

Submission to the Commonwealth Treasury

Review of Sanctions in Corporate Law

Consultation Paper

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Introduction

This submission addresses the release of the Commonwealth Treasury's consultation paper on the *Review of Sanctions in Corporate* (March 2007). The University of Western Sydney (UWS) has a corporate law academic group within the School of Law, who wish to provide an informed debate on these critical issues. Some of the suggestions that have been provided in this submission are of a policy nature and observe under which circumstances the Australian Securities and Investments Commission (ASIC) uses the different penalties available to it within the corporations' law domain.

If any of the responses require further explanation please contact Professor Michael Adams at the UWS School of Law at Michael.Adams@uws.edu.au

Staff involved in producing this response

The University of Western Sydney, School of Law, has a variety of staff from many different areas of the law. In respect of this submission, the substantive legal submissions have been prepared by Professor Michael Adams, Dr Masudul Haque, Margaret Hyland, John Juriansz, John McGrath and Marina Nehme.

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General Observations:

The consultation paper, *Review of Sanctions in Corporate Law*, reviews the criminal, civil and administrative sanctions present under the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth). It additionally looks at the defences that may be available for directors in case of breaches of directors' duties and it considers certain changes to the provisions of market manipulation in the *Corporations Act*.

The observation of the UWS Corporate Law Academics can be summarised in the following manner:

- Introduction of administrative penalties in the instances of low level offences.
- There is a need to update Schedule 3 in the *Corporations Act*.
- The provisions in relation to civil penalties need to be clarified in certain instances
- Administrative sanctions are important and need to stay as a part of company law.
- There is no need to create a new general defence. The UWS Corporate Law Academics proposes to reform the business judgement rule defence and extend it to other breaches of directors' duties.
- The market manipulation provisions require some clarification as to the definition of market manipulation but there is no need to include new elements to the definition (for instance, recklessness).

Consideration Issue 1 (Chapter 1)

Are you aware of any situations where the prospect of potential sanctions under corporate law influenced a decision about whether to engage in a certain business activity? If so:

- *Which provision gave rise to the concern?*
- *Was this due to the prospect of imprisonment or personal liability for a fine or compensation order, for something you considered to be out of your control?*
- *Was this due to uncertainty about the operation of the law in a particular fact scenario?*

Are you aware of any situation where the absence of sufficient sanctions under corporate law influenced a decision about whether to engage in a certain business activity?

Do you consider that the regime for corporate regulation in Australia deters responsible risk-taking more or less than is the case in other comparable jurisdictions?

Are there areas that you consider the law has gone to far to protect investors, at the cost of entrepreneurship? Are there areas where the law has not gone far enough?

A study conducted by Michael Kent Block and Frederick Carl Nold tested the effect of antitrust enforcement in the US in 1981. They reached the conclusion that the likelihood of imposition of large damage awards in cases of antitrust had a deterrent effect of reducing mark-ups in the bread industry.¹ More recently, Simpson has asserted that criminal deterrence has major limitations in the corporate context.² Simpson holds that the potential for deterrence by the use of civil and regulatory means is limited.³ However, Simpson's study, at least with respect to the criminal law acting as a deterrent, is not supported with solid empirical evidence. Most of her evidence is dated and does not take into account that the criminal law has not been readily used to deter corporate wrongdoing.⁴

In Australia, certain provisions in the corporate law field have influenced directors, officers of companies and corporations to do or not to do certain actions. For example, s. 588H(5) observes that if the directors are in breach of s. 588G they may

¹ Michael Kent Block and Frederick Carl Nold, "Deterrent Effect of Antitrust Enforcement" (1981) 89 *The Journal of Political Economy* 429, at 445

² See generally Sally S. Simpson, *Corporate Crime, Law, and Social Control*, (edn., Cambridge University Press: Cambridge, 2002).

³ Sally S. Simpson, *Corporate Crime, Law, and Social Control*, edn., Cambridge University Press: Cambridge, 2002.

⁴ See generally Jeffrey H. Reiman, *The Rich Get Richer and the Poor Get Prison* (4th ed., Allyn and Bacon, Boston, 1995). Reiman points out that the label of "criminal" has been used disproportionately to label those who engage in street crimes as criminals. Meanwhile, many corporate crimes are dressed up as the cost of doing business.

be able to escape liability by proving that they took all reasonable steps to prevent insolvent trading. Accordingly, if the directors of a company believe that their organisation is insolvent, they may be motivated to put the company under voluntary administration to protect themselves from breaching their duty of preventing insolvent trading and avoid being personally liable for the corporation's debts that were incurred after the company became insolvent.

In other instances, companies or individuals may be investigated by Australian Securities and Investment Commission (ASIC) for breaches of the law. They will have one of two choices: enter into an enforceable undertaking or face civil proceedings. They may accept in order to stop the alleged breach by entering into an enforceable undertaking because it is the lesser of the remedies available.⁵ The High Court of Australia has recently affirmed in two important decisions ASIC's Constitutional power to enforce banning orders and suspend liquidator's registration.⁶

Another example that illustrates that companies action are motivated by meticulous calculation as to the cost of possible legal action to the organisation is in case of infringement notices.⁷ For instance, Solbec⁸ elected to comply with an infringement notice in relation to the alleged breach of its continuous disclosure obligations. It observed in its media release that it did not breach the provisions of continuous disclosure and that the only reason it complied the infringement notice is for commercial reasons to avoid the costs of defending its position.⁹

⁵ Marina Nehme "Enforceable Undertakings in Australia and Beyond", (May 2005) 18 *Australian Journal of Corporate Law*, 68- 87.

⁶ *Visnic v Australian Securities and Investments Commission* [2007] HCA 24 (24 May 2007); *Albarran v Members of the Companies Auditors and Liquidators Disciplinary Board* [2007] HCA 23 (24 May 2007)

⁷ The Commonwealth Treasury has a separate consultation paper on Infringement Notices (5 March 2007, <<http://www.treasury.gov.au/contentitem.asp?NavId=&ContentID=1198>>). The UWS Corporate Law Academics made a separate submission in respect of infringement notices (14 May 2007).

⁸ ASIC, "ASIC issues first infringement notice for continuous disclosure breach", Media release, 1 August 2005, <<http://www.asic.gov.au/>> viewed on 30 May 2007

⁹ McCullough Robertson Lawyers, "Continuous Disclosure- ASIC Issues First Fine Under New Powers", <<http://www.mccullough.com.au/publications/publications.aspx?p=47&itm=1486> > viewed on 16 May 2007.

Consideration Issue 2 (Chapter 2)

Criminal sanctions

Should criminal sanctions only apply where there is an effect or potential effect on the integrity of the market that warrants the severest condemnation or punishment, and/or where the market would expect an element of retribution, and/or where a breach is intentional or reckless?

In our view, the kinds of behaviour that should be subject to criminal sanctions (including imprisonment) are those that involve intentional harm-doing to others that can be fairly imputable to the agent or corporation being held responsible.¹⁰ Hence, the harmful consequences must flow from intentional or reckless conduct of those who are being held responsible. The harm could setback the interests of individuals interests, the collective interests of shareholders or society more generally (i.e., where the corporation dumps toxic waste in a river that supplies water to the general populace and so forth).¹¹ Mere recklessness or foreseeability of harm is not sufficient for the purposes of invoking the criminal law. Furthermore, disproportional civil penalties may be tolerable if they could deter the unwanted wrongdoing (arguably, the unfairness is counterbalanced in the civil context as the offender's is not labelled as a criminal and is able to avoid potential imprisonment), but disproportional criminal penalties are not acceptable as a means of deterrence. Criminal penalties ought to be proportional to the wrongdoing, harm-doing and culpability involved.¹²

We agree with the words of his Honour Justice Finkelstein in *ASIC v Vizard*¹³, cited in Chapter 1 of the Consultation Paper, that corporate offences have a tendency to “erode the moral base of the law and provide an opportunity for other offenders to justify their misconduct.”¹⁴ We would add that, to the extent that corporate wrongdoing involves behaviour analogous to non-corporate crime, as such the wrongdoing should be criminalised. A fraudulent banker would cause greater economic harm than a pickpocket. Hence, corporate regulation has to factor in the most effective of the means being used to deter the wrongdoing with reference fair labelling, just deserts and the censuring and communicative elements in criminal punishment. Mislabelling conduct as non-criminal when it causes or potentially causes, serious harm to others, imposing ... disproportionate sanctions, it is said,

¹⁰ Dennis J. Baker, “The Moral Limits of Criminalising Remote Harms”, [2007] 10(3) *New Criminal Law Review*.

¹¹ Joel Feinberg, *The Moral Limits of the Criminal Law: Harm to Others* (O.U.P., New York, 1984) 227-232.

¹² Andrew von Hirsch, and Andrew Ashworth, A., *Proportionate Sentencing: Exploring the Principles*, (ed., O.U.P., Oxford, 2005) at chap. 2.

¹³ *Australian Securities and Investments Commission v Vizard* [2005] FCA 1037.

¹⁴ *Australian Securities and Investments Commission v Vizard* [2005] FCA 1037, [2].

would breed disrespect for law and hence a weakening of the moral influence of the penalty structure.¹⁵

If this review is concerned with the question whether criminal sanctions ought to be reduced and/or whether a greater emphasis should be placed on civil penalties, we would submit that very careful consideration be given to the particular behaviour that is to be labelled as criminal. The UWS Corporate Law Academics submit that, in the more serious types of behaviour, *only* a criminal sanction be available (there should not be the option of choosing between prosecuting under criminal proceedings or prosecuting under a civil penalty provision).

There is no evidence to suggest that in the corporate world, as compared with other contexts,¹⁶ the principle of general deterrence has any more or any less scope. Simpson¹⁷ notes that deterrence is not achieved in any significant way by imposing civil penalties. Thus, deterrence should merely be a secondary consideration. Deterrence is likely to be achieved as an indirect effect of imposing appropriate criminal penalties. Of course, this hypothesis is based, in large part, on anecdotal evidence, and it is essential that it be operationalised and empirically verified. Like the general “deterrence” theory, it is at present an untested hypothesis. The overriding consideration ought to be whether the conduct deserves a criminal law response, civil law response or a regulatory response. If the conduct involves the potential for harm that has been brought about by the culpable actions of the corporation or individuals, then it should be criminalised so as to maintain respect for the law. It would be inequitable to use civil penalties to deter corporate conduct that causes serious harm to others and at the same time use the criminal law to deter non-corporate crime that may result in less serious harm such as shoplifting. Both corporate fraud and shoplifting are harmful in the accumulative sense.

We would argue that, if the deterrence theory is of any value, it might well be more effective than in many non-corporate criminal contexts. In the corporate world, many decisions will be made in a context where careful weighing of options is possible, and the risk of criminal sanction may well have the desired deterrent effect. In most cases, the risk of a civil monetary penalty will be insufficient for the purpose of deterrence, simply because the risk of being caught and the consequences of that will be calculated economically. In other words, the improper conduct will be undertaken where it is economically valuable, regardless of its moral worth.

Indeed, it may be that some of the offences in the corporations law should be subject *only* to criminal sanction rather than only to civil penalty or to both. Mr Vizard’s behaviour might be in the former category. We would like to illustrate the point with a

¹⁵ Andrew von Hirsch, and Andrew Ashworth, A., *Proportionate Sentencing: Exploring the Principles*, (ed., O.U.P., Oxford, 2005) 17.

¹⁶ Andrew von Hirsch, and Andrew Ashworth, A., *Proportionate Sentencing: Exploring the Principles*, (ed., O.U.P., Oxford, 2005) 17.

¹⁷ Sally S. Simpson, *Corporate Crime, Law, and Social Control*, (edn., Cambridge University Press: Cambridge, 2002).

comparison of two cases of dishonesty; one involving a corporations offence (*ASIC v Vizard*), and one involving social security fraud (*R v Purdon*¹⁸ – what is regarded as a leading case on sentence in cases of social security fraud).

The criminal law in relation to social security fraud makes it clear that nothing less than a term of imprisonment is acceptable punishment except in very special circumstances. Mrs Purdon was convicted of defrauding the Commonwealth of roughly \$86,000, which she received over a period of about eight years. She had claimed the Supporting Parents Benefit to which she was not entitled. There were compelling subjective circumstances in her case: there was valuable evidence of her good character, and hers was not a case of greed, but of need – Mrs Purdon spent most of the money on necessities for her children. She was ordered to repay the money (which she was just able to do through forfeiture of her joint interest in the matrimonial home). She was not a wealthy woman. She was sentenced to nine months periodic detention. In imposing the sentence on appeal, Hunt CJ at CL said the following:

The rationale stated for the rule that a custodial sentence is to be imposed for social security fraud except in very special circumstances is that the offence is easy to commit but difficult to detect, it is widespread, and the introduction of more checks upon applicants for social security would cause delays in the payment of benefits and therefore hardship to those whose need is urgent. It has also been said that the rule reflects a concern for the protection of the revenue, but I would prefer to express it as a concern for the additional burden upon all taxpayers who shoulder the heavy burden of providing the funds for the social security system to operate and the even heavier burden created by the widespread abuse to it by frauds such as these. The rule is not based upon the fact that many of the frauds are perpetrated for motives of greed rather than need. Both types of fraud are widespread. They are equally difficult to detect. If the fraud is based upon a perceived need, a custodial sentence must be expected except in very special circumstances. If the fraud is based on greed, the custodial sentence will be longer.

What strikes us is that all of the same (or similar) arguments can be made in respect of Mr Vizard's behaviour in *ASIC v Vizard*. Insider trading is easy to commit but difficult to detect. It may be widespread – anecdotal evidence suggests so.¹⁹ Increased vigilance by the regulatory authority would surely be costly and detrimental in the same way (or similar ways) that increased vigilance in social security matters would. While insider trading does not affect the taxpayer, it can hardly be labelled as a “victimless” crime. The shares bought by Vizard could have been bought by a

¹⁸ *R v Purdon* (unreported, NSW Court of Criminal Appeal, 27 March 1997).

¹⁹ It is unclear how Justice Hunt comes to the conclusion that social security fraud is widespread. But the point, in any event, is that it *might* become so if penalties are insufficient for deterrence. Note evidence in Mark Freeman, and Michael Adams, “Australian Insiders Views” (1999) 10 *Australian Journal of Corporate Law* 148.

genuine investor. And, there is the potential for the integrity of the market to be affected, potentially affecting many individuals.²⁰

Mr Vizard, like Mrs Purdon, was dishonest. But, unlike Mrs Purdon, he was also in a position of trust. He seriously abused that trust and the privileges afforded him as a company director. It could be argued that his was not a crime of need, but of greed. It should be noted that the High Court has been quite specific in describing the duties owed by directors to a company are those of fiduciaries, and that powers conferred upon them by virtue of their special position of trust and confidence cannot be exercised in order to obtain some private advantage or for a purpose foreign to the power.²¹ Commentators have suggested that directors should not take up an opportunity for profit if it is within the scope of the business which the company carries on, or plans to engage in at some future time.²²

And yet nothing in the corporations' legislation mandates a custodial sentence²³ in relation to this behaviour. The reason is that the director's behaviour is covered both by a criminal sanction and by a civil penalty. His behaviour *could* be regarded as criminal under s184 (and subject to imprisonment): use of confidential information dishonestly or recklessly to gain an advantage for himself. Or his behaviour could have been, as it was, categorised as a mere civil breach: improper use of (confidential) information obtained by virtue of his position (see s183). The civil breach provision does not provide for punishment by imprisonment.

There was much criticism at the time for ASIC's preference to proceed under the civil penalty provisions rather than via criminal prosecution. The reason put forward was that there was insufficient evidence to mount a criminal prosecution due to a key witness's refusal to testify against Mr Vizard. It is not clear why a subpoena could not have been issued compelling the witness to testify, and why the prosecuting authorities could not have applied to cross-examine the witness under section 38 of the *Evidence Act 1995* (Cth).

Our point is that perhaps there should not have been a choice for ASIC. If *all* breaches of trust and offences of gross dishonesty are categorised as criminal (and carrying the stigma attaching to that label), the message is clear. The business community will be put on notice that dishonesty and breaches of trust are not tolerated. The decision to act dishonestly will no longer be simply a commercial risk. The law, by appropriate sanctions, provides a palpable standard of commercial morality. In the words of

²⁰ See generally Stuart P. Green, "Concept of White Collar Crime in Law and Legal Theory", [2004-2005] 8 *Buffalo Criminal Law Review* 1; Roland Hefendehl "Enron, WorldCom, and the Consequences: Business Criminal Law between Doctrinal Requirements and the Hopes of Crime Policy", [2004-2005] 8 *Buffalo Criminal Law Review* 51.

²¹ As per Dixon J in *Mills v Mills* (1938) 60 CLR 150 at 188.

²² R.P Austin 'Fiduciary Accountability for Business Opportunities' in PD Finn (ed), *Equity and Commercial Relationships*, Law Book Company, Sydney, 1987.

²³ Note that we do not believe that imprisonment should be *mandated* in relation to Mr Vizard or to Ms Purdon. The point is that the law does so in Mrs Purdon's case but not in Mr Vizard's. We believe that imprisonment should be the maximum penalty and that discretion should allow a judge, in the right circumstances, to impose any penalty below that, including an order that a conviction not be recorded.

Justice Finkelstein “a message must be sent to the business community that for white collar offences [such as in Mr Vizard’s case] “the game is not worth the candle””.²⁴ Appropriate labelling and censuring²⁵ requires a criminal response for this type of wrongful harm-doing.

However, a look at the criminal sanctions leads the UWS Corporate Law Academics to observe that there is a need to update the Schedule 3. Schedule 3 contains certain sections that may not be relevant anymore. In addition, it does not contain certain sections that may need to be included.

The sections in the schedule that may not be relevant anymore and as a consequence may need to be removed from the schedule are the following:

- Sections 237 and 242 deal with derivative action and as a result are no longer dealing with criminal offences.
- Section 242AA(3): This number of section no longer exist under the current legislation. It used to be in relation to lodgement of notices in relation to officers of the company with ASIC.
- Section 614: no longer exist. This section was repealed in 1990 yet it is still in the schedule.
- Section 892B: The schedule notes that a breach of s 892B (4) is an offence. However there is no such subsection in the Act.
- Sections 919B(4), 919C(1), 919C(2), 919C(3) and 919D: No longer exist in the Act but they are still present in the schedule.
- Section 1432: This is a transitional provision that deals with the continuity of the relevant old legislation. It could not have been intended to be criminal in nature.

²⁴ *ASIC v Vizard*, para 48.

²⁵ “[C]riminal Punishment involves imposing deprivation (“hard treatment”) on someone, in a manner that conveys censure. ... That punishment connotes blame or reprobation is evident enough. ... A central reasons for such a blaming response concerns penal censure’s communication to the act’s perpetrator. The punishment conveys to the actor a certain normative message concerning his conduct: for example, that he has culpably harmed or risked harming someone, and is disapproved of for having done so. This message treats him as a moral agent—that is, an agent capable of moral deliberation. He is being confronted with disapproval in virtue of the wrongfulness of his conduct, and not solely in order to produce preventive or other social benefits that such censure might achieve”. Andrew von Hirsch, and Andrew Ashworth, A., *Proportionate Sentencing: Exploring the Principles*, (ed., O.U.P., Oxford, 2005), Chapter 2.

The sections that are missing from the schedule are the following:

- Section 496: is a strict liability offence that deals with the duty of the liquidator when the company turns out to be insolvent.
- Section 637(2): is a strict liability offence that deals with the bidder's statement formalities. The schedule 3 only mentions s 637(1).
- Section 661B(1) & (2): is a strict liability offence in relation to compulsory acquisition notice.
- Section 723: Strict liability offence in relation to issue or transfer of securities under a disclosure document.
- Section 1300(3): is a strict liability offence. The schedule only mentions s 1300(2A)
- Section 1302: is an offence that deals with location of registers of companies.
- Section 1308(1): is an offence in relation to false or misleading statements.

Should strict liability offences be limited to situations where:

- *the offence is not punishable by imprisonment and is punishable by a fine of up to 60 penalty units for an individual (300 for a body corporate);*

Strict liability offences should not result in imprisonment.²⁶ A fine up to 60 penalty units is enough. Some of the strict liability offences under the *Corporations Act* have imprisonment included as a penalty. This may not be desired as imprisonment should be left to more serious offences (as noted below). However, the strict liabilities offences under the act do not have a fine that exceeds 60 penalty units. As a consequence, no changes need to occur in relation to the current fines imposed under the legislation.

- *the punishment of offences not involving fault is likely to significantly enhance the effectiveness of the enforcement regime in deterring offences; or*
- *there are legitimate grounds for penalising persons lacking 'fault', for example because they will be placed on notice to guard against the possibility of any contravention?*

The imposition of strict liability needs to be dealt with carefully because it leads to the convictions of people who do not deserve to be labelled and punished as criminals. Accordingly, a number of scholars believe that the use of strict liability is unjustified.²⁷ However there is a need to distinguish between two scenarios: strict liability in relation to stigmatic offences (i.e., conduct that carries a criminal conviction) should not be allowed; strict liability in relation to non-stigmatic (i.e., those that do not involve a conviction or imprisonment) offences may be acceptable. A look at most of sections in relation to strict liability offences under the *Corporations Act* lead the UWS Corporate Law Academics to the conclusion that these sections fall under the latter category.

Such strict liability offences may result in the increase of efficiency and the effectiveness of law enforcement agencies, especially in relation to the corporate defender. Strict liability offences may also have a deterrent effect because they may lead to greater precautions taken by the business community.²⁸ They can also be an efficient mechanism for allocating the costs of risk-creating activities.²⁹

²⁶ Generally, a person should only be held responsible for her own intentional harm-doing: See Dennis J. Baker, "The Moral Limits of Criminalising Remote Harms", [2007] 10(3) *New Criminal Law Review*.

²⁷ AP Simester, *Appraising strict liability* (2005, Oxford University Press) 21.

²⁸ Jeffrie G. Murphy, and Jules L. Coleman, *Philosophy of Law: An Introduction to Jurisprudence*, Revised ed., Westview Press, Boulder, 1990 at pp. 128 et seq.

²⁹ AP Simester, *Appraising strict liability* (2005, Oxford University Press) 25.

However, a number of the strict liability offences deal with non-compliance with formalities noted in the Act such as the lodgement of documents or the calling of company's meeting. Such breaches of the legislation may be dealt with through the imposition of administrative sanctions such as monetary administrative penalties proposed in *Regulatory Justice: Sanctioning in a Post Hampton World*.³⁰ In such a situation, the regulator can apply a fixed or variable monetary penalty as an alternative to criminal prosecution. The offender may be able to review the regulator's decision in the Administrative Appeals Tribunal or appeal it to the Federal Court. Such an option will have a deterrent effect through payment of a monetary administrative penalty and is less controversial than strict liability offences.³¹ After all, Nagel remarked that strict liability offence 'may have its legal uses, but seems irrational as a moral position.'³²

It is interesting to note that this *Consultation Paper* is not taking into consideration absolute liability offences.

Should imprisonment only be retained as a penalty for serious criminal offences with the maximum term being at least six months?

Yes, imprisonment should be retained as a penalty for serious criminal offences with the maximum term being at least six months. In most Western countries, imprisonment is the foundation of the system of punishment and of the harshest criminal sanctions and should target serious and not minor criminal offences. The offences for which imprisonment ought to be used should include some element of harm and culpability.³³ This might include conduct that involves dishonesty, gross recklessness and the giving of false or misleading information.³⁴

The main advantage of imprisonment as a sentencing option is that it communicates disapproval. Some commentators claim that imprisonment has at least one shortcoming, which will usually ensure that it is only used when necessary: prison costs too much. Every public dollar that is spent on housing prisoners is one less dollar the government can use in another field such as education or health.³⁵ An alternative argument is put forward by Richards:³⁶ 'Certainly, if there are good moral reasons for criminalising certain conduct, quite extraordinary enforcement costs will

³⁰ Richard Macrory, *Regulatory Justice: Sanctioning in a Post Hampton World* (May 2006).

³¹ Richard Macrory, *Regulatory Justice: Sanctioning in a Post Hampton World* (May 2006), 23.

³² Thomas Nagel, *Mortal Questions* (Cambridge, 1979), 31.

³³ Dennis J. Baker, "The Moral Limits of Criminalising Remote Harms", [2007] 10(3) *New Criminal Law Review*.

³⁴ Mirko Bagaric and Jean Du Plessis, "Expanding Criminal Sanctions for Corporate Crimes: Deprivation of Right to Work and Cancellation of Education Qualifications", (2003) 21 *Companies and Securities Law Journal* 7, 17.

³⁵ Mirko Bagaric and Jean Du Plessis, "Expanding Criminal Sanctions for Corporate Crimes: Deprivation of Right to Work and Cancellation of Education Qualifications", (2003) 21 *Companies and Securities Law Journal* 7, 17.

³⁶ Richards, D. A. J., 'Drug use and the Rights of the Person: A Moral Argument for Decriminalisation of Certain Forms of Drug Use,' [1980-1981] 33 *Rutgers Law Review* 607 at p. 614.

be borne'. In practice, high costs have had little bearing on criminalisation and punishment decisions. Notwithstanding the injustices and disproportional fiscal costs involved in implementing populist punitive policies, such as "three-strikes-and-you-are-out",³⁷ politicians and legislatures have clutched such policies with alacrity.³⁸

The main advantage of imprisonment as a sentencing option is that it almost certainly inflicts pain. It is also deterrence and has educative value. However, imprisonment has at least one shortcoming, which will usually ensure that it is only used when necessary: prison costs too much. Every public dollar that is spent on housing prisoners is one less dollar the government can use in another field such as education or health.³⁹

In 1998, the Senate Scrutiny of Bills Committee found that imprisonment still plays an important part in punishing offences related to the provision of information in revenue matters, or in punishing offences that deal with the legislative power to investigate breaches or make determination. But it has also stressed that imprisonment should be reserved for the most serious offences.⁴⁰ We support this approach. The criminal law should be used as a last resort for the most reprehensible forms of wrongful harm-doing.⁴¹ The criminal law should be kept to a minimal, but essential, role and this is best achieved by assessing the wrongdoer's culpability, and the harmfulness and wrongfulness of the conduct involved, rather than relying of criminal "labeling biases"⁴² that favor certain social classes.

Sanctions must also meet the requirements of proportionality, if they are to accord with notions of justice and fairness.⁴³ In the decision of *R v Williams*⁴⁴, the Supreme Court of New South Wales found that Raymond Williams had breach his duties as a director of HIH Insurance Ltd and was involved in a series of misleading statements. The sentence of the court was imprisonment for four years and six months. Accordingly, imprisonment can be seen as the ultimate sanction. For this reason, there are intermediary sanctions to ensure that crime can be deterred.

³⁷ Greenwood, P. W., *et al.*, *Three Strikes and You're Out: Estimated Benefits and Costs of California's New Mandatory-Sentencing Law*, ed., Rand, California, 1994.

³⁸ Bottoms, A. E., 'The Philosophy and Politics of Punishment and Sentencing,' in Clarkson, C. M. V. and Morgan, R., *The Politics of Sentencing Reform*, ed., Clarendon Press, Oxford, 1995 at pp. 39-40.

³⁹ *Ibid.*

⁴⁰ Senate Scrutiny of Bills Committee, Parliament of Australia, *Scrutiny of Bills Eighth Report of 1998: The Appropriate Basis for Penalty Provisions in Legislation Comparable to the Productivity Commission Bill 1996* (1998) [2.17], [4.9].

⁴¹ Husak, N. Douglas, "The Criminal Law as Last Resort" (2004) 24 *Oxford Journal of Legal Studies* 207.

⁴² Jeffrey H. Reiman, *The Rich Get Richer and the Poor Get Prison* (4th ed., Allyn and Bacon, Boston, 1995).

⁴³ Andrew von Hirsch, and Andrew Ashworth, A., *Proportionate Sentencing: Exploring the Principles*, (ed., O.U.P., Oxford, 2005), Chapter 2.

⁴⁴ *R v Williams* (2005) 23 ACLC 601; [2005] NSWSC 315.

It is our view that the criminal penalties in relation to certain sections in the *Corporations Act* need to be amended. For example, s 144(1) notes that a company must display its name prominently at every place at which it carries on a business. A breach of this section may lead to three month imprisonment. This is disproportional when measured against the harm-doing and culpability involved. This is excessive. Imprisonment should be reserved for more serious offences. A pecuniary penalty is sufficient under the circumstances for a contravention of s 144.

With the introduction of the Commonwealth *Criminal Code Act* 1995, a number of commonwealth crimes had to be redrafted by 2001. As a consequence, the introduction of the *Financial Services Law Reform Act* 2001 (Cth) and the redrafting of the Commonwealth crimes resulted in an overall increase of 289% in offences in Chapter 7 of the *Corporations Act* 2001 (Cth).⁴⁵

Civil sanctions

Should greater use be made of civil sanctions for breaches of corporate law?

If so, should civil sanctions apply?

- *Where misconduct affects or potentially affects the integrity of the market, but there is an absence of intention in the conduct that makes the offence less egregious than an offence attracting a criminal sanction?*
- *Where strict liability applies to all elements of an offence?*

Civil penalties have a defined function. They play an important role in ensuring compliance with the certain provisions of the *Corporations Act* and they can be considered today as a key part of the legislation. The civil penalty provisions in the *Corporations Act* include the basic duties of directors and other company officers such as the duty to act honestly in good faith and for proper purpose. They also include contraventions in relation to company accounts, certain capital transactions and the management of managed investment schemes. *The Financial Service Reform Act 2001 (Cth)* extended the application of the civil penalty provisions to cover the market misconduct provisions. These include provisions proscribing continuous disclosure, market manipulation, insider trading, false trading, market rigging and dissemination of information about illegal transactions.⁴⁶ The UWS Corporate Law Academics support the increase of the civil penalties under the *Corporations Act* as long as the civil penalties do not replace but co-exist with the criminal penalties. In the case of serious conduct, criminal sanctions only should be available (not both criminal and civil). Accordingly, the civil penalties should not deal with conduct that involves gross dishonesty, recklessness or any other type of intentional harm-doing that is ought to be subject to criminal action. Additionally, the civil penalties

⁴⁵ Michael Adams, "Does Increasing Criminality Make for Better Reform of the Financial Services Industry" (2002) 14 *Australian Journal of Corporate Law* 202.

⁴⁶ George Gilligan, Helen Bird and Ian Ramsay, *Regulating Director's Duties: How Effective are the Civil Penalty Sanctions in the Australian Corporations Law?* (Centre for Corporate Law and Securities Regulation, 1999) 7-8.

provision should, where possible, deal with the provisions in the Act that deal with strict liability offences.

Should there be an increase, or a reduction, in the amount of civil pecuniary penalties? If maximum pecuniary penalties are thought to be inadequate, would alternative options like those proposed for the Trade Practices Act 1974 be appropriate in corporate law?

Yes, there is a need to increase the civil pecuniary penalty as the amount of \$200 000 has been in place for over a decade. Introducing a system similar to the recent amendments to the *Trade Practices Act 1974* (Cth) is desired. Such an introduction allows the imposition of a pecuniary penalty of the greater of the maximum penalty or three times the gain from the contravention or, where gain cannot be readily ascertained ten per cent of the turnover of the body corporate and all of its interconnected bodies corporate. This gives flexibility to the judge and will have a strong deterrent effect. It is in a language which businessmen understand and has proved to be a very effective deterrent in implementation of competition laws within the European Union.

It is important for the exercise of the Court's accrued jurisdiction pursuant to the *Trade Practices Act 1974* (Cth) to be consistent with that of the imposition of sanctions by the Courts, both State and Federal, under the *Corporations Act*.

It is worth noting that in 2002, the professional body, Chartered Secretaries Australia, proposed a Corporations Panel⁴⁷ to resolve many of the smaller disputes that arise in corporate law. The Corporations Panel would work on a similar basis and jurisdiction as the current Takeover Panel.

Should the rules of procedure to be adopted by the courts in civil proceedings under the Corporations Act be more clearly defined in the Act?

Again, there should be consistency with analogous administrative law proceedings in other areas of Federal jurisdiction. The drafting of the civil penalty provisions in relation to the procedure that need to be followed is unclear. The meaning of the words "civil evidence and procedures rule" in s 1317L of the *Corporations Act* is opaque.⁴⁸ This section states that the court must apply the rules of evidence and procedure for civil matters in proceedings for a declaration of a contravention or a pecuniary penalty order.

⁴⁷ For more details on the discussion of the Corporations Panel, see <http://www.csaust.com/Content/NavigationMenu/NewsAdvocacy/Submissions/Corps_Panel_Final.pdf> viewed on 29 May 2007.

⁴⁸ Tom Middleton, "The Difficulties of Applying Civil Evidence and Procedure Rules in ASIC's Civil Penalty Proceedings under the Corporations Act" (2003) 21 *Companies and Securities Law Journal* 507, 508.

A wide variety of civil evidence and procedure rules may apply in civil proceedings under the *Corporations Act* and the *ASIC Act*. As a consequence, a lack of clarity can appear which encourages procedural challenges. In recent civil penalty proceedings under the *Corporations Act* the courts have adopted some procedural rules that are more applicable to criminal proceedings.⁴⁹ Such an approach ignores the requirement in s 1317L and blurs the distinction between civil and criminal proceedings.⁵⁰

If rules were to be included in the Act, should they be the same as the rules followed in civil remedial actions or should they be some type of hybrid between criminal and civil procedure?

The procedural rules may be the same as the one followed in civil remedial action. There should be uniformity for all civil actions to lessen confusion and encourage ASIC to use the civil penalties.

Are there any particular privileges available under the criminal law that should be abrogated in civil actions?

The UWS Corporate Law Academics assert that the different procedural protections for civil and criminal procedures as laid down in Article 6 *European Convention for the Protection of Human Rights and Fundamental Freedoms*, 4 November 1950, 213 U.N.T.S. 222, (entered into force generally on 3 September 1953), could be tolerable.

Administrative sanctions

Do you agree that there is scope in corporate law for administrative sanctions to apply to breaches of low level record keeping and reporting provisions? Are there any types of misconduct within these low level offences that administrative sanctions should not apply to?

Administrative penalties in Australian law are largely understood as sanctions inflicted by the regulator without the intervention of a court or tribunal. However, appeals provisions are usually available either on the merits or the law to the appropriate State or Federal bodies. The UWS Corporate Academic Group agrees that there is a scope in corporate law for administrative sanction to apply to breaches of low level record keeping and reporting provisions. We believe that monetary administrative penalties with possibility of appeal and enforceable undertakings can deal with these low level offences efficiently. Such administrative penalties may save

⁴⁹ *Rich v Australian Securities and Investments Commission* (2003) 203 ALR 671

⁵⁰ Tom Middleton, "The Difficulties of Applying Civil Evidence and Procedure Rules in ASIC's Civil Penalty Proceedings under the Corporations Act" (2003) 21 *Companies and Securities Law Journal* 507, 507- 508.

ASIC legal costs and they can be extended to other minor breaches of the law. For example, ASIC announced on 16 April 2007 that it successfully prosecuted 144 company officers in a period of three months mostly in relation to officers hampering the investigation of the liquidator and lack of notification of ASIC in relation to change of address of the company. The fines ranged from \$0 to \$4200.⁵¹ Such minor breaches may also be subject to administrative sanctions and this will save ASIC the cost of litigations.

Consideration Issue 3 (Chapter 3)

Application of a general defence

Do you consider that the introduction of a general defence would improve the balance between discouraging undesirable conduct and promoting responsible risk taking?

Do you consider that the proposed elements of the general defence are correct?

- *Are there any particular concepts in the general defence that may require further consideration or elaboration?*

Having a general defence to protect directors' from breaching their duty is desirable. However, there is a need to ensure that the general defence is readily useable and it improves the balance between discouraging undesirable conduct and promoting responsible risk taking. However, the general defence that is proposed by the Consultation paper is not readily useable and as a result the UWS Corporate Law Academics do not support it. The problem with the general defence emanates from its proposed elements:

- in a bona fide manner;
- within the scope of the corporation's business;
- reasonably and incidentally to the corporation's business; and
- for the corporation's benefit.

These limbs are not really coherent. What is meant by 'reasonable and incidentally to the corporation's business'? How is that different from 'within the scope of the corporation's business'? The limb 'reasonably and incidentally to the corporation's business' is absurd and may cover a range of situations and as a result is open to abuse. Additionally, if a person has a material interest that he did not disclose to the board, can he use this defence? Under the current preconditions the answer would be yes. Such a situation is unacceptable.

⁵¹ ASIC, "ASIC Prosecutes 144 Company Officers in Response to Public Complaints", Media release, 16 April 2007, www.asic.gov.au viewed on 16 April 2007.

The UWS Corporate Law Academics believe that there is no need to create a new defence. The only thing that is needed is improving the business judgement rule and expanding it to apply to all breaches of directors duties’.

In the United States of America’s corporate law, the business judgement rule is the offspring of the fundamental principle, codified in many statutes, that the business affairs of a company are managed by or under its board of directors.⁵² The US version is based on the common law precedent of *Smith v Van Gorkom*.⁵³ This rule that is used as a defence for all breaches of directors’ duties has been incorporated in the *Corporations Act* under s 180(2). But we note that the scope of the business judgment rule in our country is much limited than the rule in United States. It only applies in the duty of care and due diligence context.⁵⁴ The business judgement rule should be extended to apply to all breaches of directors duties including in cases of insolvent trading. Redmond has observed that there is a lack of litigation with respect of solvent companies.⁵⁵ This reality by itself makes us doubt the usefulness of any defence that does not apply in cases of insolvency of the company.⁵⁶ Additionally, there is a need to reconsider the pre-conditions of the business judgement rule. Due to the current condition of these pre-conditions, the business judgement rule is rarely used successfully as a defence.

Should the general defence apply to the ‘core’ duties in sections 180-183 and section 588G?

Yes, the defence should be in relation to all directors’ duties.

- *Are there any adverse consequences that may result from a general protection applying to the duties of use of position (section 182) and use of information (section 183)?*

No, there are no adverse consequences as long as the defence has a material interest test that can be lifted in case the director disclosed his/her interest in the transaction to the board of directors.

⁵² Julie Cassidy, “Standards of Conduct and Standards of Review: Divergence of the duty of care in the United States and Australia”, *Australian Business Law Review*, June 2000, Volume 28, p. 195.

⁵³ *Smith v Van Gorkom* 488 A.2d 858

⁵⁴ Julie Cassidy, “Standards of Conduct and Standards of Review: Divergence of the duty of care in the United States and Australia”, *Australian Business Law Review*, June 2000, Volume 28, p. 195.

⁵⁵ Redmond, ‘Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule’ in I Ramsay (Ed), *Corporate Governance and the Duties of Company Directors*, The Centre for Corporate Law and Securities Regulation, Melbourne, 1997, p 188.

⁵⁶ Helen Horsington, *Directors’ Duties During Insolvency*, (Lawbook Co, A Thomson Company, 2001), p. 197.

- *Would an extension of the general defence to the insolvent trading provisions encourage insolvent trading? Would an extension be to the detriment of creditors?*

No, there is no such risk if one adopts an improved business judgement rule.

- *If the general defence is applied to the duty to exercise care and diligence (section 180) is there a need to clarify its interaction with the business judgement rule in subsection 180(2)?*

The UWS Corporate Law Academics is proposing to extend the use of the business judgement rule to all breaches making it the general defence available to directors and officers. There is no need to add more defences when we can use defences that already exist and improve their efficiency and application.

- *If the general defence is applied to the insolvent trading provisions, is there a need to clarify its interaction with the existing defences?*

Yes.

Should the general defence apply to those strict liability offences that are intended to protect shareholders interests?

It is agreed that general defences should be available to non-criminal regulatory contraventions that consist of a physical element only. Currently, the Commonwealth *Criminal Code* applies such defences to strict liability offences — offences where there are no fault elements — and may be extended beyond the *Criminal Code* to analogous non-criminal contraventions. The further balance might be achieved by imposing a negligence standard, in certain narrowly defined circumstances, in place of strict liability.

The defence of mistake of fact currently available in response to offences of strict liability could be extended to non-criminal regulatory contraventions. However, it should be borne in mind that if such a non-criminal contravention took the civil form of an absolute liability offence, then no such defence should be made available.

Further, in formulating appropriate defences to non-criminal regulatory contraventions, it is worth considering some other general defences currently contained within the *Criminal Code*, such as ‘intervening conduct or event’.⁵⁷

The business judgment rule in subsection 180(2) also applies to equivalent duties at common law and in equity. Should a general defence also apply as a defence to actions brought in relation to equivalent duties at common law or equity?

Yes, a business judgement rule as a general defence may be applied to duties under common law, equity and statute.

Inconsistent approach between ss 180 and 181

Should the lack of symmetry between sections 180 and 181 on what constitutes acting ‘in the best interests of the corporation’ be addressed by introducing the concept of ‘rational belief’ to section 181?

No, there is no such need. One test is in relation to the duty of good faith and proper purpose under s 181 and the other test is in relation to a the business judgement rule defence. This justifies the difference between both requirements.

Reliance s 189

Does the requirement to make an independent assessment of information or advice received, place too high a burden on directors?

No, it ensures that the directors do not blindly rely on the advice of another person.

Is the original formulation of subparagraph 189(b)(ii) preferable to the current formulation?

No, the current formulation is more than acceptable.

The obligation to keep financial records

Does the penalty for breach of section 286 provide an adequate deterrent?

There are a number of penalties available for breach of s 286 and they provide adequate deterrent.

⁵⁷ See generally, Part 2.3 Div 10 *Criminal Code Act 1995* (Cth).

Are there alternatives to pecuniary penalties that could apply to a contravention of section 286?

Yes, there are alternative pecuniary penalties that could apply in case of minor contraventions of s 286. Monetary administrative penalties with possibility of appeal may be the answer for low level breaches (see above).

Drafting of offence provisions

Would specifying the maximum penalty within a provision in the Corporations Act improve understanding and clarity of offence provisions?

Are there any provisions in corporate law where confusion is arising in the application of the provision because of inconsistency with requirements under the Criminal Code?

Are there any provisions in corporate law where confusion is arising because of 'reasonable excuse' defences, or other defences that replicate defences under the Criminal Code?

With regard to the *Corporations Act 2001* (Cth), the *Commonwealth Criminal Code*, by virtue of its labelling requirements, has undoubtedly distinguished criminal offences from civil penalty provisions. However, certain related distinctions have not been made and unnecessary confusion has been the end result. Whilst the *Criminal Code* cannot be held accountable for this confusion, these grey areas are worthy of mention as they detract from the overall effectiveness and clarity of both the *Criminal Code* and the civil penalty regime.

For example, within Part 9.4B there now exists two classes of civil penalty provisions — 'corporation/scheme' civil penalty provisions and the new 'financial services' civil penalty provisions. The benefit of such duplication is hard to see. Moreover, neither of these varieties are defined within Part 9.4B, other than by reference either to each other or to the sections to which they apply.

A second example is that of the penalty unit. It is difficult to comprehend why the only direction within the *Corporations Act 2001* as to the pecuniary value of a penalty unit is found in s 1375;⁵⁸ and it is, at best, an obtuse cross-reference. There is no longer a definition of 'penalty unit' with the dictionary found in s 9, nor is there a definition of the same in the *Criminal Code*.

⁵⁸ Section 1375 deals with the offences committed before 2001 which had a financial penalty of \$100 per unit rather than the current \$110 per unit. A penalty unit is actually defined in s 4AA *Crimes Act 1914* (Cth)

However, in the last sentence of a note to clause 11.4 – entitled ‘Incitement’ – of the *Criminal Code*, the panacea is found: Penalty units are defined in section 4AA of that Act. ‘That Act’ being the *Crimes Act 1914* (Cth).

Hence, whilst the *Criminal Code* is clear about what is a criminal offence, there is considerable uncertainty in key areas in relation to civil penalties.

Market Manipulation

Should section 1041B be amended to clarify the circumstances in which someone will be criminally liable, as a result of the combined effects of section 5.6 of the Criminal Code and the deeming provision in subsection 1041B(2) of the Corporations Act?

If so, would it be appropriate to amend the section so a person is criminally liable:

- *if that person intended or was aware or was reckless that matched trades or a trade without change of beneficial ownership would occur; or*
- *if that person intended or was aware or reckless that a false or misleading appearance would occur?*

The number of prosecutions in relation to market manipulation is very low because such cases are hard to prove. Adding an element of intent will make the prosecution of breaches to the market manipulation provisions even harder to be achieved. Marshalling of persuasive expert evidence is always an expensive and complex adjunct to litigation.

Should there be a change to the circumstances in which criminal liability is incurred as a result of the application of subsection 1041B(2), so that a person is criminally liable without needing to prove any knowledge, intent or recklessness, but has a defence if it is proved that the purpose or purposes for which the person did the act was not, or did not include, the purpose of creating a false or misleading appearance of active trading in particular financial products on a financial market?

Yes, such a defence is reasonable to protect innocent parties, and is consistent with the Trade Practices Act civil code of conduct.

Should there be a change to the circumstances in which civil liability is incurred as a result of the application of subsection 1041B(2)?

If so, would it be appropriate that civil liability is incurred:

- *if a person intended or was aware or reckless that matched trades or a trade without change of beneficial ownership would occur; or*
- *if a person intended or was aware or reckless that a false or misleading appearance would occur; or*
- *without needing to prove any mental element, as at present, but allowing a defence if it is proved that the purpose or purposes for which the person did the act was not, or did not include, the purpose of creating a false or misleading appearance of active trading in particular financial products on a financial market; or*
- *as now, but giving the Court the discretion not to make a declaration of contravention where a person has contravened section 1041B?*

No there should not be a change in relation to the circumstances in which civil liability is incurred as a result of the application of s 1041B(2).

Conclusion:

The consultation paper provided by Treasury, is an important discussion point on the variety and intensity of legal sanctions that can be employed to enforce and comply with the corporations legalisation. It is worth noting that the Australian Law Reform Commission⁵⁹ in 2002 completed a very detailed report on Federal civil and administrative penalties, which would have a direct bearing on corporate law sanctions. As with all amendments to the law, it is important to balance the enforcement aspects with appropriate defences. The development of a consistent business judgment rule across all contraventions of officers' duties would be a positive step forward for the Australian business community. Aligning the corporate criminal provisions with policy and criminal theory, would be of great benefit to the social cost of business.

UWS Corporate Law Academics,

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31 May 2007

⁵⁹ Australian Law Reform Commission (ALRC), *Principled Regulation: Federal Civil and Administrative Penalties in Australia*, Report No 95 (2002).