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Case No: U20170287

IN THE CROWN COURT AT SOUTHWARK
IN THE MATTER OF s. 45 OF THE CRIME AND COURTS ACT 2013

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 10 April 2017

Before :

THE PRESIDENT OF THE QUEEN'S BENCH DIVISION
(THE RT. HON. SIR BRIAN LEVESON)

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Between :

SERIOUS FRAUD OFFICE	**Applicant**
- and -	
TESCO STORES LIMITED	**Respondent**

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Sasha Wass QC and **Esther Schutzer-Weissmann** (instructed by **the SFO**) for the Applicant
Clare Montgomery Q.C. and **Clare Sibson Q.C.** (instructed by **Kingsley Napley** and **Freshfields Bruckhaus Deringer**) for the Respondent

Hearing dates: 27 March, 10 April 2017

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Judgment Approved

Sir Brian Leveson P:

Introduction

1. If false or misleading information is provided to the market by a listed company, a false market can be created. As a consequence, securities will trade at a higher (or, depending on the nature of the false or misleading information, a lower) price than otherwise would be the case. Thus, in the case of a higher price, purchasers of the securities will have paid more than they would have paid had there not been a false market; in the case of a lower price, vendors will have received less. Thus, for such a company, the accuracy of financial results reported to the market is of critical importance and substantial loss can be caused if material inaccuracy is subsequently identified.

2. For the financial year 2013/2014, ending for Tesco plc on 22 February 2014, the accounts and financial statements were published on 22 May 2014. UK revenue of £43 billion was reported along with a trading profit of £2.19 billion. These figures relied on accounting information supplied by its subsidiaries including Tesco Stores Ltd (to which I will refer throughout this judgment as "Tesco Stores"). On 29 August 2014, Tesco plc issued a trading update for expected trading profits for the six months up to 23 August 2014: the estimate was in the region of £1.1 billion. It is undeniable that the market will have reacted to this news.

3. 24 days later, on 22 September 2014, before trading opened, Tesco plc issued a further trading update in which it announced that it had identified an overstatement of its expected profit for the half year, principally due to the wrongly accelerated recognition of commercial income and delayed accrual of costs. That overstatement was then put at over £250 million. Subsequent detailed forensic investigation of the overstatement revealed that it was £284 million, made up of £155 million relating to periods prior to financial year 2013/14, £53 million to 2013/14 and £76 million to the first half of 2014/15.

4. On the day of the correction, the share price of Tesco plc fell by 11.59%, causing a reduction in total share value of £2.16 billion. Thus, it is undeniable that purchasers of shares and bonds in Tesco plc between 29 August 2014 and 22 September 2014 paid a higher price than they would have paid had the false impression not been created and, provided that they continued to hold some or all of them immediately prior to the issue of the corrective statement on 22 September, will have suffered a loss as a result.

5. The announcement on 22 September 2014 was precipitated four days earlier when a report written by an employee of Tesco Stores was provided by him to the legal department. This was passed to the Chief Executive Officer of Tesco plc and led to an urgent investigation by internal and external auditors. There were two main Board meetings on 21 September which led to contact with the UK Listing Authority and the announcement. Three days later, on 25 September, there was a meeting with the Serious Fraud Office ("SFO") at which Tesco plc and Tesco Stores offered full co-operation: a copy of the report which had been prepared was provided to the SFO on the following day.

6. Thereafter, on 30 September, the Financial Conduct Authority ("FCA") notified its intention to commence an investigation but when, on 29 October 2014, the Director of the SFO commenced its investigation, the FCA discontinued that aspect of its work although two years later it has become involved in the issue of compensation to which I will later refer.

7. Following the SFO investigation, the Director was satisfied that there was a realistic prospect of conviction of Tesco Stores in relation to an offence of false accounting contrary to s. 17 of the Theft Act 1968. The proposed indictment would contain particulars of the offence in these terms:

> "Tesco Stores Ltd between the 1st day of February 2014 and 23rd day of September 2014 dishonestly falsified or concurred in the falsification of an account or any record made or required for any accounting purpose, namely the digital accounting records of Tesco Stores Ltd and Tesco PLC and draft statutory interim accounts for Tesco PLC by relying on commercial income figures which gave a false account of the commercial income earned by Tesco Stores Ltd and a false account of the financial position of Tesco PLC and Tesco Stores Ltd with a view to making a gain for itself or another, or causing loss to another."

8. The concept of a deferred prosecution agreement ("DPA") is now well understood. By s. 45 and Schedule 17 of the Crime and Courts Act 2013 ("the 2013 Act"), there is a mechanism whereby, for certain economic or financial offences, a body corporate can avoid prosecution by entering into an agreement on negotiated terms with a designated prosecutor. This is not a private arrangement but requires, both provisionally before final agreement is reached, and after such agreement, the approval of the court. In short, the agreement must be in the interests of justice and its terms fair, reasonable and proportionate: see paras. 7 and 8 of Schedule 17.

9. The conditions set out in para. 1.2(i)(a) of the Code of Practice covering DPAs having been met, the Director of the SFO invited Tesco Stores to enter into negotiations with the object of reaching a DPA in relation to its potential criminal liability. Following detailed discussion, on 15 March 2017, an application was made to the court for a declaration pursuant to para. 7(1) of Schedule 17 to the 2013 Act. On 27 March, in private, I declared that the proposed DPA was likely to be in the interests of justice and that its proposed terms were fair, reasonable and proportionate: with the agreement of the parties, I reserved my reasons for doing so.

10. Although a hearing pursuant to para. 7(1) must be in private (not least because if the court does not provisionally approve the agreement, the possibility of prosecution must not be jeopardised), having declared that the proposed DPA was likely to be in the interests of justice and, subject to final agreement between the parties, likely to go forward, with my approval, Tesco plc then made an appropriate announcement to the market pursuant to its obligations under article 17(1) of the Market Abuse Regulations (Regulation (EU) No 596/2014). This followed the practice that I had approved in *SFO v Rolls Royce plc* (U20170036), 17 January 2017 (at [14]). Inevitably, therefore, absolute confidentiality was lost.

11. Following this decision, and the finalised agreement of a DPA, the Director of the SFO now applies for a declaration under para. 8 of Schedule 17 that the DPA is in the interests of justice and that its terms are fair, reasonable and proportionate. Thus, the court continues to retain control of the process although I repeat the observation I made in *SFO v Rolls Royce plc* at [9]:

> "To that end, it remains open to continue the argument in private, again on the basis that, if a declaration under para. 8(1) is not forthcoming, a prosecution is not jeopardised although it has to be recognised that, absent a material change of circumstances between the para. 7 hearing and the para. 8 hearing, it is difficult to see how the court could conclude that a DPA which it considered likely to be in the interests of justice with terms fair, reasonable and proportionate was not, in fact, in the interests of justice with terms which are fair, reasonable and proportionate."

12. The hearing under para. 8(1) must be in public with the facts and circumstances opened and argued so that the process becomes open to public scrutiny. Having said that, although para. 8(7) of Schedule 17 requires publication of the DPA, together with the declarations under para. 7 and para. 8, along with the reasons, the prosecutor may be prevented from doing so by an order of the court.

13. Parallel to these proceedings, a criminal prosecution has been commenced and, in the context of those proceedings, I have received submissions that this para. 8 hearing should be deferred until the conclusion of those proceedings. Suffice to say that I consider it neither necessary nor desirable (let alone in the public interest) to take that course but I shall return to the difficult issue of publication later in this judgment.

The Facts

14. At all material times, Tesco Stores operated (and still operates) the largest supermarket business in the UK. A wholly-owned subsidiary of Tesco plc, its principal activity is the operation of food stores and associated operations. At the end of the financial year ending 22 February 2014, Tesco Stores had 2,614 stores throughout the UK and, on average over the course of the year, some 278,876 employees. It is the largest single contributor of revenue to Tesco plc.

15. Tesco plc has subsidiaries and joint venture interests across Central Europe, Asia and also within the UK including Tesco Bank and Tesco Mobile. It is listed on the London Stock Exchange and, as one of the hundred companies listed on this exchange with the highest market capitalisation, the value of its shares contribute to the Financial Times Stock Exchange 100 Index. In addition, according to its website, at the year end, it had donated 18 million meals through food surplus redistribution work and neighbourhood food collection.

16. It is important to underline that no criticism is made of the conduct of Tesco plc whose conduct throughout has been exemplary: as soon as the most senior management of Tesco plc understood what had happened, it could not have moved more swiftly to address the issue with the market, the regulators and the SFO. It then mounted the fullest investigation and voluntarily disclosed its results. This deserves

recognition and great credit. Having said that, however, it cannot be denied that it is truly devastating that the conduct of Tesco Stores, a company of such central importance to the United Kingdom, should fall to be examined in the context of a criminal investigation. Even more serious is that the investigation of Tesco Stores has revealed clear evidence of what amounts to a serious breach of the criminal law and, without reaching any conclusion (which, in the light of criminal prosecutions that are presently being pursued, at the time of this judgment is still to be determined), implicates senior management.

The Structure

17. Tesco plc operates through a board, consisting mainly of non-executive directors (including the Chairman) and two executive directors, the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). It is a coincidence that new persons were appointed to both these executive positions after the publication of the misleading announcement. Thus, on 1 September 2014, Dave Lewis became the CEO and, on 23 September 2014, Alan Stewart was appointed CFO (his predecessor having resigned with effect from 4 April 2014 thereby leaving a vacancy).

18. Five committees reported directly to the Board of Tesco plc, which included the Audit Committee and the Disclosure Committee. The role of the former Committee was to provide confidence in the integrity of the processes and procedures in relation to internal control risk management and corporate reporting. Its responsibilities included reviewing the financial statements and announcements issued by Tesco plc relating to its financial performance and, where necessary, challenging the actions and judgements of management in relation to the interim and annual financial statements before submission to the Board. It also had responsibility for reviewing external and internal audit processes, the external auditors then being PricewaterhouseCoopers LLP ("PwC"). The role of the Disclosure Committee was to oversee compliance with the disclosure obligations of Tesco plc to the market, that is say, to ensure the accuracy and completeness of those disclosures.

19. Turning to Tesco Stores, on 23 February 2014, its Board of Directors comprised from Tesco plc the CEO, CFO, General Counsel and Chief Property Officer and, in addition, the UK Managing Director. In terms of Tesco's finance organisation, the CFO was responsible for all aspects of financial governance and, to that end, the Group Finance Team and the Group Planning and Analysis Team reported ultimately to him. The Group Internal Audit Team reported to the CFO.

20. The Group Finance Team was responsible for defining and policing the accounting standards of Tesco plc, working on the production of financial statements and liaising with the external auditors in relation to financial statements. The Group Finance Team issued requirements defining the relevant accounting standards, known at the relevant time as Tesco Group Accounting Policy ("TGAP").

21. TGAP was launched in October 2012, updated in January 2014, and, as was its predecessor, was stated to be compatible with UK and International Accounting Standards. TGAP was readily accessible across the business. Thus, by way of example, it was posted on the intranet operated by Tesco plc, and every finance director and manager was required to attend a training course on it. Over the relevant

period there were no relevant dispensations to depart from TGAP. Tesco plc required complete compliance with its terms.

22. Turning to the accounts, the process within Tesco Stores was as follows. There were two accounting systems: the first, to prepare the main accounting record; the second, to produce periodic financial reports at a Group level, where they were consolidated by Group Finance. UK Commercial teams provided input into the first accounting system of the details of the transactions that they had entered into. At the end of every month, in order to permit the preparation of reports, the data on the first accounting system was transferred into the second accounting system at which point it was reviewed by the UK finance team before being sent to Tesco Group Finance. The UK Finance Director was personally responsible for the truth and accuracy of the data submitted to Tesco plc, which required his certification (or authorisation to be certified) as giving a true and fair view of the business unit; he did so by means of a secure digital PIN issued to him.

23. After the data was sent to Tesco plc, the Group Finance Team would review the figures, approve them in a periodic close meeting, and then use these figures to prepare financial statements. In doing so, the Group Finance Team relied on Finance Directors across the businesses of Tesco plc to supply them with full and complete information compiled in accordance with TGAP. The financial statements would then be sent to the Group Planning and Analysis Team, who would provide summary management accounts to the CFO and Group Executive. This team was responsible for reviewing the consolidated accounts against the budget, and commenting on any variances.

24. The Group Internal Audit Team was independent, and had a mandate throughout the Group to undertake a continuous programme. This included review of the internal control and risk management processes, the identification of audit risks and the review and putting into place of procedures to manage and minimise them.

25. As external auditor, PwC provided shareholders with reasonable assurance that the financial statements provided by Tesco plc were free from material misstatement, by fraud or error. An auditor is entitled to expect that information given to it is true and complete. Similarly, any draft announcement to the market had to be free from material misstatement for which purpose it was reviewed before approval by the CEO, the CFO, the Audit Committee and the Board of Tesco plc which ultimately was responsible for the announcement.

26. The CFO resigned from Tesco plc with effect from 4 April 2014, following which a Finance Committee was established. This Committee served as a forum where the functional finance leaders below CFO level could inform and consult each other. It was not a committee of the Board of Tesco plc and neither did it report to that Board or discharge the function of a CFO. Having said that, when discussing performance against forecast and budget, Tesco Stores would often be covered. At no point were concerns raised by the UK Finance Director (who sat on the committee) about the manner in which commercial income was being recognised.

The Overstatement

27. Commercial income earned by Tesco Stores consists of the difference between the till price and purchase price of goods (known as front margin) and of volume related allowances, promotional and marketing allowances and various other fees and discounts received in connection with the purchase of goods from suppliers for resale (known as back margin). Most back margin income relates to adjustments to the core price of a product although, on occasion, receipt of the income is conditional on some specified action or performance condition being achieved by Tesco Stores. Payments or credit notes received from suppliers (contrasted with the difference between the till price and purchase price of goods) are generated by rebates for volume transactions or charges for services supplied (such as advertising placement or prominence). Accounting for this income requires an element of judgment. This was recognised by the Audit Committee, the Board and PwC.

28. It was also an issue for Tesco plc. On 4 April 2012, following a report by PwC concerning the inaccurate recording of commercial income by a non-UK subsidiary, the then CFO issued an explicit reminder by email to company and regional finance directors to comply with Tesco accounting rules. It was also underlined as a key focus for Tesco plc and PwC; it was noted in the Annual Report and Financial Statements, 2014 in these terms:

> "We focussed on this area because of the judgement required in accounting for the commercial income deals and the risk of manipulation of these balances."

29. Notwithstanding the warning in 2012, commercial income appears to have been misstated prior to the year ending February 2015 although the SFO's investigation was confined to the first half of the year ending February 2015. It may be significant that in April 2013, Tesco plc had announced its first fall in profits in nearly 20 years as a consequence of adverse general economic conditions and competition from other retailers. Against that background, annual budget and financial targets were set by the CEO in consultation with the Group Executive Committee and approved by the Board. Once finalised in March 2014, the commercial and financial teams at Tesco Stores were informed.

30. Although it was then widely believed by commercial and finance teams within Tesco Stores that the targets were unachievable, it was clear that the expectation was that they would be met. This gave rise to a culture of pressure to deliver in line with budget with the result that between 1 February 2014 and 18 September 2014, commercial income was misstated so that by 23 August, Tesco Stores had wrongly recognised £257 million of commercial income which was a figure made up of legacy misstatements from earlier years and pulling forward of income, a practice that involved recognising commercial income that should not have been recognised until a future accounting period, if at all.

31. The effect of the misstatement in the accounts was falsely to inflate the commercial income figures of Tesco Stores, thereby creating a false account of the financial position of that company and distorting the process by which the budgets of Tesco Stores (based on reported past performance) were set. The consequence was to create a shortfall in the income of Tesco Stores for the accounting period and cause an inaccurate analysis of expected performance to be submitted to the Board of Tesco plc for the first half (and full year) 2014-2015.

32. From the material that has been placed before the court (including correspondence between March and September 2014), it is clear that certain members of the senior leadership team of Tesco Stores were well aware of its underperformance and its inability to meet the targets together with the challenge of filling the gap in the accounts left from previous years' pull forward and the extent of the further pull forward necessary to meet targets. Equally, employees at various levels of seniority in the Finance and Commercial Teams at Tesco Stores, albeit acting under the direction and guidance of senior employees, were also aware of improper recognition of commercial income. Throughout H1 and into H2 2014/15, senior managers in Tesco Stores were provided with many opportunities to alert others including Group Finance, the board of Tesco Stores Board and the board of Tesco plc to the fact that the Tesco Stores numbers were false. They failed to take any of these opportunities and instead concealed the true position.

33. On 7 August 2014, at the half-year planning meeting with the PwC Audit Team, the relevant Finance Director for Tesco Stores confirmed he was not aware of any fraud. On 29 August the trading update was published. Meanwhile, further work on the accounts continued and, on 11 September 2014, at an audit clearance meeting with senior Tesco Finance officers which was the final part of the PwC review of the interim accounts, the same Finance Director declared that there were no issues with commercial income. Further, on 17 September 2014, a draft pack of Tesco interim financial results was delivered to PwC, showing a profit figure of £641 million. The true figures were concealed from Group Finance and PwC, neither of whom saw a paper, dated the previous day, which had been provided to the relevant senior leaders of Tesco Stores.

34. How did this come about? For Tesco Stores, Clare Montgomery Q.C. explained that it may well have been the consequence of bad practice by individuals to meet low level shortfalls and could have been occurring for some time. In that regard, it may be that individual overstatements were too small to have been picked up and that the materiality of the figures only became clear when the sums were considered cumulatively. A cumulative figure in excess of £30 million was first identified in June 2014. In that regard, it may be relevant that, for Group accounting purposes, sums under £150 million were not material as a matter of accounting practice although, since these events, that threshold has been reduced to £50 million in part to reflect the Group's reduced level of profitability.

Disclosure and Investigation

35. An employee within the Finance Department of Tesco Stores had such concern about what he considered to be accounting irregularities in relation to commercial income and the emerging cumulative figures that, on Thursday 18 September 2014, courageously, he went over the heads of his superiors and provided a written report to the legal department of Tesco plc. This report was quickly escalated within the legal department and, the following morning, the new CEO was informed. On the same day, PwC and Tesco Group Internal Audit began to verify the figures contained in the report, working over the weekend. As I have recounted, following two meetings of the Board of Tesco plc on Sunday, on Monday 22 September, various steps were taken to deal with the position. These were:

i) senior employees who were aware of the overstatement and failed to report it were immediately suspended;

ii) the Group Internal Audit Team, together with PwC, were instructed to continue working to confirm the extent of the overstatement and its impact on the full-year results;

iii) Deloitte were instructed independently to conduct a comprehensive review of this process, and the wider issues;

iv) arrangements were made to issue a trading update to the market before it opened on the following day, reporting both an overstatement of its expected profits for the half-year to 23 August 2014 of an estimated £250 million, and its continuing review of the position; and

v) the Board committed to a course of full co-operation with the SFO from the outset of its dealings with it.

36. On 22 October 2014, Deloitte confirmed that the proposed adjustment in respect of overestimated commercial income was reasonable. The following day, Tesco plc released its interim results for the period ending 23 August 2014 to the market, with a UK profit figure of £499 million.

37. On 29 October 2014, acting pursuant to s. 1(3) of the Criminal Justice Act 1987, the Director of the SFO opened a criminal investigation into Tesco plc and Tesco Stores in relation to the misstatement. This investigation (with which Tesco plc and Tesco Stores have provided the very fullest co-operation, providing all relevant documents and digital material) focused upon the first six-month accounting period of 2014, in which the misstatement was made. This involved:

i) obtaining and then reviewing the key documents identified by enquiries conducted by Tesco Group Internal Audit, PwC and Deloitte;

ii) obtaining and then reviewing digital repositories or email containers, where available and appropriate, of 59 key players or former employees, and four corporate mailboxes, all unfiltered for potential privilege, and, with Tesco's agreement, resolving any issues of privilege arising by reference to independent counsel;

iii) securing access generally to hard copy documents from Tesco plc and Tesco Stores; and

iv) making other, targeted, requests for material, including personnel files, employee diaries and audit files.

38. Throughout the criminal investigation, proactive assistance continued with the offer of information, and both prompt and constructive responses to requests made of it by the SFO. Thus Tesco plc and Tesco Stores:

i) at the SFO's request, refrained from interviewing witnesses or taking statements during the course of the criminal investigation, despite the fact that

they faced both actual and threatened civil proceedings, both in this jurisdiction and in the United States of America;

ii) agreed a limited waiver of privilege over relevant material which pre-dated the profit statement;

iii) voluntarily disclosed other material which appeared to them to be significant to the criminal investigation;

iv) provided mailbox accounts of its employees and former employees, without first filtering their contents for any privileged items which fell outside the limited waiver, agreeing that any issues of privilege that might arise as a result could be resolved by independent counsel;

v) scheduled over 1,600 evidence bags of hard copy materials in order to facilitate the SFO's inspection of that material;

vi) assisted the SFO to arrange interviews with current and former employees and kept it updated of developments in its business that might impact on the criminal investigation; and

vii) generally helped to facilitate a swift conclusion to the investigation.

39. These steps led to the acquisition and review, primarily using digital review methods, of over 3.5 million documentary items. In addition to its acquisition and review of documentary evidence, the SFO conducted 47 interviews pursuant to s. 2 of the Criminal Justice Act 1987 of current and former employees of Tesco plc and Tesco Stores and third parties. The SFO also interviewed five suspects under caution as a result of which three have been charged with criminal offences and await trial.

Other Consequences

40. In November 2014, Tesco plc dismissed for gross misconduct senior employees who were aware of the overstatement but failed to report the matter or take steps to ensure that proper accounting practices were followed and the practice stopped. Two have commenced proceedings for unfair dismissal and High Court proceedings have also been intimated. Other, including more junior, employees were suspended but were thereafter permitted to return to duty.

41. Secondly, although the FCA ceased its own investigation, it later became involved with both Tesco plc and Tesco Stores in relation to the issue of restitution. That has now also been resolved by the announcement of a scheme which is relevant to the overall financial consequences of what has happened. It also provides a different focus on the assessment of the harm caused. I shall return to this topic when discussing the terms of the DPA.

42. In addition, Tesco plc is involved in civil litigation in which a number of claimants seek an unquantified sum in excess of £10 million; two others have sought very much smaller sums. Separate proceedings, involving two companies, involve a claim of $212 million. Ms Montgomery confirmed that there was an overlap between the sums involved in these proceedings and the subsequent agreement with the FCA in relation to restitution but that was not complete. Finally, without admission of liability, Tesco

plc has, first, with court approval, settled a class action brought in the US District Court for the Southern District of New York for some $12 million and, second, settled proceedings filed against it in the US District Court of the Southern District of Ohio.

43. For the sake of completeness, it is also appropriate to add that, on 22 December 2014, the Financial Reporting Council launched an investigation under the Accountancy Scheme into PwC and individuals at that firm and at Tesco in relation to the preparation, approval, and audit of financial statements for Tesco plc for the financial years ended 25 February 2012, 23 February 2013, and 22 February 2014 and into conduct in relation to the matters reported in the interim results for the 26 weeks ended 23 August 2014. This investigation continues.

The Interests of Justice

44. The statutory requirements in para. 7(1) and 8(1) of Schedule 17 of the 2013 Act require that entering into a DPA is, respectively, likely to be and is in the interests of justice and, again respectively, that the proposed and actual terms are fair, reasonable and proportionate. In relation to the interests of justice, CrPR 11.3(3)(i) requires any application for a DPA to explain why such an agreement is likely to be in the interests of justice and complies with the other requirements. The DPA Code of Practice (August 2016) ("the Code") provides a measure of guidance on which factors are relevant, and the relative weight to be attached to each of them, at para. 2.6 in these terms:

> "In applying the public interest factors when considering whether to charge, seek to enter a DPA or take no further criminal action the prosecutor undertakes a balancing exercise of the factors that tend to support prosecution and those that do not. This is an exercise of discretion. Which factors are considered relevant and what weight is given to each are matters for the individual prosecutor. It is quite possible that one public interest factor alone may outweigh a number of other factors which tend in the opposite direction. Decisions will be made on an individual case by case basis."

45. In this case, the SFO have approached the interests of justice by examining, on the one hand, the seriousness of the offence and, on the other, six features of relevance. These are the extent of co-operation, changes in leadership in Tesco Stores (and, indeed, Tesco plc), the remedial measures undertaken, the consequences of a conviction for false accounting, the efficient use of public resources and, finally, the importance of incentivising future co-operation from other organisations. I agree that these factors can and do form the background against which the interests of justice can be assessed.

<u>Seriousness of the Offence</u>

46. The Code provides that the starting point when analysing the interests of justice is the seriousness of the offence at para. 2.5:

> "Public interest factors that can affect the decision to prosecute usually depend on the seriousness of the offence, which

> includes the culpability of [the organisation] and the harm to the victim. A prosecution will usually take place unless there are public interest factors against prosecution which outweigh those tending in favour of prosecution."

The more serious the offence, the more likely it is that prosecution will be required in the public interest, and, accordingly, the less likely it is that a DPA will be in the interests of justice.

47. There a number of factors to be considered under this heading, all of which, in the absence of countervailing features, could point to prosecution. First, and in my judgment, foremost is the substantial harm caused to the integrity of the market and the damage to the essential confidence in the way in which it operates (see para. 2.8.1(vii) of the Code). The second is that Tesco Stores, through senior management, played a leading role in what was organised and planned misconduct, involving other employees through the application of pressure. Thirdly, although the proposed count on the indictment is limited to one set of results, it is clear (and not in issue) that the accounts had been overstated over a number of years (cf. para. 2.8.1(v) of the Code).

48. The fourth aggravating feature is that not only the senior management but the culture at Tesco Stores placed its accounting and finance functions under pressure to help to deliver to budget, including through illegitimate methods that ended up undermining their independence and true function to record and report, accurately, upon performance. Fifth, Tesco Stores senior managers who were aware of the unlawful activity failed to take opportunities to alert Group Internal Audit, Group Finance and the boards of Tesco plc and Tesco Stores to it and also concealed it from the external auditors.

49. Having said that, it is important to recognise that a number of these features (identified by the SFO) are subsets or consequences of the same problem, namely, the culture and practice set by senior management at Tesco Stores which was reflected through the activities of the company. Once that has set off in the wrong direction, in the absence of positive action, the others (such as the period of time over which misstatements occurred and the extent of the concealment) almost inevitably follow.

Co-operation

50. Turning to the countervailing factors to be balanced against what might otherwise be a strong case in favour of prosecution, the first and critical is the unreserved and enduring co-operation, outlined above. Thus, the Code provides that such co-operation is the first, and a potentially potent public interest factor against prosecution, at para. 2.8.2(i) in these terms:

> "Considerable weight may be given to a genuinely proactive approach adopted by [the organisation's] management team when the offending is brought to their notice, involving within a reasonable time of the offending coming to light reporting [the organisation's] offending otherwise unknown to the prosecutor and taking remedial actions including, where appropriate, compensating victims."

51. From 19 September 2014, that is the day that the overstatement was reported to the new CEO of Tesco plc, I repeat that the companies acted immediately, and responsibly. Of particular importance is the immediate instruction to the internal and external auditors urgently to examine and advise, the involvement of an independent auditor to review what had happened, the reference to the market and the assistance given to the SFO.

52. Also relevant was the action taken against the senior management involved; four senior employees were dismissed, three of whom now face prosecution. Others were suspended but, after investigation, allowed to return to work not least because of the extent to which they were diverted from their duty by more senior managers. Only one now remains in the company.

Leadership

53. It is important to underline that a company is a structure which can only operate through its directors, employees and agents. Stripping out the human beings, a company itself can have no will or ability to decide how it should behave. Thus, as I made clear in *SFO v Rolls-Royce and another* (U20170036) at [48], it is "of real significance" whether or not those who were implicated in or should have been aware of illegal behaviour, or of a culture which permitted illegality to thrive, remain members of the senior management.

54. In fact, there have been significant changes to the leadership of Tesco plc and Tesco Stores some of which were in train before the discovery of what had been happening in Tesco Stores. Thus, prior to this misstatement coming to light, on 1 September 2014, Dave Lewis took over as CEO. Without commenting in any way about his predecessor's leadership, as soon as it was brought to his attention on 19 September 2014, Mr Lewis has adopted a highly proactive approach to what he learnt. Going beyond him, there are two current non-executive members of the Board of Tesco plc who were members at the time of the misstatement but the current CFO, Chairman, and six non-executive directors joined that Board on or after the publication of the 22 September 2014 announcement. There is also a new Company Secretary.

55. Ms Montgomery explained that there were three reasons for this radical change in the Board – only one of which related to the misstatement of accounts. The other reasons included a real concern about the trading of Tesco as a whole and the decision to simplify company management structure. In other words, it is not to be inferred that there is any more serious structural problem within Tesco plc; I am also assured by Ms Montgomery that the acceleration of the appointment of the CEO by one month was unrelated to the conduct here being considered.

56. In relation to Tesco Stores, the UK Leadership Team which governs the UK business and reviews performance, including financial performance and managerial accounts, is also now very different. None of the current members of the UK Leadership Team were members at the time of the misstatement and the only directors who were members of the Board of Tesco Stores at the time of the alleged conduct, and still remain members, are the Group General Counsel and the Chief Property Officer.

57. It is these new senior management teams that have authorised all that Tesco plc and Tesco Stores have done since the alleged conduct was reported and investigated. In

these circumstances, I am satisfied that both the senior management and those responsible for the strategic direction of Tesco plc and Tesco Stores are different to those responsible for the operation of the business at the time of the events relevant to this application.

58. Having said that, it is important to make a more general point relevant beyond this case. Although I have emphasised the importance of the individuals running any corporate entity, a complete change at the top (and even more so in relation to non-executive positions) is not a prerequisite for approval of a DPA. It is, however, likely to be difficult to demonstrate the critical corporate recognition of the need for change if anyone in a senior management position who is specifically implicated in criminal behaviour remains in position.

Remedial Measures

59. The third factor that falls to be considered is the existence and, if so the extent of, any remedial measures in order to address the failings identified as a result of the conduct that was uncovered. The Report on the Response to the Overstatement of Expected Profit, Corporate Renewal and Remediation, dated 15 March 2017, begins its conclusion at para. 146 in the following terms:

> "The measures undertaken by [Tesco] are wide ranging and comprehensive. They demonstrate that [Tesco], under new leadership, has made substantial progress towards remediation and renewal. It has invested significant time and resource in this process and has increased oversight at various levels throughout the business to ensure that its controls are effective and have been implemented successfully. [Tesco] has also made significant improvements to its culture to ensure that employees feel that they can report wrongdoing and that there is appropriate escalation of any issues."

60. In particular, the Report on Remediation evidenced a number of tangible remedial measures, that can properly be described as wide-ranging and comprehensive. These are as follows:

    i) Reporting lines have been simplified to ensure that there is clearer accountability, and that those who have oversight are independent from those that lead (para. 24);

    ii) In terms of escalation, Tesco plc has re-launched its externally-run whistle-blowing service, which is promoted to colleagues and suppliers, so as to raise awareness (paras. 56-8);

    iii) Tesco plc has increased personnel in the Finance, Legal, Compliance and Group Internal Audit Teams, and re-launched its Code of Business Conduct (paras. 19(d), 70, 71 and 92);

    iv) In relation to commercial income, Tesco plc has introduced a new commercial buying model, which has shifted the emphasis from back margin which is the

type of commercial income involved in this case, to front margin i.e. the profit on goods sold (paras. 104-5); and

v) Tesco plc has invested significantly in new technology in order to support and enable its new financial control framework, with a total estimated cost of £315 million to implement and run the system, set for deployment in March 2018 (paras. 134-6).

Consequences of a Conviction

61. Looking at the consequences of a conviction, it is first worth noting and underlining the relevance of the fact that neither Tesco plc nor Tesco Stores have been the subject of criminal or regulatory sanction for this type of conduct before (cf para. 2.8.2(ii) of the Code). Account can also be taken of the extent to which disproportionate consequences would follow from a conviction, whether under domestic or European law, or the law in other jurisdictions (see para. 2.8.2(vi) of the Code). Such repercussions for Tesco Stores would also impact on Tesco plc with a risk for innocent, third party interests, which constitute a further public interest factor: see para. 2.8.2(vii) of the Code.

62. Such repercussions, in this case, include adverse effects to the UK supermarket and food industry with impairment of competition and consequential impact on the supply chain. Additionally, potentially, there would be a real impact in the share price of Tesco plc. Either individually or in combination, these could result in loss of employment throughout the component businesses that make up Tesco plc and potential weakening of its Pension Scheme.

63. I recognise that the national economic interest is irrelevant to the analysis of the question whether or not a DPA is in the interests of justice and the fact that Tesco Stores is a large company should not and does not render it immune from prosecution. I repeat the observation made in *SFO v Rolls-Royce plc* (U20170036) at [57]:

> "As I have made clear before, and repeat, a company that commits serious crimes must expect to be prosecuted and if convicted dealt with severely and, absent sufficient countervailing factors, cannot expect to have an application for approval of a DPA accepted."

64. Having said that, as Tesco Stores is a wholly-owned subsidiary of Tesco plc, a FTSE 100 company, I have no difficulty in accepting that these features demonstrate that a criminal conviction recorded against Tesco Stores could have a real impact on persons who have no connection at all with the accounting practices of the company, including its employees, pensioners, and those in its supply chain. It is undeniably a relevant factor.

Efficient Use of Public Resources

65. Of less importance, but still relevant, is the efficient use of public resources to investigate the endemic problems of serious fraud. Those resources most significantly are resources of expertise and time, both of which are hard pressed. Dealing with this case by means of a DPA allows that expertise to be deployed on other cases, even

taking into account the need to continue to deal with the forthcoming criminal prosecution of individuals. Further, although it is not appropriate to weigh the potential financial cost of a prosecution as a disincentive to such an approach, the fact that resources will be released for other work must be a relevant factor.

66. Another aspect of using public resources efficiently (as I have made clear in each of the DPAs that have been negotiated) is to encourage and incentivise the self-reporting of wrong-doing by corporate entities in a similar situation to Tesco Stores and Tesco plc: see para. 2.9 of the Code. Anything that can properly be done to improve the ethical behaviour of companies by encouraging them to 'come clean' where economic crimes are uncovered or revealed is undeniably in the public interest (as well as being in the public interest of the corporate entity itself). As I put it in *SFO v Rolls Royce plc* (at [60]):

> "[T]he effect of the DPA is to require the company concerned to become a flagship of good practice and an example to others demonstrating what can be done to ensure ethical good practice in the business world."

Conclusion

67. Without in any sense minimising the conduct revealed by this investigation, I am entirely satisfied that the balance in this case comes down firmly on the side of concluding that it is in the overall interests of justice to conclude a DPA in this case. Conduct that is more egregious than that disclosed by the activities of Tesco Stores has resulted in such an approach and there is no basis for adopting a different view, not least because of the extent of the co-operation which has been afforded to the SFO in the investigation as well as the other positive features revealed by what has happened since this misstatement came to light. In the circumstances, I turn to whether the proposed terms are fair, reasonable and proportionate.

The Terms of the DPA

68. The essential basis of this DPA is that, effective from the date of a declaration under paras. 8(1) and (3) of Schedule 17 to the 2013 Act, for a period of three years, the SFO will agree, having preferred the Indictment, to suspend it and, subject to compliance with the terms of the DPA, after that period, discontinue the proceedings.

69. Taken together, the requirements falling upon Tesco Stores are as follows:

   i) Co-operation with the SFO, other law enforcement and regulatory authorities and agencies (as further described) in all matters relating to the conduct arising out of the circumstances of the draft Indictment and Statement of Facts;

   ii) Payment of a financial penalty of £128,992,500;

   iii) Payment of the costs incurred by the SFO (assessed as being in the order of £3 million); and

   iv) At its own expense, commissioning external auditors acting for Tesco Stores to review and report on two aspects of Tesco's Global Finance Transformation Programme, and then implement any recommendations.

No tax reduction shall be sought in relation to any part of the payments of penalty or costs. It is also proposed that the penalty will be paid within 30 days of the DPA and the costs within 10 days with interest being payable at the SFO's discretion at the prevailing rate for judgment debts in default if payment of either the penalty or costs is late. There are provisions for termination in the event of breach whereupon the suspension of the indictment may be lifted and criminal proceedings reinstated.

70. Other conditions include the absence of any protection from prosecution or regulatory action in relation to conduct that has not been disclosed by Tesco Stores prior to the date on which the DPA comes into force or from any future criminal conduct. Neither is there protection from prosecution of any present or former officer, director, employee or agent of Tesco Stores. Finally, there is a provision that fresh proceedings may follow if Tesco Stores provided to the SFO inaccurate, misleading or incomplete information which it knew or ought to have known to be so. I emphasise that this last condition is for completeness and not because of any suggestion that this is what has happened.

71. As for its duration, the DPA must be of sufficient length that the proposed terms are effective, and its aims accomplished. Obviously, this is dependent on the individual circumstances and, given that Tesco Stores has co-operated fully, allowing the SFO to conduct a thorough investigation, and that there have already been improvements in its compliance programme, three years (that is until 10 April 2020) appears to be an appropriate length of time. Such a period will allow the SFO to complete its investigation and prosecution of individuals; it should also be sufficient for Tesco plc and Tesco Stores to complete their programme of transformation. As a result, I turn to consider the terms individually.

Co-operation

72. The future co-operation of Tesco Stores is set out in paras. 9-14 of Section A of the DPA (as visualised by para. 7.8 of the Code which provides that a condition for co-operation will normally be present). Thus, the agreement provides for the co-operation of Tesco Stores (and for the procurement of the full and honest co-operation of Tesco plc) in the investigation and prosecution of individuals related to the conduct which is the subject of the draft Indictment and described in the Statement of Facts.

73. As Tesco Stores will ordinarily be the main repository of material relevant to the prosecution of individuals, both in terms of evidence and disclosure, it is obviously fair, reasonable and proportionate that it is required to assist in the pursuit of any investigation or prosecution. It is not the purpose of a DPA to absolve individuals from their responsibility for offending, if such is established. In the context of this case, neither is it surprising that Tesco Stores is also required to procure the same assistance from Tesco plc. To facilitate this co-operation, for the duration of the DPA, the company is also required to keep the material gathered during the course of its investigation and that of the SFO within this jurisdiction. Additionally, Tesco Stores agrees that its co-operation, and the co-operation that it shall procure from Tesco plc, shall include best efforts to make available for interview, as requested by the SFO, present or former officers, directors, employees or other third parties.

Disgorgement of Profits and Compensation

74. It is not possible to identify any profit to be disgorged derived by Tesco plc or Tesco Stores as a result of the conduct alleged in the proposed charge. the question of disgorgement, therefore, does not arise.

75. As for compensation, the negotiation proceeded on the basis that the SFO did not intend to suggest that such a condition should be included not least because it would not be a simple or straightforward case to assess compensation and only two of the institutional investors approached by the SFO were willing to assist the investigation. This is to be contrasted with *SFO v Standard Bank plc* (U20150854) in which it was possible to require the Bank to pay the Government of Tanzania the sum which it would have received but for the payment of the bribe which led to an increased fee being charged. It was in that context that I made it clear in *SFO v Rolls-Royce plc* (U20170036) at [81]:

> "Although s. 130 of the Powers of the Criminal Courts (Sentencing) Act 2000 requires a court, after conviction, to consider the question of compensation and the Guideline states that the court must consider compensation, it is intended for 'clear and simple cases' (*R v Michael Brian Kneeshaw* (1974) 58 Cr App R 439), also described as "the simple, straightforward case" (*R v Kenneth Donovan* (1981) 3 Cr App R (S) 192). Equally, it is clear in *R v Ben Stapylton* [2012] EWCA Crim 728 that:
>
> > 'there is no jurisdiction to make an order where there are real issues as to whether those to benefit have suffered any, and if so, what loss': *R. v Horsham Justices Ex p. Richards* (1985) 7 Cr. App. R. (S.) 158, 993."

76. The SFO also noted that it had not been approached by any investor seeking compensation and only two investors were willing to assist the investigation having been approached by the SFO. In the event, as recorded above, civil proceedings are being pursued independently, as they still can be by others.

77. Quite apart from this entirely appropriate approach, while the DPA was being negotiated, independently of the SFO, the FCA concluded that the publication of the August statement disseminated false or misleading information which constituted market abuse contrary to s. 118(7) of the Financial Services and Markets Act 2000 ("the 2000 Act"). Having reached that conclusion, pursuant to s. 384 of the 2000 Act, the FCA has the power, if it is satisfied that one or more persons have suffered loss as a result of that market abuse, to require restitution to be paid to the appropriate persons of such amount as the FCA consider to be just having regard to the extent of loss.

78. In those circumstances, the FCA has pursued the question of a restitution or compensation scheme with Tesco plc and Tesco Stores for purchasers of the relevant securities in the period when the market was misled about the results, that is to say between 29 August 2014 and 22 September 2014, who retained those securities thereafter. The loss suffered by each such purchaser is the overpayment for the relevant securities, less any amount by which the loss was mitigated, for example, by sales during the relevant period.

79. It is necessary to add that the FCA also found that, for the purposes of market abuse, there was knowledge at a sufficiently high level, albeit below the level of the Board of Tesco plc as to the fact that the statement was false or misleading, for that knowledge to constitute the knowledge of Tesco plc. As a result, the FCA has required Tesco plc and Tesco Stores and they have agreed to pay £84.4 million under the statutory scheme prescribed by the 2000 Act. This reflects total potential, principal liability to eligible share and bondholder claimants. That fact is also relevant to the overall penalty to be imposed as part of the DPA.

80. Before leaving the issue of restitution, it is appropriate to emphasise that whatever might be the view of the FCA in relation to market abuse in the context of the 2000 Act, the agreed Statement of Facts arising out of the SFO investigation does not make any criticism of Tesco plc. This DPA relates to Tesco Stores only.

Financial Penalty: Introduction

81. It is clear that a financial penalty can be imposed as part of a DPA (see para. 5(3)(a) of Schedule 17 of the 2103 Act) the size of which must be "broadly comparable" to that which would have been imposed on conviction for the offence following a guilty plea (para. 5(4) *ibid*). The position was set out in the judgment under para. 7(1) of Schedule 17 in connection with Standard Bank plc (*SFO v Standard Bank plc* (U20150854), 30 November 2015) in relation to failure to prevent bribery in these terms (at [44]):

> "Thus, although there is no question of a conviction, the legislation requires any financial penalty to demonstrate broad comparability with a fine following conviction. That exercise can only be undertaken by analysing and applying the approach adopted by the Sentencing Council Guideline; this follows that mandated by s. 143 of the Criminal Justice Act 2003 to the effect that when considering the seriousness of any offence, the court must consider the offender's culpability in committing the offence and any harm which the offence caused, was intended to cause or might foreseeably have caused. In connection with corporate offenders in relation to this type of offence, that then translates into a non-exhaustive hierarchy of culpability characteristics with harm represented by a financial sum related (in the case of offences under the Bribery Act 2010) to the gross profit from the contract obtained, retained or sought."

82. To that analysis of the position, it is only worth adding that in a criminal court, the approach identified by the relevant Sentencing Guideline (in this case for Corporate Offenders: Fraud, Bribery and Money Laundering) must be followed unless it is contrary to the interests of justice to do so: see s. 125(1) of the Coroners and Justice Act 2009. In addition to harm and culpability, the Guideline also requires consideration to be given to the financial circumstances of Tesco Stores. To achieve broad comparability, therefore, the same approach must be adopted for DPAs.

Financial Penalty: Harm

83. The Sentencing Guideline does not make specific provision for determining a harm figure where an offence of false accounting has been committed by a corporate offender. Further, unlike in a case of bribery where gross profit can be assessed, in this case of false accounting, there is no specific gain made or loss caused. In those circumstances, the Guideline provides that the appropriate measure will be the amount that was likely to have been achieved in the circumstances. The Guideline goes on:

> "In the absence of sufficient evidence of the amount that was likely to be obtained, 10-20% of the relevant revenue (for instance between 10-20% of the worldwide revenue derived from the product or business area to which the offence relates for the period of the offending) may be an appropriate measure."

84. Recognising the difficulties inherent in this approach (not the least as a consequence of the way in which the proposed indictment has been drafted) the SFO approached the assessment of harm by having regard to the reported UK Food Commercial income of Tesco Stores for the relevant period covered by the draft indictment. This amounts to £1.021 billion. From this, the overstatement (some £257 million) is deducted giving a 'true' figure of £764.4 million. Taking a starting point for determining the percentage at 15%, this was reduced to 11.25% to reflect the fact that the harm arising from this misstatement to the market lasted for three weeks only. Thus, the overall harm figure assessed by the SFO, then, was £85.995 million.

85. I readily understand the difficulties surrounding this approach but following the provisional agreement of this figure, an alternative mechanism became available against which it could be tested: that is the calculation agreed between Tesco plc, Tesco Stores and the FCA in relation to the restitution or compensation scheme for net purchasers of the ordinary shares and listed bonds who suffered loss as a result of the effect that the misleading statement had on the price of those securities. The FCA had a database of all reported transactions during the relevant period and, with the assistance of independent expert advice, has estimated the total amount of compensation that will be payable under the scheme is approximately £85 million plus interest (broadly comprising £78.4 million in respect of shares and £6 million in respect of bonds).

86. The SFO accept that the approach of the FCA provides a realistic analysis of the class of investors who may have suffered loss as a result of the trading update and that those losses could reasonably be taken as an alternative harm figure. Its figure is within the same bracket as the £86 million assessed by following the approach described in the Guideline. In the circumstances, I am entirely content that the figure put before the court as representing the harm caused is fair, reasonable and proportionate.

Financial Penalty: Culpability

87. Having assessed a figure representing the harm caused, it is necessary to determine the appropriate offence category by reference to culpability. The Guideline identifies a non-exhaustive hierarchy of the culpability characteristics used to determine into which of three categories the conduct falls. Using the appropriate culpability category, a starting point for a multiplier to the harm figure can be derived. Adjusting

within the category range for aggravating and mitigating factors (again by reference to a non-exhaustive list set out in the Guideline) allows for the assessment of a final multiplier. The Guideline recognises that the culpability might be such that it is appropriate to move outside the category range altogether.

88. In this case, it is recognised that the circumstances fall into the category of high culpability which has a starting point of 300% and a category range of 200%-400%. That is because, over a sustained period, senior management played a leading role in organising, planning and pursuing the deliberate misstatement of commercial income, applying pressure on employees to do so. Factors increasing seriousness are those which were identified when analysing the interests of justice and, in particular, the maintenance of a culture within Tesco Stores of requiring delivery to budget which led to illegitimate accounting practices, concealing that behaviour from others at Tesco plc (including Group Finance and external auditors) and, as a result, causing substantial harm to the integrity of and confidence in the markets. It would also be right to include the fact that specific concerns expressed by at least one member of staff were ignored.

89. On the other side of the equation, there are four factors which operate to reduce seriousness and reflect mitigation. These are, first, the fact that Tesco Stores has no previous relevant convictions and has not been subject to civil or regulatory enforcement action. Second, Tesco Stores voluntarily reported the offending, made early admissions, and co-operated with investigations. Third, Tesco Stores has taken steps to deal with the cultural problem and what happened occurred as a consequence of the decisions of leaders who are no longer in place. Finally, it is beyond argument that although loss was caused to those who purchased shares acting as a consequence of the misstatement, Tesco Stores did not and never could derive gain or profit from what happened.

90. The DPA proceeds on the premise that the aggravating and mitigating features balance each other out and that it is appropriate to conclude that the financial penalty should be based on the starting point of a multiplier of 300%. Thus, taking the harm figure of £85.995 million, prior to discount, a financial penalty of £257.985 million is appropriate. I agree with this approach.

91. Complying with s. 164 of the Criminal Justice Act 2003, the Guideline then requires the court to 'step back' to consider the overall effect of the financial orders, ensuring that, in combination, they remove all gain, provide appropriate additional punishment and can act as a deterrent. The Guideline goes on:

> "The fine must be substantial enough to have a real economic impact which will bring home to both management and shareholders the need to operate within the law. Whether the fine will have the effect of putting the offender out of business will be relevant; in some bad cases this may be an acceptable consequence."

92. In cases where the viability of the company is in jeopardy, in the interests of justice and in order to ensure that impecuniosity is not rewarded, I have deferred the process of 'stepping back' until discounts for guilty plea and other assistance have been taken into account: see *SFO v XYZ Ltd* (U20150856), 24 June 2016 in relation to the para.

7(1) decision at [56] and 8 July 2016, in relation to para. 8(1) decision at [23]-[24]. In this case, that approach is unnecessary and not justified. Suffice to say, I accept the submission made by the SFO (recognised and endorsed by Miss Montgomery) that the overall penalty achieves the objectives of punishment and deterrence, and, taking into account Tesco Stores' financial circumstances, is substantial enough to have a real economic impact.

Financial Penalty: Discount

93. Any penalty under a DPA must be comparable to a fine imposed upon a conviction after a guilty plea and must reflect s. 144 of the Criminal Justice Act 2003, and the Guideline issued by the Sentencing Guidelines Council on Guilty Pleas, which remains in place until 1 June 2017 when the new Guideline issued by the Sentencing Council comes into force (although in the context of this case, there is no material difference). In that regard, the SFO accurately recognises that, taking into account the agreement by Tesco Stores to resolve the alleged conduct in the proposed Indictment by way of a DPA, the full reduction of one third of the proposed penalty is appropriate.

94. A reduction of one third reflects a guilty plea at the first available opportunity. In relation to DPAs, however, the admission (and, in particular, the saving of public time and money on investigation and prosecution) justifies a higher discount. This approach is reflected in the judgment following the para. 7(1) hearing in *SFO v XYZ Ltd* (U20150856), 24 June 2016 at [57], which was restated in *SFO v Rolls-Royce plc* (U20170036) at [120]:

> "In addition, given that the admissions are far in advance of the first reasonable opportunity having been charged and brought before the court, that discount can be increased as representing additional mitigation. In the circumstances, a discount of 50% could be appropriate not least to encourage others how to conduct themselves when confronting criminality …"

95. In light of what the SFO have described as "the exemplary standard of co-operation" exhibited by Tesco Stores in relation to its enquiries, the same approach is justified, that is to say, to lead to a total discount of the financial penalty to 50%. That reduces the total financial penalty to £128,992.500. Having regard to all the circumstances, I conclude that it is fair, reasonable and proportionate to assess the overall financial penalty in this sum.

Compliance Programme

96. There is no doubt that Tesco plc has previously encountered problems with the recognition of commercial income in subsidiaries outside of the jurisdiction. Thus, in the Report on Corporate Renewal and Remediation, it is reported that there have been issues in relation to Tesco Poland and also the Malaysian and Thai subsidiaries of Tesco plc: see paras. 82-83. Furthermore, as reflected in para. 24 of the DPA, in its 2016 audit opinion, Deloitte specifically recognised that commercial income is a key risk. Thus, it is particularly apposite that the DPA Code of Practice, at para. 7.10(iii) provides that a DPA may include a condition that a robust compliance and/or monitoring programme is put in place but also that para. 7.11 makes it clear that a

genuinely proactive and effective corporate compliance programme will be an important consideration.

97. Following that Report, it is clear that, in accordance with its terms, a programme of corporate reform has been put in place. Thus, Part E of the DPA has been designed to be consistent with and to underpin that programme and requires the external auditors to Tesco Stores (now Deloitte LLP) to review and report on two aspects of Tesco's Global Finance Transformation Programme.

98. The first report, to be commissioned by 10 May 2017, will be concerned with, comment upon, and make recommendations for improvements to:

    i) the controls applied to the recognition of commercial income within Tesco Stores;

    ii) the operation of Tesco's Commercial Income Governance Body;

    iii) the segregation of duties within Tesco Stores between the Commercial and Finance Teams and, separately, between the business partner finance function and its control finance function; and

    iv) the training and policies within Tesco Stores relating both to the recognition of commercial income, and the impact on the extent to which the Commercial and Finance employees working in Tesco Stores understand their roles and responsibilities in respect of the recognition of commercial income.

99. The second report, to be commissioned by 20 May 2019 with a scope to be agreed with Deloitte and the SFO, will focus on aspects of the Global Finance Transformation Programme that are, as yet, undeveloped, and relate to the deployment of planned technological upgrades, including:

    i) the controls applied to the recognition of commercial income within Tesco Stores;

    ii) the segregation of duties within the finance team at Tesco Stores; and

    iii) the impact on controls within Tesco Stores consequent upon the automation of certain processes.

100. Express provision is made for the external auditor to Tesco Stores (presently Deloitte LLP), to access any such material that they reasonably request, and to co-operate generally with the SFO as may be requested. Additionally, there is specific recognition that Tesco Stores retains responsibility for identifying, assessing and addressing risks from its business and, if necessary and appropriate, will adopt or modify existing controls, policies or procedures in order to ensure that it complies with all applicable finance best practice.

101. There are further provisions for the provision of implementation plans and reports to be reviewed by the external auditor and submitted to the SFO with a requirement that recommendations for action by the external auditor must be implemented by 10 April 2020. Because of these aspects of the DPA, it has not been considered necessary to require the appointment of a monitor (see 7.11-7.20 of the Code of Practice). It is

sufficient for me to confirm my agreement that these terms are obviously fair, reasonable and proportionate.

Costs

102. The proposed DPA also makes provision for the costs incurred by the SFO in the investigation and pursuit of this case which, by para. 5(3)(g) of Schedule 17 of the 2013 Act, may be imposed as part of the DPA. In that regard, para. 7.2 of the Code of Practice makes it clear costs should ordinarily be sought. This approach coincides with the practice following conviction. As a matter of public policy, it is obviously right that a defendant with means to do so should pay the costs incurred by the Crown, arising out of investigation and prosecution.

103. It is not suggested that Tesco Stores does not have the means, or the ability to pay the Crown's costs and the public policy which underlines the general rule is not challenged. It is obviously fair, reasonable and proportionate that a further term of the DPA includes a provision to that effect; the estimate provided is £3 million.

Conclusion

104. Although these proceedings have been required to validate a proposal and then a concluded agreement, in relation to the investigation by the SFO into the conduct of Tesco Stores, it is important to underline that the court has not acted merely to provide formal confirmation of that agreement. On the contrary, I have considered the position, from an overall perspective, following a detailed analysis of the circumstances of the investigated offence and an assessment of the financial penalties that would have been imposed had the draft Indictment advanced to trial and conviction. Neither have I approached the position in a way that is identical to that adopted by the parties.

105. The financial impact of this DPA, including the compensation and restitution required by the FCA and putting to one side the civil law litigation substantially exceeds £200 million. To that sum must be added the professional costs incurred by Tesco Stores both in relation to its investigation and representation (for which purpose I ignore the cost of the compliance regime which was clearly required in any event). Putting to one side the inevitable reputational damage that will flow from the misstatement of its results, I have no doubt that the financial penalty and consequences will bring home both to management and shareholders the need to operate within the law. Suffice to say that, in the light of all the circumstances, I am satisfied that the disposal of this investigation by means of a DPA is in the interests of justice and that its terms are fair, reasonable and proportionate.

Order and Publication

106. In line with this judgment, pursuant to para. 8(1) of Schedule 17 of the 2013 Act, I declare that the DPA is in the interests of justice, and that its terms are fair, reasonable and proportionate. I consent to the preferring of a bill of indictment charging Tesco Stores Ltd with false accounting, contrary to s. 17 of the Theft Act 1968, in the terms set out in the draft that accompanied the application: see s. 2(2)(b) of the Administration of Justice (Miscellaneous Provisions) Act 1933. I note that, pursuant to para. 2(2) of Schedule 17 of the 2013 Act, these proceedings are automatically

suspended. The terms of the DPA now fall to be enforced in default of which an application can be made under para. 9(1) of Schedule 17.

107. In the normal course of events, the DPA, the Statement of Facts, and this judgment containing the reasons for my rulings under paras. 7(1) and 8(1) of Schedule 17 of the 2013 Act would now enter the public domain. As is evident from the judgment, however, criminal proceedings against three former employees of Tesco plc and Tesco Stores are now taking place; these proceedings are active within the meaning of the Contempt of Court Act 1981 ("the 1981 Act").

108. By para. 7(4) of Schedule 17, the hearing under para. 7(1) was conducted and determined in private and, in the normal course of events, would have remained so unless and until the DPA was approved under para. 8(1). In fact, publication of the fact of the declaration under para. 7(1) (and the Final Notice issued by the FCA) had to be disclosed to the market pursuant to article 17(1) of the Market Abuse Regulations. In the circumstances, I then made an order both *ex parte* under s. 4(2) of the 1981 Act and as a judge of the High Court in terms that:

> "Any report of any proposed or agreed deferred prosecution agreement between Tesco Stores Limited and the Serious Fraud Office (the DPA), shall be postponed until 11 April 2017 or until further order, unless the report also makes clear in terms that any DPA:
>
> a. concerns only the potential criminal liability of Tesco Stores Limited; and
>
> b. does not address whether liability of any sort attaches to Tesco plc or any employee or agent of Tesco plc or Tesco Stores Ltd."

109. In addition to submitting that the para. 8 hearing should be adjourned until the conclusion of criminal proceedings, representations have also been made by those against whom criminal proceedings are active that nothing at all should be permitted to enter the public domain about the conclusion that I have reached or the reasons for it. This is not least because the basis of the DPA might be thought to undermine the defence to be pursued and, if it enters the public domain, the potential prejudice to jurors could undermine the unalienable right to a fair trial. Ms Montgomery recognises that the Statement of Facts and this judgment provide details which should not be published until the conclusion of the trial but submits that the DPA itself can (not least because its financial terms have been communicated to the market) and, in any event, Article 17 of the Market Abuse Regulations will require it not least because the market now anticipates the agreement and if it is not made may well speculate (with adverse consequences to Tesco plc) that it has been refused. She also points to the need accurately to reflect the financial consequences of the DPA in the published accounts.

110. It is beyond argument that the court can restrict publication of the DPA, the background information and the public hearing through two mechanisms. The first is prescribed by para. 12 of Schedule 17 to the 2013 Act in these terms:

> "The court may order that the publication of information by the prosecutor under paragraph 8(7), 9(5), (6), (7) or (8), 10(7) or (8) or 11(8) be postponed for such period as the court considers necessary if it appears to the court that postponement is necessary for avoiding a substantial risk of prejudice to the administration of justice in any legal proceedings."

111. That does not cover the public hearing but, the second mechanism, also in order to avoid substantial risk of prejudice but providing a more extensive remit, is contained within s. 4 of the 1981 Act in these terms:

> "(1) Subject to this section a person is not guilty of contempt of court under the strict liability rule in respect of a fair and accurate report of legal proceedings held in public, published contemporaneously and in good faith.
>
> (2) In any such proceedings the court may, where it appears to be necessary for avoiding a substantial risk of prejudice to the administration of justice in those proceedings, or in any other proceedings pending or imminent, order that the publication of any report of the proceedings, or any part of the proceedings, be postponed for such period as the court thinks necessary for that purpose."

112. Thus, there is power to prevent not only publication of the documents identified in para. 12 of Schedule 17 but also any report of the public hearing under para. 8(1) of Schedule 17. On the basis that I was contemplating an order in proceedings which, unlike the hearing under para. 7(1) were not being conducted in private, in accordance with para. 6B4(e) of the Criminal Practice Directions, the press was notified of the hearing. Although many representatives of the press attended and I made clear the background of and basis for the application to restrict reporting until the conclusion of any trial or further order, in the event, no representations were made.

113. Miss Wass argued that because of blogging and other forms of mass communication, the risk of publication of a judgment that was handed down (even if subject to restrictions) was such that I should maintain the confidentiality of the reasons to prevent any risk of prejudice. The same is so in relation to decisions of the court which lead to re-trials but the interests of open justice (even if what is said cannot enter the public domain until some date in the future) are such that it would be wrong not to provide reasons for the conclusion that I have reached. In the circumstances, I have provided an oral summary of this judgment subject to reporting restrictions. This written judgment, however, will be made available as soon as the order which I shall now make lapses.

114. In addition to the orders on the DPA, therefore, I have made the following orders both in these proceedings and in the prosecution both under s. 4(2) of the Contempt of Court Act 1981 and (in the case of the former) para. 12 of Schedule 17 of the 2013 Act:

> "There shall be postponed until the conclusion of the trial of Carl Rogberg, Chris Bush and John Scouler or further order the publication of:
>
> (a) the deferred prosecution agreement between Tesco Stores Ltd and the Serious Fraud Office approved by the court ("the DPA");
>
> (b) the statement of facts in support of the DPA;
>
> (c) any report of the hearing pursuant to para. 8(1) of Schedule 17 of the Crime and Courts Act 2013; and
>
> (d) the reasons for the decisions of the court under paras. 7(1) and 8(1) of the said Schedule
>
> save only for the facts that:
>
> i. Tesco Stores Limited has entered into a DPA with the Serious Fraud Office as described in the RNS announcement made by Tesco plc on 28 March 2017;
>
> ii. subject to compliance with the terms of the DPA, the investigation by the SFO into Tesco plc and Tesco Stores Ltd is concluded;
>
> iii. the DPA only relates to the potential criminal liability of Tesco Stores Limited and does not address whether liability of any sort attaches to Tesco plc or any employee, agent, former employee or former agent of Tesco plc or Tesco Stores Ltd;
>
> iv. Tesco plc will take a total exceptional charge of £235m in respect of the DPA of £129m, the expected costs of an FCA compensation scheme of £85m, and related costs. This has been recorded in the financial statements in the year to 25 February 2017 of Tesco plc as an adjusting post balance sheet event.

Concluding Remarks

115. Before leaving this case, it is important to add some remarks about the significance of DPAs in general and this DPA in particular. As I have said, any corporate entity is only a structure that operates through its directors and employees. If they commit crime in apparent interests of the company, that criminal offence is personal to them unless they are a controlling mind in which case the crime can be brought home against the company itself. Although there is reputational damage however junior the employee, the higher up the chain of management, the more serious the damage. That damage can only be limited by the demonstration of integrity, by the company operating through its most senior management.

116. There are, of course, different ways in which discovered criminality can be managed. I sought to address these possibilities in *SFO v Rolls-Royce plc* (U20170036), when I put the matter in this way (at [143]):

> "A cynic (or irresponsible company) might look at the costs which Rolls-Royce have incurred in their own investigation and wonder whether it be more sensible to keep quiet and hope that its conduct does not fall under the eye of the authorities. Quite apart from the total failure to acknowledge the difference between right and wrong, that is to fail to understand that such an approach carries with it cataclysmic risks. Whatever the costs Rolls-Royce have incurred, they are modest compared to the cost of seeking to brazen out an investigation which commences; absent self-disclosure and full co-operation, prosecution would require the attention of the company to be entirely focused on litigation at the expense of whatever business it is trying to conduct and conviction would almost inevitably spell a far greater disaster than has befallen Rolls-Royce."

117. Another way of making the same point is to identify what demonstration of integrity means. It generally requires self-reporting to the authorities, co-operation with an investigation, a willingness to learn the lessons and recognition that where corporate liability could be established, a penalty must be imposed for punishment and deterrence. In that way, the company concerned can demonstrate to its Board, its employees, its agents, its customers and its shareholders that it has learnt and will adhere to the highest standards required of those engaged in corporate activity in this country. In that regard, from 19 September 2014, after learning of the misstatement, Tesco plc and Tesco Stores have done as much as possible to learn from what has happened and to start to rebuild the trust necessary to operate in a society where that trust is so important. Both deserve great credit for doing so.

118. I end by expressing my thanks both to the parties and their legal teams for the care and attention which they have brought to this case and the clear way that it has been possible to present the facts and the arguments, fully reflecting the interests of both sides and, in addition, the interests of justice.