7bn worth of finance to a commodity board in Farland. One of the other banks in the syndicated deal bribes the Chairman of the local commodity board to ensure that the XYZ Bank consortium gets the finance deal. XYZ Bank approved this. XYZ Bank provides \$450m of the \$2.7bn loan.</p> <ul style="list-style-type: none"> • XYZ Bank Revenue from the deal is \$2.9m • XYZ Bank Profit from the deal is \$0.95m 	<p>a. XYZ Bank's gross profit from the corruptly obtained contract.</p>
<p>2. XYZ Bank is included in a deal to support oil exports from Veryfarland. The deal is secured on future delivery of refined oil in a specific shipment. XYZ's trader discovers that the specific shipment has been illegally intercepted and bribes a local employee in the oil shipping agency in Veryfarland to amend the next cargo documentation to favour XYZ's consortium and ensure delivery of oil.</p> <p>The shipment of oil covers around 100m barrels of oil requiring financing of \$100m. XYZ Bank's share of the deal is 35% of the exposure ie \$35m</p> <ul style="list-style-type: none"> • XYZ Revenue from the deal is \$700k • XYZ Profit from deal is \$350k 	<p>a. The cost avoided by not having to pursue the parties who illegally intercepted the oil shipment; or</p> <p>b. The gross profit element of the deal</p> <p>In this scenario, XYZ Bank has legitimately entered into the underlying deal and but for the unlawful actions of a third party, would have earned its revenue and profit on the deal as a matter of course. Therefore, the cost avoided would be the more appropriate measure.</p>

Profit a fairer starting point than 10% of revenue

In each of the above examples, a revenue-based ‘harm’ figure would result in a disproportionately high fine, and would mean that low-margin businesses are hit harder than businesses with higher margins. The punitive element of a fine should be reflected in the multiplier applied to the ‘harm’ (i.e. intended benefit) figure, not in the calculation of the ‘harm’ figure itself.

A 10% of global revenue test will be disproportionate, unfair and/or unworkable in many circumstances and in a number of ways:

- 10% may be significantly greater than average margins in the relevant industry, and would have a far higher impact on lower margin businesses than on higher margin business.
- Ascertaining “relevant global revenue” for “the product or business area to which the offence relates” would be difficult or arbitrary for many businesses and could lead to an unjust result.
- Would a court/prosecutor look at the business division to which the corruptly obtained project or other benefit most closely related (e.g. CoCo Plc’s rail broader, mature rail business outside Farland)?
- To what period does the 10% of revenue test apply?
- In any event, such an approach would be unfair and disproportionate, unless the bribery is intended to benefit or protect, in some material respect, a company’s broader business outside the particular business in which the unlawful conduct took place.
- The punitive element of a fine is provided for in the draft guidelines by the application of a multiplier to the benefit obtained figure (i.e. ‘harm’). Therefore, targeting legitimately earned revenue at the initial stage of the calculation will in most cases be disproportionate.