Australian Banking Association

07 February 2020

The Hon Justice SC Derrington
President
Australian Law Reform Commission
By email: corporatecrime@alrc.gov.au

Dear President

Submission – Corporate Criminal Responsibility Discussion Paper (DP 87) November 2019

Thank you for the opportunity to provide submissions on the proposals outlined in this discussion paper (the paper).

Summary

The ABA supports a principled approach to policy making on Commonwealth criminal responsibility. Such an approach stands to enhance confidence in the regulatory framework by providing consistent, predictable treatment of conduct across the regulatory landscape.

As well as prescribing such a principled approach to Australian policy making, the paper makes some valid and insightful observations regarding the current state of law and policy in relation to corporate criminal responsibility in Australia. In particular, we endorse the paper's finding that Australian policy makers have not applied a coherent, principled approach to appropriately discriminate between contraventions of the law that warrant criminal status and those that do not.

While we agree with the broad conclusions and principles outlined above, in our view, some of the key proposals in the paper require further consideration. In particular, the proposals should be carefully considered in light of various reforms that have been implemented or are in the process of being implemented. These include recommendations of the ASIC Enforcement Review; the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry; the Banking Executive Accountability Regime (BEAR); and, more recently, the Financial Accountability Regime (FAR).

While the ALRC is obviously aware of these processes, in our view their impact has not been fully considered in the context of proposing the reforms outlined in the paper. For example, Proposal 5, in our view, runs contra to the principled approach to discriminating between civil and criminal sanctions set out in proposals 1 to 4. Moreover, a justification offered in the paper for this proposal – the need to deter corporations from treating consequences of contravening civil penalty provisions as a 'cost of business', was a matter taken into account by the ASIC Enforcement Review in recommending enormous increases to maximum civil penalty amounts.

Similarly, proposals 9 and 10 are based on different foundations than important reforms that have been implemented in the financial sector through the BEAR and (and will be implemented through the FAR). The effect of these regimes should be assessed over a reasonable period before any new regime was introduced.

The paper's call for Commonwealth criminal law to be recast so that it reflects a principled approach is sensible. However, care should be taken to emphasise the holistic approach recommended in the paper and in any final report. That is, a response that 'cherry picked' aspects of the recommendations would undermine the balanced approach proposed by the ALRC:

> "The ALRC's view is that a principled approach can reveal a distinct purpose for corporate criminal responsibility: one that reserves it for instances of corporate misconduct that cannot adequately be regulated by civil penalties. If a principled approach is implemented, as set out in Chapter 4, this approach would have the effect of reducing the exposure of corporations to criminal penalties compared with the current position whilst simultaneously improving the efficacy of criminal enforcement where it is indeed appropriate and necessary."

The final report should emphasise that recommendations around reform of the criminal provisions are made in this holistic sense, and that adoption of the reforms without the corresponding reduction in exposure of corporations to criminal liability would not be appropriate.

We elaborate on these and other issues in more detail below.

Key points

- The proposal for a principled approach by policy makers to the setting of corporate criminal and civil liability is appropriate and necessary.
- Proposal 5 – the criminalisation of flagrant or repeated contraventions of civil penalty provisions sits uneasily and as a curious anomaly that runs contra to the principled approach set out in proposals 1 to 4.
- The method for attribution of corporate responsibility for individual conduct set out in proposal 8 is flawed because:

  (a) it effectively abandons the requirement for any real nexus between the act of an individual and the culpability of the corporation. At a minimum, attribution should occur only where there is conduct engaged in within the actual or apparent scope of the Associate's employment (not simply 'action on behalf of the corporation'); and

  (b) placing the onus on the corporation to prove due diligence is too onerous. This should be an element of the attribution method that must be proved by the prosecution.
- Proposals 9 and 10 represent a considerable expansion in exposure of individuals to risk of civil and criminal responsibility for corporate contraventions. Unlike the BEAR and FAR, they would attribute liability indiscriminately based only on a person being 'in a position to influence the conduct of the body corporate'. Such a broad expansion of exposure to liability stands to deter individuals from taking on roles such as non-executive directorships and other important positions, and to drive up costs such as directors and officers' insurance.
  - Moreover, a regime such as that set out in proposals 9 and 10, should not be introduced for industries subject to the BEAR and FAR. ADIs and now the financial sector more broadly are subject to considerable expense and disruption in adjusting to the BEAR and now FAR. Adding to this, a regime that attributes responsibility under a different and indiscriminate paradigm would undermine the careful process of allocation of individual responsibility that is required under the accountability regimes, and further disrupt business models developed to comply with them.
- Proposal 15(e), to allow courts to order dissolution of a company on sentencing for an offence is not warranted as it adds little to existing grounds for dissolution of a company and risks unintended or undesirable consequences.
- The ASIC Enforcement Review conducted an extensive review of civil and criminal penalties, resulting in very substantial increases in both categories. These reforms have just been implemented and their effect should be assessed before any further reviews are considered.
- For the reasons outlined by the ASIC Enforcement Review, maximum penalty amounts provide valuable guidance to courts in the sentencing process and should be retained.

Australian Banking Association

Appropriate and Effective Regulation of Corporations

Proposal 1 *Commonwealth legislation should be amended to recalibrate the regulation of corporations so that unlawful conduct is divided into three categories (in descending order of seriousness):*

a) criminal offences;

b) civil penalty proceeding provisions; and

c) civil penalty notice provisions.

Proposal 2 *A contravention of a Commonwealth law by a corporation should only be designated as a criminal offence when:*

a) the contravention by the corporation is deserving of denunciation and condemnation by the community;

b) the imposition of the stigma that attaches to criminal offending is appropriate;

c) the deterrent characteristics of a civil penalty are insufficient; and

d) there is a public interest in pursuing the corporation itself for criminal sanctions.

Proposal 3 *A contravention of a Commonwealth law by a corporation that does not meet the requirements for designation as a criminal offence should be designated either:*

a) as a civil penalty proceeding provision when the contravention involves actual misconduct by the corporation (whether by commission or omission) that must be established in court proceedings; or

b) as a civil penalty notice provision when the contravention is prima facie evident without court proceedings.

Proposal 4 *When Commonwealth legislation includes a civil penalty notice provision:*

a) the legislation should specify the penalty for contravention payable upon the issuing of a civil penalty notice;

b) there should be a mechanism for a contravenor to make representations to the regulator for withdrawal of the civil penalty notice; and

c) there should be a mechanism for a contravenor to challenge the issuing of the civil penalty notice in court if the civil penalty notice is not withdrawn, with costs to follow the event.

As the paper notes, the AGD Guide to Framing Offences recognises that care should be taken in deciding whether to attach a criminal offence to a particular contravention. However, Commonwealth policy makers increasingly seem to adopt an expansive approach with little regard to the principles and considerations set out in the Guide.

A recent example can be found in the implementation of the Product Intervention and Design and Distribution Obligation regime in 2019. The Explanatory Memorandum to the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 explains the approach:

> "A contravention of every obligation in the new regime is both a civil penalty provision and an offence. This allows the regulator or prosecutor (as the case may be) to take a proportional approach to the enforcement of the new regime." (para 1.134)

In other words, policy makers are not assessing whether particular contraventions warrant criminal status and instead leaving the decision to pursue a contravenor for a civil penalty or criminal offence to the relevant enforcement agency.

It is this kind of policy thinking that has led to the position, set out by the ALRC in its media release of November 2019, where:

> "There is an overregulation by the criminal law of low-level contraventions and a failure to effectively use the criminal law for serious contraventions.

> As a result, there is no principled regulation in any meaningful sense — diluting the efficacy of corporate criminal responsibility and undermining the rule of law.
>
> If to be labelled a criminal is to have any sting, the criminal law must be exclusively focused on serious morally reprehensible conduct, and yet:
>
> > It is a criminal offence for a corporation to fail to notify ASIC of a change in office hours."

We can point to another example in the regime we referred to above, in that a person who fails to make a target market determination available to the public free of charge, commits a criminal offence under the Design and Distribution Obligation regime (see section 994B(9) *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019*).

For the reasons set out above we broadly endorse proposals 1 to 4. We note, however, that some further thought could be given to the wording of these proposals – especially proposal 2. It is not clear, for example, what paragraph (b) in proposal 2 adds to paragraph (a). Arguably, they say the same thing.

Further, paragraph (d) of proposal 2 sits oddly in this context. Public interest considerations appear as factors that prosecuting authorities must take into account under the *Prosecution Policy of the Commonwealth*[1]. The application of such a criterion in relation to decisions about the prosecutions in individual cases can readily be made sense of. However, its application in a decision about whether to designate a particular contravention as criminal is less obvious. Again, it is unclear what paragraph (d) adds to paragraphs (a) and (b). Presumably, if a contravention by a corporation is deserving of denunciation and condemnation by the community (paragraph (a)), then it seems likely that it will be in the public interest for it to be designated a criminal offence (there being no question of taking account of circumstances of individual cases at this stage of the process).

The proposals could, we submit, be improved if these matters were addressed.

> **Proposal 5** *Commonwealth legislation containing civil penalty provisions for corporations should be amended to provide that when a corporation has:*
>
> > *a) been found previously to have contravened a civil penalty proceeding provision or a civil penalty notice provision, and is found to have contravened the provision again; or*
> >
> > *b) contravened a civil penalty proceeding provision or a civil penalty notice provision in such a way as to demonstrate a flouting of or flagrant disregard for the prohibition;*
>
> *the contravention constitutes a criminal offence*.

We do not support proposal 5. This proposal sits uneasily and as a curious anomaly that runs contra to the principled approach used to justify proposals 1 to 4. In particular, the justification for criminalising repeated conduct (at page 101-102) is misconceived. It discusses elevation of penalties for repeated transgressions of section 74 of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*. Elevating from one criminal penalty to a higher one for what are already *criminal* offences is conceptually fundamentally different from changing the character of an offence from civil to criminal. The latter should be underpinned by some factor that changes the character of the conduct from civil to criminal.

An example of an appropriate schema for the elevation of contravening conduct from civil to criminal can be found in sections 180 to 184 of the Corporations Act. Sections 180 to 183 proscribe certain conduct or omissions by directors and officers of corporations. Section 184 criminalises such conduct, but only where there is recklessness, dishonesty, and the failure to exercise power in good faith or for a proper purpose. In other words, where traditional factors of criminal culpability are present. Any elevation of conduct to criminal status should be based on the presence of some characteristic of the impugned conduct that is traditionally criminal in nature.

[1] Commonwealth Director Of Public Prosecutions, Prosecution Policy of the Commonwealth: Guidelines for the making of decisions in the prosecution process, August 2019.

Mere repetition of offending conduct, or even 'flagrancy', without more, should not be enough to convert conduct that is not otherwise criminal to the status of conduct that is. Repeated contraventions of certain general conduct obligations (for example, s912A(1)(a) Corporations Act) may occur as a result of distinct, unrelated events and would not appear to warrant automatic escalation to a criminal sanction.

Concerns about the consequences of breaching civil penalty provisions being treated as 'the cost of doing business' have been addressed by the massive elevation in maximum civil penalties that has occurred following the ASIC Enforcement Review. The fact that considerations of this sort will be taken into account in setting civil penalties is also reinforced in proposal 14. Paragraph 14(f) notes that repeated transgressions are a factor that the court must take account of in this context, and other paragraphs – including 14(a),(h),(i),&(j) – would be relevant to 'flagrancy'.

> **Proposal 6** *The Attorney-General's Department (Cth) Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers should be amended to reflect the principles embodied in Proposals 1 to 5 and to remove Ch 2.2.6*.
>
> **Proposal 7** *The Attorney-General's Department (Cth) should develop administrative mechanisms that require substantial justification for criminal offence provisions that are not consistent with the Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers as amended in accordance with Proposal 6*.

We endorse proposals 6 & 7, with the caveat that reference to proposal 5 should be removed from Proposal 6.

Reforming Corporate Criminal Responsibility

Proposal 8 *There should be a single method for attributing criminal (and civil) liability to a corporation for the contravention of Commonwealth laws, pursuant to which:*

> *a) the conduct and state of mind of persons (individual or corporate) acting on behalf of the corporation is attributable to the corporation; and*
>
> *b) a due diligence defence is available to the corporation*.

The paper's proposal that there be a 'single method for attributing criminal (and civil) liability to a corporation' is sensible. However, we do not support the proposed single method outlined in the paper. This method is objectionable on two grounds:

> (a) it effectively abandons the requirement for any real nexus between the act of an individual and the culpability of the corporation; and
>
> (b) placing the onus on the corporation to prove due diligence is too onerous.

At a minimum, attribution should occur only where there is conduct engaged in within the actual or apparent scope of the Associate's employment (not simply 'action on behalf of the corporation').

The absence of due diligence should, rather than a defence, be incorporated as an element of the contravention to be made out by the prosecuting entity.

Individual Liability for Corporate Conduct

Banking Executive Accountability Regime (BEAR) and Financial Accountability Regime (FAR)

As the ALRC has noted, the BEAR requires Authorised Deposit-taking institutions (ADIs) to formally identify 'accountable persons' and their respective responsibilities and provide this information to APRA. This 'accountability map' is then used as the basis for attributing individual responsibility for contraventions by the corporation. Although the discussion paper makes only brief mention of the BEAR – noting it had considered it as a model of attributing corporate fault to individuals, but not pursuing the option due to the 'untested' nature of the BEAR – the ALRC has since issued a release (on 19 December 2019) noting that APRA is considering the relevance of the BEAR in a matter within its purview, and calling for interested parties to revisit the question of whether the BEAR could be used

as a model for attribution of individual liability in the context of corporations generally (not only those regulated by APRA).

To this should be added that the Government released, on 22 January 2020, a Proposal Paper on extending the application of the BEAR and at the same time subsuming it into a new Financial Accountability Regime (FAR). The FAR will, initially, extend the BEAR principles to:

- Registrable Superannuation Entity (RSE) licensees;
- All APRA regulated insurers; and
- All APRA regulated financial services institutions.

We note that the ALRC release of 19 December asks the question:

- Could the BEAR provide an alternative model for individual liability? (i.e. including for non-financial corporations)

We would add a second question:

- Is it appropriate to subject the financial sector, which is in the midst of adjusting to (or implementing) the BEAR and the FAR, to a radically new (and contradictory) model of attribution of individual liability?

To the ALRC's question, our answer is that the BEAR and FAR models aspire to appropriately attribute responsibility to individuals where a clear nexus can be shown with the impugned conduct – i.e. where the individual had actual responsibility for the part of the business in which the relevant conduct arose. This is a characteristic which is lacking in Proposal 9 of the paper.

To our own question, we suggest that it would be inappropriate to overlay the regime in Proposals 9 (and 10) onto the BEAR and FAR. ADIs and now the financial sector more broadly are subject to considerable expense and disruption in adjusting to the BEAR and now FAR. Adding to this a regime that attributes responsibility under a different and indiscriminate paradigm would undermine the careful process of allocation of individual responsibility that is required under the accountability regimes, and further disrupt business models developed to comply with them.

Proposal 9

> **Proposal 9** *The Corporations Act 2001 (Cth) should be amended to provide that, when a body corporate commits a relevant offence, or engages in conduct the subject of a relevant offence provision, any officer who was in a position to influence the conduct of the body corporate in relation to the contravention is subject to a civil penalty, unless the officer proves that the officer took reasonable measures to prevent the contravention*.

As will be plain from our discussion above, in our view, any proposal for individual liability for corporate misconduct needs to be considered alongside the accountability regimes, and should not be overlayed on to corporations and individuals subject to that regime.

Apart from the considerations that arise regarding the relationship of Proposal 9 to the accountability regimes, in our view, this proposal (and Proposal 10), require further development. As presently cast, these proposals give rise to a number of concerns:

- The concept of 'any officer who was in a position to influence the conduct of the body corporate' is undefined and it is not clear how this would be applied in relation to roles with broad compliance responsibilities across multiple lines of business (e.g. Chief Compliance Officer).
- In relation to the proposed defence, the concept of 'reasonable measures to prevent the contravention' is vague and ambiguous, and hence difficult for an individual to prove.
- The breadth of the potential allocation of responsibility under the proposals, and the lack of a requirement for any real nexus between the individual and the contravention, is likely to have unintended and undesirable consequences. These include increased risk aversion by individuals when considering whether to undertake roles such as non-executive directorships, and associated difficulty in firms' ability to attract/retain talent; siloed decision-making, and

increased cost/unavailability of Directors and Officers Insurance coverage. Each of these potential consequences could have a material impact on the broader economy.

Proposal 10

> **Proposal 10** *The Corporations Act 2001 (Cth) should be amended to include an offence of engaging intentionally, knowingly, or recklessly in conduct the subject of a civil penalty provision as set out in Proposal 9.*

This proposal is odd on a number of counts. Firstly, knowledge or intentionality are not necessarily absent (and sometimes will effectively be required) elements in respect of civil penalty provisions. Yet, if, as the prescribed in proposals 1 to 4, an appropriate process has been conducted to determine that a given contravention should be a civil penalty provision and not a criminal offence, what is the policy basis for converting a contravention to a criminal offence only because knowledge or intention is present? Such a conversion should require dishonesty to change the status to criminal.

Secondly, converting proposal 9 behaviour to criminal based on knowledge, intention or recklessness sits oddly with attribution based on failure to prevent. For example, how is it to be shown that a person knowingly failed to take reasonable measures? More sense could be made of the proposal if the intention was to capture circumstances where a person has intentionally used their position to influence the conduct of the body corporate to bring about the contravention.

Sentencing Corporations

In general, we are comfortable with the proposals in the paper on sentencing of corporations, with the following exceptions. The first of these relates to proposal 15(e), on orders dissolving the corporation as a sentencing option.

> **Proposal 15** The Crimes Act 1914 (Cth) should be amended to provide the following sentencing options for corporations that have committed a Commonwealth offence:
>
> e) orders dissolving the corporation**.**

We note that the paper describes this penalty as extreme, and rightly confined to the most serious offending. Nevertheless, we question what this provision would add to existing provisions on dissolution. For example, there is an existing ground for a court to order the winding up of a corporation where ASIC reports concludes that "it is in the interests of the public, of the members, or of the creditors, that the company should be wound up."[2] In addition, courts have a general discretion to order the winding up of a company where they are of the opinion that it is just and equitable to do so.[3]

Examples given in the paper of circumstances that could justify a dissolution order – such as in the case of the most serious offending or that the corporation was operated primarily for a criminal purpose – could be addressed under either of those provisions. Adding a separate ground for winding up on sentencing may be interpreted as inviting courts to impose dissolution as a punishment, potentially at the expense of shareholders, creditors, and, in the case of banks, the brooder economy. Where it has not been shown that the existing provisions are deficient, the prudent course would be to avoid any risk of unintended consequence by introducing a further ground for dissolution.

> **Question F** Are there any Commonwealth offences for which the maximum penalty for corporations requires review?

No. The ASIC Enforcement Review undertook an extensive review of civil and criminal penalties and its recommendations have been accepted and now implemented. Penalties, both civil and criminal have been very substantially increased under these reforms and the effect of this should be assessed before any further review is conducted.

> **Question G** Should the maximum penalty for certain offences be removed for corporate offenders?

[2] Corporations Act, section 461(1)(h)(ii)
[3] Corporations Act, section 461(1)(k)

No. The ASIC Enforcement Review considered this approach by did not propose it on the basis that nominal maximum penalties provide valuable guidance to courts in deciding on penalties, and we concur with that view:

> "The question can reasonably be asked as to whether there should be any upper limits on penalties at all. In the United Kingdom there are no maximum limits on amounts that can be imposed in respect of comparable contraventions to those under ASIC-administered legislation. This approach is considered in greater detail below. The Taskforce has, however, stopped short of adopting such a position. Although the Australian courts are well versed in imposing sentences from first principles (see for example *Australian Competition and Consumer Commission v Reckitt Benckiser* (Australia) Pty Ltd [2016] FCAFC 181, where the Full Court of the Federal Court calculated a penalty largely by reference to profit made, after concluding that "in a practical sense, the overall maximum penalty was so great that there was no maximum penalty"), the Taskforce's view is that a nominal maximum provides valuable guidance to courts faced with the task of imposing a penalty appropriate to the case before them."[4]

Illegal Phoenix Activity

> **Proposal 21** The Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019 should be amended to:
>
> a) provide that only a court may make orders undoing a creditor-defeating disposition by a company, on application by either the liquidator of that company or the Australian Securities and Investments Commission; and
>
> b) provide the Australian Securities and Investments Commission with the capacity to apply to a court for an order that any benefits obtained by a person from a creditor-defeating disposition be disgorged to the Commonwealth, rather than to the original company, where there has been no loss to the original company or the original company has been set up to facilitate fraud.
>
> **Proposal 22** The Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019 should be amended to:
>
> a) provide the Australian Securities and Investments Commission and the Australian Taxation Office with a power to issue interim restraining notices in respect of assets held by a company where it has a reasonable suspicion that there has been, or will imminently be, a creditor-defeating disposition;
>
> b) require the Australian Securities and Investments Commission and the Australian Taxation Office to apply to a court within 48 hours for imposition of a continuing restraining order; and
>
> c) grant liberty to companies or individuals the subject of a restraining notice to apply immediately for a full de novo review before a court.

We have some concerns around the notion (or label) of "Legal Phoenix". A legitimate "restructure" involving transfer of assets needs to have been by agreement of impacted creditors or with court approval. A better label would be "Approved Structure" given perception that a phoenix is not acceptable.

Transfer of assets from one company to another is not in and of itself a bad thing unless that transfer is undervalued. We note there is difficulty in assessing the value especially in circumstances where enterprise value only effectively lies with the current business owner. Transfer at undervaluation is probably adequately covered in existing laws

We understand the issue to be addressed in the new proposed legislation is around how to identify intent of the current owners.

We are concerned around the power provided to ASIC in the current proposed legislation. In our view, this power should lie with the courts. ASIC, Controllers and Creditors should be all able to commence actions with the courts. Practically we question whether ASIC has the resources to police hence the importance of having Controller and Creditor led proceedings. Timing may be critical.

[4] ASIC Enforcement Review, Positions Paper 7 *Strengthening Penalties for Corporate and Financial Sector Misconduct*, para 17.

The “Proposals” in the paper appear to partly address this in that ASIC interim powers must apply to the courts within a short timeframe – but is silent on who would be the “Controller” of the assets after that.

Yours faithfully

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