



**Fraud Bill:
Guidance for Industry**

April 2006

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Introduction

The Fraud Bill is currently expected to receive royal assent in April 2006 and to come into force later this summer.

The Fraud Advisory Panel issues this guidance to the Fraud Bill to members of the Panel to assist in bringing to their attention the possible effects and consequences of particular aspects of the Bill. For further and more detailed guidance, members are advised to take independent professional advice as appropriate.

New offence of “fraud”

The Bill creates a statutory offence of fraud, committed in three ways, where a person dishonestly:

- makes a false representation, or
- wrongfully fails to disclose information, or
- secretly abuses a position of trust

With intent to make a gain or to cause loss or to expose another to the risk of loss.

It should be noted that the new offence relies on proof of dishonesty (*mens rea*) on the part of the defendant, rather than the effect of any representations made on the mind of the victim, as in traditional offences of deception. The new offence will replace at least eight Theft Act offences covering obtaining by deception and related offences. It is envisaged that the offence of conspiracy to defraud will be retained.

A person wrongfully fails to disclose information to another person if he or she is under a legal duty to disclose it; or if the information is of a kind which he or she is trusted to disclose, and it is reasonable to expect him or her to disclose it.

A person secretly abuses a position of trust, when they have been given a position in which they are expected to safeguard another's financial interests, and they abuse that position without the other's knowledge.

The Bill will also create two new offences:

- obtaining services dishonestly; this will cover a situation where a credit card that has been improperly obtained is used to obtain services from the internet, or any other situation where false information is provided to a machine. This conduct could not be charged as an offence under current law as deception is an element required in order to obtain services by deception under the Theft Act.
- Possessing articles for use in frauds, this will mean that computer programs designed to generate credit card details that are then used to commit or facilitate fraud will be covered by this new offence.

One of the notable features of the new offence of fraud is that the offence will be sufficiently flexible to allow prosecutions where a defendant has been proved to have acted dishonestly, irrespective of the method used to carry out the offence, thus allowing for the law to keep pace with technological advances.

Extension of the offence of fraudulent trading to sole traders and others and increase in penalty

Clause 9 of the Fraud Bill creates a new offence of fraudulent trading which will apply to those knowingly a party to the carrying on of types of business not currently caught by s.458 Companies Act 1985. The most obvious type of business entity to which s.458 applies is a company, but that provision also applies to those carrying on business through other types of entity such as a limited liability partnership or a European economic interest grouping. Clause 9 of the Fraud Bill is designed to apply to sole traders, partners and trustees who cannot presently be accused of fraudulent trading using s.458.

The maximum penalty for the clause 9 offence is to be 10 years to bring it line with the new offence of fraud contained in clause 1 of the Fraud Bill. At the request of the DTI the Home Office has included a provision in clause 10 of the Fraud Bill increasing the penalty for the s.458 CA 1985 offence to 10 years also to make it consistent.

The effect on corporate recovery

It should be noted that the extension of the offence of fraudulent trading to sole traders, partners and trustees will not be matched by any comparable civil remedy akin to fraudulent trading in the corporate field (sc. Insolvency Act 1986, s 213). This may be justified by the fact that the public require more protection from company directors and others who take advantage of the privilege of the corporate veil, whereas sole traders etc are personally liable in any case.

The simplification of the law of fraud is likely (and no doubt intentionally so) to increase the number of successful prosecutions for fraud. This may represent a benefit by a side-wind for the insurance industry since many policies (eg Directors and Officers Policies) exclude liability for fraud. If activity which previously could be called negligent is now characterised as fraudulent, such policies will not respond. However that is an inevitable and acceptable consequence of the much needed streamlining of fraud.

If a higher conviction rate arises, and more confiscation orders follow, more will need to be done to dovetail the confiscation regime with the insolvency regime. The confiscation regime lacks the more sophisticated tools available in the insolvency regime, eg for the fair distribution of funds to victims of fraud under a collective procedure. At present, the two systems sit a little uneasily together, and there is a concern that funds may sometimes be confiscated which could and should have been shared amongst victims.

Particular relevance of the Bill to artists and the art market

Traditionally the art market is noted for its opacity: dealers and auction houses tend to refer to expert opinion (usually regarding attribution—the assignment of an artist) and provenance (history of ownership) only if such references enhance the value. Controversial or conflicting references, detracting from value, are traditionally excluded; individuals rarely successfully sought remedy under civil law. Given the potential for criminal prosecution, the proposed Fraud Bill under **clause 2 (fraud by false representation)** and **clause 3 (fraud by failing to disclose information)** may make dealers adopt greater transparency.

For instance, a dealer might fail to disclose information regarding ownership of the work during the Holocaust era or an expert opinion countering the attribution which he provides with an art work. If he was in possession of that information, a case could be made that he

knew that his statement/omission was or might be misleading (**clause 2 (a) (b)**), (The mindset of the “victim” is, as noted above, no longer relevant). The dealer would also receive a greater return (by not revealing provenance) or cause the buyer loss or risk of loss, should the true provenance later be revealed.

In terms of attribution, although the dealer may still claim “in his opinion” the work is by “X”, when it was painted by “Y”, he would be in a weak position, given that he made a financial gain or the purchaser suffered a loss or risk of loss by his not revealing at the time of the sale conflicting expert opinion or potential claim of title, conditions necessary under **clause 3 (b)**. In both provenance and attribution examples, the dealer could, under the Ghosh test, be regarded as dishonest.

The critical element under **clause 3 (fraud by failing to disclose information)** is whether the dealer was legally obliged to disclose the information. In terms of attribution, this will continue to be difficult to establish. Dealers’ Codes of ethics contain legal disclaimers alongside assurances of skill in attribution. The provisions of the Bill could encourage greater accountability and transparency, particularly significant in a market fundamentally self-regulated.

In contrast, there would be a legal obligation of disclosure under the Sale of Goods Act 1979 (s.12 (2) (a) (b)), where the seller is obligated to disclose any charge or encumbrance affecting transfer of title or subsequent quiet possession and affirms (s. 13 (1)) that the goods correspond to the description. These legal requirements would enable prosecution under terms of the new fraud legislation **clauses 2 and 3**.

Clause 4 (fraud by abuse of position) may enable criminal prosecution of executors or trustees of artists’ estates who dishonestly abuse their position by, for example, signing a contract with a gallery/publisher without securing competitive contractual offers or giving permission for reproductions of works (still in copyright and creator’s moral rights). Whether the Court’s will consider that “dishonest abuse” means anything more than to act dishonestly in a position of trust remains to be seen, but a prosecutor would have to establish dishonesty on Ghosh principles. Certainly evidence of secret profit by a trustee at the expense of the trust would be prima facie evidence of dishonesty, although one acknowledges that commercial negotiations themselves are often sensitive and confidential and thus secrecy of itself is not necessarily dishonest.

A dealer could also be prosecuted under this limb of the offence as he is in a position of trust vis a vis his client: he is his agent. A dealer who, rather than achieve the best price for his client, took an additional payment direct from the purchaser without disclosing this to his client would be an example of dishonest abuse of position, although it might also amount to other offences such as corruption.

The elimination of the condition in the new offences to “permanently deprive” another of property [Theft Act s (15)] would open the way for prosecutions of individuals who take an art work, video, cultural object, etc. from the rightful owner in order to have copies even if they then return the original subsequently, when the process is intended “to make a gain for himself or another” or “to cause loss to another or to expose another to a risk of loss.

Clauses 6 and 7 (possession etc. of articles for use in frauds and making or supplying articles for use in frauds) importantly allow prosecutions of individuals involved at various stages with the production and supply of counterfeit art. An individual creating “fakes” or altering a work (for instance by adding a signature), or even *offering to do so, knowing or intending* that it was to be sold as original (*even if a sale had not occurred*) will now be able to be prosecuted along with the supplier. **Clause 8’s** definition of “article” leaves latitude in terms of technology, the sophistication of which is constantly evolving.

Clause 9 brings sole traders (which applies to many art dealers/consultants) on par with registered companies in terms of carrying out fraudulent business.

Tax fraud

Incidences of tax evasion, whilst generally and properly regarded as a species of fraud, are prosecuted as offences outside what might be called the mainstream fraud offences examined by the Law Commission and tackled by the new Fraud Bill. The main tax fraud offences are those found in s72 Value Added Tax Act 1994 (“VATA”) and the common law offence of cheating the Revenue¹. The Law Commission saw these offences, along with other fraud offences found outside the Theft Acts, as specialist forms of fraud particular to their own specialist setting and requiring separate consideration. As a result of this, tax fraud offences have remained outside the scope of the Fraud Bill. That the Fraud Bill has no effect on the tax fraud offences is confirmed by the absence of any reference to the VATA or the common law offence of cheating the public revenue in the schedules describing the consequential amendments, transitional provisions and repeals.

Notwithstanding this there is a similarity of approach between the new Fraud offences and the existing Tax fraud offences in that there is no requirement to prove that a deception operated on the mind of a person deceived. This was seen as a difficulty in certain circumstances and one which the Fraud Bill sought to address.

The ingredients of the three s72 VATA offences are, in essence, (1) being knowingly concerned in or taking steps with a view to the fraudulent evasion of VAT, (2) using a false document with intent to deceive or (3) furnishing information which is known to be false. Whilst still prosecuted in, for example, excise duty frauds, the scope of the s72 VATA offences has recently been curtailed in the context of missing trader frauds². In these cases HMRC now charges the offence which the former Inland Revenue commonly used in their prosecutions for serious tax fraud: cheating the Public Revenue. That offence is committed where a person makes a false statement relating to tax with intent to defraud the Revenue.

The effect on NHS counter-fraud investigations

The National Health Service Counter Fraud Security Management Service (CFSMS) Operational Directorate believes that were the Fraud Bill to become law in its current form the most significant effects on the Directorate will be:

- Efficiency savings in investigations due to the simplification and modernisation of the existing law;
- Less complex prosecutions as a result of clearly defined offences and the focus on the defendant’s *mens rea* rather than the effect of the deception on a victim;
- A reduction in the scope for legal arguments and appeals in those CFSMS investigations that result in a criminal prosecution;

¹ In addition to these there are offences of fraudulent evasion of income tax contrary to s144 Finance Act 2000 (which essentially mirrors the common law offence of cheating the Public Revenue), the offence of falsifying, concealing, destroying or disposing of documents sought by the Revenue pursuant to their powers under s20 Taxes Management Act 1970, offences relating to the improper acquisition, disposal or possession of certificates or vouchers used in the construction industry subcontracting scheme contrary to s561 Corporation Taxes Act 1988 and offences in relation to specified EU taxes contrary to s71 Criminal Justice Act 1993

² HM Revenue and Customs now adopt the position that VAT was never applicable to transactions that form part of carousel frauds and thus it could not be said that VAT was being evaded

- An increased deterrent effect as a result of the more expeditious and effective investigation of allegations of fraud;
- Enhance the ability of CFSMS to adapt to changing technologies and new forms of financial instruments.

The National Health Service (NHS) is a complex organisation with many delegated systems and in common with all such organisations can be vulnerable to fraudulent behaviour. As with many other agencies CFSMS has found that due to the overly specific 'Deception' offences within the Theft Act (1968) and the lack of simple, clearly defined offence of fraud, the investigation and prosecution of such allegations within such an environment is both complex and resource intensive. Due to these factors CFSMS has faced a number of difficulties in the investigation and prosecution of allegations of fraud when using the statutory provisions of the Theft Act. Historically these have related to issues involving the identification of a 'victim' who has been 'deceived', or proving a gain as required by some current legislation, and the selection of an appropriate charge under which to prosecute.

A feature of CFSMS investigations is that on many occasions the person who has been 'deceived' is often not the person who has suffered the 'loss' often leading to issues relating to the identification of a victim or indeed though behaviour which was clearly dishonest was demonstrated it proved impossible to identify a monetary loss or gain. Similarly, although many CFSMS investigations involve substantial sums these can on occasions be low value high volume, necessitating the identification of large numbers of witnesses to prove the totality of the offence.

The key feature of all three elements of the new proposals (Fraud by False Representation, Fraud by Failing to Disclose and Fraud by Abuse of Position) will be the shift of emphasis away from notions of appropriation and the deception of a victim contained in the Theft Act 1968 and a new focus on the defendant's *mens rea* and the subsequent outcome of his/her behaviour. For CFSMS, in most instances this will remove the need to identify substantial numbers of 'victims' leading to more targeted and focussed investigations with positive effects on both the time and resources required to adequately investigate and subsequently prosecute allegations.

A further result of the focus on the dishonest intent of the perpetrator rather than the effect on the victim should be the removal of the need to 'shoehorn' the behaviour of the defendant into highly specific Theft Act offences which may not adequately fit his/her fraudulent behaviour, leading to overly complex prosecutions often subject to legal or technical challenge.

Other aspects of the new proposals will have similarly beneficial effects for CFSMS. As examples, the new offence of Possessing Equipment to Commit Fraud and the extension of the offence of Fraudulent Trading will open avenues to successful prosecutions in a variety of offences routinely investigated by CFSMS. Similarly, the retention of the Common Law Conspiracy to Defraud will allow an alternative avenue for the prosecution of long term complex cases in the light of changing technologies and new financial instruments.

The effect on financial services sector

The Fraud Bill proposes a new offence of fraud which is designed to modernize, strengthen and simplify the existing statutory offences which are numerous and considered to be too specific. The aim is to encapsulate within a wider definition the range of behaviour currently capable of amounting to fraudulent conduct. It is also hoped that the definition will be flexible enough to deal with developing technology and its abuse.

Under FSMA the FSA has the ability to prosecute a number of specific fraud type criminal offences, both created by FSMA and pre-existing. Although the offences contained in FSMA fell outside the scope of the Law Commission's report on Fraud (2002) upon which the Fraud Bill was based the conduct giving rise to some of those offences will also fall within the new fraud offence which will be capable of being prosecuted by the SFO or the CPS. Although the FSA can prosecute those who are not regulated it has not as yet flexed its prosecutorial muscles, generally preferring to use its regulatory tools. Therefore this overlap, which facilitates criminal prosecution of such conduct under the new fraud offences by the regular prosecution agencies, is not surprising³.

There are three ways to commit the new offence of fraud, which requires dishonesty: by false representation, by failing to disclose information and by an abuse of position.

Fraud by false representation may well cover some existing FSMA offences such as making misleading, false or deceptive statements and creating a false or misleading impression as to the market in or price or value of an investment. Arguably, certain conduct constituting the regulatory offence of market abuse, such as where a misleading impression is given of the price or value of investments, may be covered by the new fraud offence if carried out dishonestly.

Conduct that currently falls outside existing legislation is 'Phishing'; where a representation is made that an email comes from a credit card company or a bank. The new offence will capture this activity as well as the unauthorized use of a credit card to buy goods or services, because the use involves the implied false representation that the card user is authorized.

Fraud by failing to disclose information would cover a situation where an investment advisor dishonestly failed to share information with a client in order to make a gain as a result, or to expose the client to loss or the risk of loss.

Fraud by abuse of position: although 'abuse' has not been defined, the Bill makes it clear that it is to be widely construed. The position occupied by an individual who may commit an offence under this limb is one where he would be expected to safeguard, or not to act against, the interests of another. In certain circumstances someone committing the offence of insider dealing would also be committing fraud by abuse of position, for example if the individual was the insider. Where an employee uses his position to make a secret profit, or to copy the intellectual property of his employer, this too would constitute conduct falling within fraud by abuse of position.

Participation in a fraudulent business; the range of businesses through which fraudulent trading can occur (presently limited to companies) is extended to other unincorporated businesses.

The new fraud offence carries a maximum custodial sentence of 10 years which is higher than the current 7 year tariff for offences of theft and false accounting. The Bill's new offences of obtaining services dishonestly and possessing articles for use in frauds carry a maximum sentence of 5 years in custody. The prison sentence for fraudulent trading remains at a maximum of 7 years.

³ Although prosecution for the FSMA offences is not limited to the FSA.

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Disclaimer

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