

THE CHALLENGE OF CORPORATE LAW ENFORCEMENT IN AUSTRALIA

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Introduction

Even before recent events, where the financial crisis in the United States and resulting global meltdown have seen the global economy rocked by a credit crisis that Alan Greenspan, former chairman of the United States Federal Reserve, has described as a “once-in-a-century event”, and the worst “by far” that he has witnessed,¹ attention had been re-focussed on corporate governance issues and the need for improved regulation. This was in the wake of major corporate collapses, such as Enron and WorldCom in the United States, Parmalat in Europe, and HIH Insurance (HIH) in Australia.

The Australian Securities and Investments Commission (ASIC) as “Australia’s corporate, markets and financial services regulator”,² plays a key role in maintaining the integrity of the market and the wellbeing of the Australian economy. It is therefore of utmost importance that ASIC is guided appropriately so as to enable it to properly discharge its regulatory functions.

Various theoretical models can be found in the literature on regulation. One such model is provided by strategic regulation theory, which underpinned fundamental reforms made in 1993 to the regime of sanctions for enforcement of the statutory duties of corporate officers in Australia when the civil penalty regime³ was introduced. By adopting this approach, which recognises that it is not possible for any regulatory agency to detect and enforce every contravention of the law it administers and which reduces reliance on the criminal law, it was hoped that ASIC could more effectively regulate corporate misconduct.

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¹ See R. P. Austin (ed), *The Credit Crunch and the Law*, Monograph 5, Ross Parsons Centre of Commercial, Corporate and Taxation Law, The University of Sydney, 2008.

² This is the way ASIC describes its ‘role’: see ASIC website www.asic.gov.au, ‘About ASIC: Our role’ (Accessed 6 August 2008). The statement is repeated in other documents published on its website, eg. ASIC, *ASIC: A guide to how we work*, p 4.

³ The regime is currently contained in the *Corporations Act 2001* (Cth) (*Corporations Act*), Pt 9.B.

This aim of this paper is to examine strategic regulation theory for the purposes of discussing not only its ability to shape ASIC's regulatory design and practice but, also the desirability of such an approach in ASIC's quest for better regulation.

Strategic regulation theory and the pyramidal enforcement model

Strategic regulation theory is an economic theory of regulation, which provides a macro perspective on the role of enforcement sanctions in achieving regulatory compliance. It advocates that regulatory compliance can be secured most effectively by persuasion, rather than legal enforcement, since legal proceedings are expensive, whereas cooperation between the regulator and the regulated is cheap.⁴

Usually, strategic regulation theory is graphically represented by the pyramidal enforcement model.⁵ The core strategic concept of a pyramid of enforcement was developed by Braithwaite who argued, in *To Punish or Persuade*,⁶ that compliance is most likely when a regulatory agency displays an explicit enforcement pyramid. The pyramid model requires the regulator to be armed with a wide range of sanctions that escalate in severity from education and persuasion at the base, through various other stages to criminal sanctions and incapacitation at the apex of the pyramid for continued non-compliance or for serious breaches of the law.⁷ The regulator should move from one level to the next, beginning at the lowest level in most cases.

Significantly, Ayres and Braithwaite, who coined the phrase 'responsive regulation' in 1992⁸ and elaborated on the pyramidal enforcement model, argue that regulatory agencies are often best

⁴ See G. Gilligan, H Bird and I Ramsay, *Research Report: Regulating Directors' Duties – How Effective are the Civil Penalty Sanctions in the Corporations Law?* Centre for Corporate Law and Securities Regulation, The University of Melbourne, 1999, Pt IV, p 9.

⁵ Ibid.

⁶ J. Braithwaite, *To Punish or Persuade: Enforcement of Coal Mine Safety* State University of New York Press, New York, 1985.

⁷ For individual offenders the criminal sanction of imprisonment is regarded as the ultimate penalty, while for corporate offenders, sanctions, such as deregistration, punitive injunctions, adverse publicity orders and license revocation are regarded as equivalent penalties.

⁸ I. Ayres and J. Braithwaite, *Responsive Regulation, Transcending the Deregulation Debate*, Oxford University Press, New York, 1992.

able to secure compliance when they are “benign big guns”.⁹ Regulators will be able to speak softly when it is known that they carry big sticks and can resort to a hierarchy of sanctions, which can be escalated in response to non-compliance to invoke strong sanctions if necessary. The tougher and more various the sanctions, the greater the success regulators are likely to achieve by proceeding softly. The more those sanctions can be kept in the background, the more regulation can be transacted through moral suasion, the more effective regulation will be.¹⁰

It is also significant that Ayres and Braithwaite make it clear from the outset, that they position themselves *after* the debate between ‘regulation’ and ‘deregulation’,¹¹ and the ‘punish’ or ‘persuade’, ‘deterrence’ versus ‘compliance’ models of regulation.¹² The aim of their work in

⁹ Ibid, p 19.

¹⁰ Ibid.

¹¹ Ibid, p 3. Although recent events have breathed new life into the ‘old’ debate about ‘regulation’ or ‘deregulation’, this debate has been criticised and many academics have sought to move beyond it. In addition to Ayres and Braithwaite, other academics who have sought to develop alternative approaches include Julia Black and Stephen Bottomley: see J. Black, “Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a ‘Post-Regulatory’ World” (2001) 54 *Current Legal Problems* 103, for a discussion of the ‘decentred’ approach, where the task of regulation has been redefined: it is to regulate ‘self-regulation’, but it is to do so *indirectly*, in a ‘post-regulatory’ way, including a proposed shift in the use of the law to move away from ‘regulatory law’, which sets substantive standards to reflexive ‘procedural’, or ‘post-regulatory’ law, which sets procedures. Importantly, this approach cuts across the distinction between public and private laws so that private institutions may assist to regulate public space, while private space may be regulated in non-traditional ways, such as through the use of ‘soft law’ like industry codes, international corporate governance standards and corporate social responsibility norms. See also S. Bottomley, *The Constitutional Corporation: Rethinking Corporate Governance*, Ashgate Publishing Company, England, 2007, for a discussion of Bottomley’s alternative theory of corporate regulation, namely ‘corporate constitutionalism’.

¹² Ibid, p 20. By adopting the terms ‘deterrence’ versus ‘compliance’, Ayres and Braithwaite rely on one of the leading formulations provided by Reiss of the binary model of enforcement strategies or styles, which has been important in the academic literature in seeking to enhance our understanding of law enforcement and the part it plays in the regulatory process: see A. Reiss Jr, “Selecting Strategies of Social Control over Organizational Life” in K. Hawkins and J. Thomas (eds) *Enforcing Regulation*, Kluwer-Nijhoff Publishing, Boston, The Hague, Dordrecht and Lancaster, 1984. The other leading formulations are those of Hawkins and Bardach and Kagan. The terms Hawkins employs in describing this model are ‘compliance’ and ‘sanctioning’: see K. Hawkins, *Environment and Enforcement: Regulation and Social Definition of Pollution*, Clarendon Press, Oxford, 1984, p 3, while Bardach and Kagan in their identification of the two basic styles of regulation call one style of enforcement typified by the title of their study: *Going by the Book* as ‘regulatory unreasonableness’ and the other, ‘regulatory reasonableness’: see Bardach and Kagan, *Going by the Book: The Problem of Regulatory Unreasonableness*, Temple University Press, Philadelphia, 1982. A ‘compliance’ strategy of enforcement, which the majority of studies have associated with regulatory enforcement (In the United States, however, Bardach and Kagan found that the unreasonable, legalistic style was predominant, at least at the beginning of the 1980’s when their study was conducted), is generally aimed at securing compliance, through both remedying existing problems and, most importantly, preventing others. The preferred methods of achieving these aims are co-operative and conciliatory. Accordingly, when compliance is less than complete, persuasion, negotiation, and education are the principal enforcement techniques. Compliance, therefore, may not be seen as achievable immediately, but instead may be viewed as a long-term objective. The use of formal methods, particularly prosecution, is considered a ‘last resort’. On the other hand, in a ‘deterrence’ strategy, which is a penal style of enforcement, prosecution plays a crucial role. Indeed, the number of prosecutions undertaken may be viewed not only as a sign of success, but visible evidence that enforcement officials and agencies

developing a general regulatory strategy is thus about alternatives to the free market versus government regulation policy choice, where they believe that there needs to be a mix of private and public regulation:

Good policy analysis is not about choosing between the free market and government regulation. Nor is it simply deciding what the law should proscribe. If we accept that sound policy analysis is about understanding private regulation - by industry associations, by firms, by peers, and by individual consciences- and how it is interdependent with state regulation, then interesting possibilities open up to steer the mix of private and public regulation. It is this mix, this interplay, that works to assist or impede solution of the policy problem... We argue that by working creatively with the interplay between private and public regulation, government and citizens can design better policy solutions.¹³

Moreover, Ayres and Braithwaite believe that the regulatory agencies most effective in achieving their objectives are those that strike some sort of balance between the ‘deterrence’ and ‘compliance’ models of regulation.¹⁴

The fundamental question has thus become: “When to punish; when to persuade?”¹⁵

The Game Theorist’s Answer

Pyramidal enforcement proceeds from the “game theory” of regulation, which posits that regulatory compliance is a dynamic game of negotiation and interaction between the regulator

have done their job. This contrasts with a compliance system where prosecution is regarded as a signal of its failure to prevent the non-compliance, notwithstanding that, to prevent violations, threats of punishment can be relied upon in compliance systems.

¹³ See Ayres and Braithwaite, *Responsive Regulation*, above n 8, pp 3-4. Ayres and Braithwaite themselves refer to other scholars whose work seeks to understand the intricacies of interplays between state regulation and private orderings, eg, S. Rose-Ackerman, “Progressive law and economics- and the new administrative law” (1988) 98 *Yale Law Journal* 341, pointing out that the empirical foundation of their analysis of what is good regulatory policy is an acceptance of the inevitability of some kind of symbiosis between state regulation and self-regulation. Ayres and Braithwaite also state that this is the case with most basic commercial legal forms quoting M. Galanter, “Justice in many rooms”, (1981) 19 *Journal of Legal Pluralism* 1 at 29-30: “The drafting of the Uniform Commercial Code was a self-conscious attempt (by Karl Lewellyn) to synthesize formal law and commercial usage: the formal law would incorporate the best commercial practice and would in turn serve as a model for the refinement and development of that practice. The Code’s broadly drafted rules would be accessible to businessmen and would provide a framework for self-regulation which would in turn furnish attentive courts with content for the Code’s categories. Thus the Code would serve as a vehicle for business communities to evolve law for themselves in dialogue with the courts, operating not as interpreters of imposed law but as articulators and critics of business usage”.

¹⁴ *Ibid*, p 21.

¹⁵ *Ibid*.

and the persons regulated.¹⁶ It presumes that those regulated are rational, single actors who decide whether to comply with regulation by an assessment of the costs and benefits resulting from compliance at a particular time.¹⁷ Accordingly, effective regulation requires more than just issuing commands in the expectation that there will be penalties for those who fail to comply. Employing the approach of game – theoretic regulation by Scholz,¹⁸ Ayres and Braithwaite¹⁹ explain the crucial role of mutual cooperation and the contingent role of deterrent punishment in cases of defection from that mutual cooperation:

Scholz models regulation as a prisoner’s dilemma game wherein the motivation of the firm is to minimize regulatory costs and the motivation of the regulator is to maximize compliance outcomes. He shows that a TFT [tit-for-tat] enforcement strategy will most likely establish mutually beneficial cooperation, under assumptions he believes will be met in many regulatory contexts. TFT means that the regulator refrains from a deterrent response as long as the firm is cooperating; but when the firm yields to the temptation to exploit the cooperative posture of the regulator and cheats on compliance, then the regulator shifts from a cooperative to a deterrent response. Confronted with the matrix of payoffs typical in the enforcement dilemma, the optimal strategy is for both the firm and the regulator to cooperate until the other defects from cooperation. Then the rational player should retaliate (the state to deterrence regulation; the firm to a law evasion strategy). If and only if the retaliation secures a return to cooperation by the other player, then the retaliator should be forgiving, restoring the benefits of mutual cooperation in place of the lower payoffs of mutual defection. Drawing on the work of Axelrod,²⁰ Scholz contends that in the prisoner’s dilemma game TFT has been pitted against other strategies to demonstrate mathematically, experimentally, and through the use of computer-simulation tournaments that TFT will often maximize the payoffs of players.²¹

As a “nice” strategy (one that does not use deterrence until after the firm defects), TFT gains the full advantage of mutual cooperation with all firms pursuing nice strategies. As a vengeful strategy which retaliates immediately, it gets stuck with the sucker payoff only once against firms that evade in every round. Yet as a forgiving strategy it responds almost immediately if a previous

¹⁶ See J. Scholz, “Deterrence, Cooperation and the Ecology of Regulatory Enforcement (1984) 18 *Law and Society Review* 179.

¹⁷ *Ibid.*, p 180.

¹⁸ *Ibid.*

¹⁹ Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 21.

²⁰ R. Axelrod, *The Evolution of Cooperation*, Basic Books, New York, 1984.

²¹ Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 21.

evader begins to comply, thereby restoring the benefit of mutual cooperation rather than the lower payoffs of mutual defection. Furthermore, the simplicity of TFT makes it easily recognized by an opponent.²²

TFT Regulation and Motivational Diversity in Business

The TFT policy prescription expounded by Scholz for regulators to try cooperation first is not premised on the assumption that business people are cooperative in nature. Rather, it proceeds on the basis that the payoffs in the regulation game make cooperation a rational choice until the other players defect from cooperation and that the motivational account of the firm is of a unitary actor concerned only with maximizing profit.²³

In *Responsive Regulation*, however, relying on the data collected from empirical work undertaken by Braithwaite on corporate offending,²⁴ Ayres and Braithwaite contend that a strong case for TFT enforcement - “regulation that is contingently provokable and forgiving” - can be made from the wide range of motivational accounts of business conduct disclosed by these studies.²⁵ The studies reveal motivations, such as reputation, social responsibility and making money, as well as demonstrating that business actors often have plural or mixed motivations, and, in some cases, unvirtuous, economically irrational or undesirable motivations. The robust nature of TFT regulation is thus highlighted justifying it as a general strategy.²⁶ Further, since sound public policy must speak to the diverse motivations of the regulated public, it is argued that TFT regulation which is consistent with these motivations may work well in not merely

²² Scholz, above n 16, p 192.

²³ Ayres and Braithwaite, *Responsive Regulation*, above n 8, pp 21-2.

²⁴ The fieldwork on the impact of adverse publicity on corporations is summarised in B. Fisse and J. Braithwaite, *The Impact of Publicity on Corporate Offenders*, State University of New York, Albany, 1983; on pharmaceutical companies in J. Braithwaite, *Corporate Crime in the Pharmaceutical Industry*, Routledge and Kegan Paul, London, 1984; on coal mining companies in Braithwaite, *To Punish or Persuade*, above n 6; on Australian regulatory agencies in P. Grabosky and J. Braithwaite, *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies*, Oxford University Press, Melbourne, 1986; and a preliminary report on the work of nursing home regulation is provided in J. Braithwaite, T. Makkai, V. Braithwaite, D. Gibson and D. Ermann, *The Contribution of the Standards Monitoring Process to the Quality of Nursing Home Life: A Preliminary Report*, Department of Community Services and Health, Canberra, 1990.

²⁵ Ayres and Braithwaite, *Responsive Regulation*, above n 8, pp 19 and 22.

²⁶ *Ibid.* See also C. Dellit and B. Fisse, “Civil and Criminal Liability under Australian Securities Regulation: The Possibility of Strategic Enforcement” in G. Walker and B. Fisse (eds), *Securities Regulation in Australia and New Zealand*, Oxford University Press, Auckland, 1994, p 575. This chapter was not retained in later edition (1998).

constraining non-compliance of purely economic actors, but also in fostering the inculcation of trust and civic virtue.²⁷

Reputation

Braithwaite's research with Fisse in *The Impact of Publicity on Corporate Offenders*, demonstrates that both corporations and individual executives are concerned about reputational interests and not just money.²⁸ The ramifications of this initial empirical questioning of the pure economic rationality model of business conduct do not appear very dramatic. If business actors are deterred not only by economic but also reputational losses, then adverse publicity sanctions should be available to deal with regulatory offenders, which are precisely the policy solutions put forward by Fisse and Braithwaite.²⁹ Thus, TFT can operate properly with adverse publicity providing a punishment payoff.³⁰

²⁷ Ibid, p 20.

²⁸ See Fisse and Braithwaite, above n 24. See also later discussion at nn198 - 205, particularly James Hardie, which is a good case study illustrating this point. The author argues that it was largely concerns about reputational damage suffered as a result of the company's controversial reconstruction and relocation of corporate headquarters to the Netherlands which had adverse consequences for victims of asbestos-related diseases caused by James Hardie's former subsidiary companies and the negative findings of the Special Commission of Inquiry set up to investigate events surrounding that corporate restructure, that forced James Hardie to eventually make proper arrangements to ensure that those victims would be adequately compensated. It should be noted that James Hardie also suffered financially as a result of its actions, but that its ultimate decision to properly fund the Medical Research and Compensation Foundation (MRCF), a separate company established by James Hardie to compensate victims "returned the company to the status of good corporate citizen, with the end result being an increase in the company's share price, stronger profits, and a more positive and secure outlook for the future": see J. McConvill, "Directors' duties to stakeholders: A reform proposal based on three false assumptions" (2005) 18 *Aust Jnl of Corp Law* 88 at 89. McConvill provides an interesting discussion of the James Hardie case from another perspective. He believes that underlying recent calls in Australia for a broadening of the statutory duties of directors to take into account the interests of stakeholder groups other than shareholders are a number of false assumptions, including that directors do not take into account stakeholder interests. McConvill argues that the James Hardie case highlights that by ultimately recognising the interests of its stakeholders, principally asbestos victims, shareholders directly benefited and the interests of the company were well and truly being pursued. This argument is part of McConvill's broader contention that developments in corporate governance should, as far as possible, be internal matters for the company, rather than a matter of external regulation in the form of rules imposed by the legislature. He states (at 100): "We should respect the abilities and intelligence of directors, senior managers and others within the company to develop and foster a positive corporate culture which recognises the interests of stakeholders, and incorporates stakeholder interests as part of the considerations of the company in general, and when directors are making high-level decisions on behalf of the company". He adds: "There is every indication that directors and senior managers are moving towards a more enlightened, long-term approach to framing objectives for the company and making decisions on behalf of the company", opining that "James Hardie is a case in point, rather than an embarrassing exception".

²⁹ See Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 22.

³⁰ Ibid.

Social Responsibility

Ayres and Braithwaite, point out, however, that other data suggest that there is a need to carefully examine the limitations of the rational choice model of business conduct.³¹

Indeed, research has found that:

Corporate actors are not just value maximizers - of profits or of reputation. They are also often concerned to do what is right, to be faithful to their identity as a law abiding citizen, and to sustain a self-concept of social responsibility.³²

Yet, research found that the rhetoric about putting social responsibility before profits was often not matched by responsible action³³ but, equally research often observed in the regulation of nursing homes, for instance, the nursing home manager doing what she regards as responsible even though she knows that it is costly, when the legal risks from failing to do it are seen as zero, and *are* in fact almost zero.³⁴

Ayres and Braithwaite explain that it was such findings which led Braithwaite to argue, in *To Punish or Persuade*,³⁵ that a sound regulatory enforcement policy could not be developed without an appreciation that sometimes business actors were powerfully motivated by making money and sometimes they were powerfully motivated by a sense of social responsibility.³⁶ Braithwaite thus rejected a regulatory strategy based solely on persuasion and one based solely on punishment. He concluded that:

³¹ Ibid: see, eg, P Yeager, “Realms of Reason: Notes on the Division of Moral Labor in Corporate Behaviour”, Paper to Edwin Sutherland Conference on White-Collar Crime, Indiana University, 1990. His paper is on deontological reasoning in business organisations.

³² Ibid. During Braithwaite’s fieldwork, business actors constantly argued that the common view of them as motivated only by money was a simplistic stereotype. While acknowledging that they were primarily motivated by economic factors, they claimed that they gave serious consideration to business responsibility, ethics, and obligations to abide by the law and to be responsive to non-shareholding stakeholders in the corporation.

³³ Ibid, p 24.

³⁴ Ibid. Ayres and Braithwaite relying on Braithwaite’s findings on nursing home regulation: see Braithwaite et al, *The Contribution of the Standards Monitoring Process to the Quality of Nursing Home Life*, above n 24, stated: Go out with nursing home inspectors in a jurisdiction that never prosecutes, never takes legal action for noncompliance with a standard, and you may be surprised at how frequently profit-making organizations agree to do costly things to comply with the law. When you ask them why, they say: “because it is the law” or “because I agree with the lady from the Health Authority when she says that it is in the interests of the residents”. It should be noted that there is an accreditation process for nursing homes and other health care providers currently in place in Australia, where presumably if certain standards are not satisfied, accreditation will be refused.

³⁵ Braithwaite, above n 6.

³⁶ Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 24.

business actors exploit a strategy of persuasion and self-regulation when they are motivated by economic rationality. But a strategy based mostly on punishment will undermine the good will of actors when they are motivated by a sense of responsibility...When actors see themselves as pursuing a higher calling, to treat them as driven by what they see as baser motivation insults them, demotivates them.³⁷

Ayres and Braithwaite go on to explain that the danger of a punitive approach which projects negative expectations of the regulated actor is that it undermines self-regulation,³⁸ a fact which they emphasize is not unique to business regulatory encounters.³⁹ They also emphasize that it is not confined to individual behaviour, with Bardach and Kagan's work identifying that one of the difficulties of a largely punitive approach is that it engenders an organized business subculture of resistance to regulation where that subculture allows for the sharing of knowledge about methods of legal resistance and counterattack.⁴⁰

However, rejecting "punitive regulation is naïve; to be totally committed to it is to lead a charge of the Light Brigade. The trick of successful regulation is to establish a synergy between punishment and persuasion".⁴¹ As Ayres and Braithwaite argue:

Strategic punishment underwrites regulatory persuasion as something that ought to be attended to. Persuasion legitimates punishment as reasonable, fair, and even something that might elicit remorse or repentance.⁴²

³⁷ See *ibid*, pp 24-5.

³⁸ *Ibid*, p 25.

³⁹ *Ibid*: see, eg, M. Lansky, "Violence, shame and the family" (1984) 5 *International Journal of Family Psychiatry* 21 at 23. Lansky makes this point about the dangers of treating violence in patients as an eruption that must be held down by regulation of movement, physical or chemical restraint, concluding that a model of "holding down" both inhibits dialogue about the interpersonal vulnerabilities which lead to violence and justifies "a type of regulation that humiliates the patient and complicates the return of self-regulation".

⁴⁰ *Ibid*: see Bardach and Kagan, above n 12. In their work, where Bardach and Kagan argued that in the United States, many regulators were being too legalistic in their approach to enforcing regulation via 'regulatory unreasonableness', they identified other difficulties with such an approach. They include that over-regulation and legalism tend to give essentially compliant firms a positive disposition to resist or to reduce their efforts to comply with the intent of the law, aiming instead for only the minimal level of compliance required with the rules, and a propensity towards unnecessarily complex rules, the 'regulatory ratchet effect', where in regulatory design and rule-making, there is a tendency towards making new rules and increasing the complexity of existing rules to cover loopholes: see later discussion at n 45.

⁴¹ *Ibid*.

⁴² *Ibid*, pp 25-26.

Moreover, Ayres and Braithwaite reject the notion that the law should solely adopt a perspective of human beings as ‘bad’,⁴³ which would necessitate adherence to the ‘deterrence’ model of regulation, securing compliance with the law only because business actors are confronted with tough sanctions.

Further, they explain how wading in with punishment as a strategy of first choice is counterproductive in a number of ways.⁴⁴ In the first place, punishment is expensive, persuasion is cheap. If persuasion is attempted first and is successful, increased resources are available to expand regulatory coverage. Second, punitive enforcement results in a game of regulatory cat-and-mouse where firms seek to defy the spirit of the law by exploiting loopholes, and the state continues to make more and more specific rules to close the loopholes. The result can be:

- (1) rule making by accretion that gives no coherence to the rules as a package; and
- (2) a barren legalism concentrating on specific, simple visible violations to the neglect of underlying systemic problems.⁴⁵

Third, reliance must be placed on persuasion rather than punishment in industries where technological and environmental factors change so fast that regulations cannot keep abreast of those changes.⁴⁶

Ayres and Braithwaite go on to explain that, in view of these problems of punitive enforcement and since large numbers of corporate actors in a variety of contexts seek to fit the model of the ‘responsible’ citizen,⁴⁷ persuasion is preferable to punishment as the strategy of first choice.⁴⁸ To adopt punishment as a strategy of first choice is unworkable, unaffordable and

⁴³ Ibid, p 26. It is interesting that this view is found in the Bible: see, eg, “The law is not made for a righteous man, but for the lawless and disobedient”. I. Timothy, i, 9.

⁴⁴ Ibid.

⁴⁵ Ibid, citing the work of Bardach and Kagan, above n 12 and Braithwaite, *To Punish or Persuade*, above n 6.

⁴⁶ Ibid.

⁴⁷ See *ibid*, pp 32-33 where Ayres and Braithwaite make this important empirical claim that business actors tend to put their best foot forward in regulatory interactions so that they, the regulator and the researcher observing them, are all likely to regard as the ‘responsible’ citizen. Ayres and Braithwaite make the same claim regarding individuals, who are also likely to put their best self forward in regulatory interactions.

⁴⁸ Ibid, p 26.

counterproductive in undermining the goodwill and motivation of those committed to compliance.⁴⁹

Accordingly, by a very different approach from the economic rationality calculus in the work of Scholz and Axelrod,⁵⁰ Ayres and Braithwaite point out that TFT was the best strategy:

TFT is the best strategy for Scholz because, in maximizing the difference between the punishment payoff and the cooperation payoff, it makes cooperation the most economically rational response. TFT is the best strategy in *To Punish or Persuade* because it holds the best hope of nurturing the non-economic motivations of firms to be responsible and law abiding... By cooperating with firms until they cheat, regulators avert the counter productivity of undermining the good faith of socially responsible actors. By getting tough with cheaters, actors are made to suffer when they are motivated by money alone; they are given reason to favour their socially responsible, law-abiding selves over their venal selves. In short, they are given reason to reform, more so because when they do reform they find the regulator forgiving. When they put reforms in place, they find that the forgiving regulator treats them as if their socially responsible self was always their ‘real’ self. For Scholz, forgiveness for firms planning to cooperate in the future is part of maximizing the difference between the cooperation and punishment payoffs. In *To Punish or Persuade*, forgiveness is advocated for its importance in building a commitment to comply in the future.⁵¹

By fostering expectations of responsibility and cooperation, “the regulator can coax and caress fidelity to the spirit of the law even in contexts where the law is riddled with gaps or loopholes,” so that in this way TFT also resolves the loophole – opening contradiction of punitive regulation.⁵²

Ayres and Braithwaite therefore conclude, importantly, that analyses of what makes compliance rational and what builds business cultures of social responsibility converge on the point that “compliance is optimized by regulation that is contingently ferocious and forgiving”.⁵³

⁴⁹ Ibid.

⁵⁰ See earlier discussion at nn 16 – 22.

⁵¹ Ayres and Braithwaite, *Responsive Regulation*, above n 8, pp 26-27.

⁵² Ibid, p 27.

⁵³ Ibid.

Making Money and the Lexical Ordering of Money and Responsibility

During Braithwaite's fieldwork on nursing home regulation,⁵⁴ he and his colleagues became aware that another distinction evident in economic thinking about regulatory compliance is also recognized in philosophical discourse. This is the notion of two principles being lexically ordered. Rawls explains that a lexical order is one "which requires us to satisfy the first principle in the ordering before we can move on to the second".⁵⁵

In the nursing home fieldwork, the objectives of making money and being socially responsible by caring for residents have been found to be differently lexically ordered by different actors.⁵⁶ Significantly, however, after discussing the different priorities of business actors set out below, Ayres and Braithwaite again argue that TFT is the best strategy for the regulator to pursue to deal with their different motivations:

- (1) exclusively motivated by money;
- (2) exclusively motivated by caring goals;
- (3) virtually exclusively oriented to caring, because it is thought that this is the best way to make money;
- (4) lexically ordered – minimum care constraint/maximum money; and
- (5) lexically ordered – minimum money constraint/maximum care.⁵⁷

In the case where an actor is motivated by social responsibility goals, in this context resident care goals, persuasion rather than punishment is the best course to nurture that motivation.⁵⁸ Ayres and Braithwaite opine that this is true, even where the commitment to achieve minimum standards is itself motivated by profit seeking, where the regulator will do best to build on that minimum, to attempt to define the requirements of the law as part of that minimum standard which the actor feels responsible to satisfy. Only when the regulator fails in getting that acceptance of such a definition should it change to adopt a tougher response.⁵⁹

⁵⁴ See Braithwaite et al, *The Contribution of the Standards of Monitoring Process in the Quality of Nursing Home Life*, above n 24.

⁵⁵ J. Rawls, *A Theory of Justice*, Oxford University Press, London, 1973, p 43.

⁵⁶ See Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 27 discussing the research of Braithwaite et al, *The Contribution of the Standards of Monitoring Process in the Quality of Nursing Home Life*, above n 24.

⁵⁷ *Ibid*, p 29.

⁵⁸ See previous discussion at *Social Responsibility*.

⁵⁹ See Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 29.

Ayres and Braithwaite state that the same applies in the obverse case where the organisation pursues maximum quality of care until a financial constraint is reached. In most situations, the regulator's persuasive strategy will achieve a positive response. However, in times of financial crises that constrain the organisation's maximizing of care at a level below that acceptable to the regulator, then even with this sort of caring organisation, the regulator is forced to switch to punishment to defend the integrity of the standards in the law.⁶⁰

As far as the uncaring actor focused only on maximizing profits is concerned, Ayres and Braithwaite believe that the reasons for playing the regulatory game TFT are provided by the economic rationalist analysis in the work of Scholz and Axelrod. TFT, by maintaining the rewards that the profit-maximizer who complies with regulation obtains from repeated cooperation, is arguably the best strategy in such cases.⁶¹

Finally, Ayres and Braithwaite consider the position where actors are neither completely committed to money or responsibility, nor to any lexical ordering of the two, but rather have a trade-off function for making the choice between being responsible and making money; "when the money involved passes a certain threshold, responsibility is forgotten".⁶² After noting that while up to a particular point on the trade-off function, these actors behave in the same way as those actors totally motivated by responsibility, beyond that point they behave in the same way as actors completely motivated by money, they advocate that since TFT is the best strategy for both actors completely motivated by social responsibility and those completely motivated by money, it follows that TFT is the best strategy for actors who trade off those two motivations.⁶³

Thus they recommend that regulators will be most effective if they play TFT in a number of *simultaneous* games, giving the following example:

[T]he regulatory agency may be in confrontation mode with an industry association that is urging its members to resist a new regulation. At the same time, it is in cooperative mode with one of the member firms of that association

⁶⁰ Ibid.

⁶¹ Ibid.

⁶² Ibid.

⁶³ Ibid.

that believes the regulation is right. This is a firm that already has corporate policies in place to require compliance. Still at the same time, the agency may be confronting the manager of a particular plant belonging to that firm who has been a recalcitrant offender against the new regulation. The agency may then seek to conspire with the cooperative corporation to sacrifice that plant manager on the altar of an individual criminal prosecution (in which the corporation is not charged). Or the regulator may hint at the desirability of the cooperative firm dismissing the uncooperative manager.⁶⁴

'Single-round regulatory encounters'

Ayres and Braithwaite, however, identify that TFT regulation is unlikely to work with the determinedly profit maximizing actor in a regulatory context where the regulator and the actor are in “a single-round regulatory encounter”.⁶⁵ While they acknowledge that Handler may be right that “continuity of relation is probably the norm in the modern state”,⁶⁶ as this is generally the case with securities regulation in Australia involving as it does a continuous relationship between ASIC, the ASX and those regulated,⁶⁷ Ayres and Braithwaite also recognize that there are areas where regulatory encounters are not continuous but are one-off episodes.⁶⁸ In such cases, it is agreed that persuasion will fail because the economically rational actor will not be influenced by the appeal of socially responsible cooperation and will cheat every time. The best strategy is therefore not TFT, but rather to prosecute *only* the more serious cases and, in less serious cases, either to seek court-ordered remedies and civil penalties or to rely on the hierarchy of available responses as a bargaining tool in negotiations for a settlement where the defendant agrees to provide a remedy or otherwise be subject to a sanction.⁶⁹

⁶⁴ Ibid, p 34.

⁶⁵ Ibid, p 30.

⁶⁶ See J. Handler, *The Conditions of Discretion: Autonomy, Community, Bureaucracy*, Russell Sage Foundation, New York, 1986, p 4.

⁶⁷ See also Dellit and Fisse, above n 26 p 573. Those who act as corporate officers or brokers or who raise funds from the public usually regard themselves as repeat players in the market. Moreover, even though a breach committed by an employee of a securities dealer may perhaps be a “one-off” from the perspective of the employee, the incident may trigger internal disciplinary action and other organizational responses where the management are aware of the value of maintaining good relations with ASIC.

⁶⁸ Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 30. They give the example of people attempting to smuggle items across borders, or committing various kinds of fraud.

⁶⁹ Ibid. See also Dellit and Fisse, above n 26, p 573.

'Pathological irrational organizations'

The other type of case that Ayres and Braithwaite identify as challenging their general conclusion that TFT is the best way to proceed involves the “*pathological irrational organization*”,⁷⁰ where some individuals may also be unrepentant confidence tricksters.⁷¹ In such cases, Ayres and Braithwaite acknowledge that TFT will certainly result in regulatory failure if its sanctions are limited to deterrent ones, such as fines.⁷² In order to deal with irrational actors, it is necessary for there to be incapacitative sanctions, such as license revocation:

The law must have sanctions designed to cope with irrational actors as well as rational actors, because where irrational actors exist they are likely to be loose cannons on the deck that can do the greatest damage.⁷³

Therefore, in the same way that it is a minor adjustment to TFT based on economic deterrence to accommodate reputational deterrence, Ayres and Braithwaite argue that it is a minor change to provide for sanctions designed with incapacitation, rather than deterrence, in mind.⁷⁴

Punishment and Motivational Diversity

The central aspect of TFT regulation which is clearly evident from the foregoing is that it does not assume a particular motivational set on the part of the actors whose cooperation is sought. Under a well-designed pyramid of enforcement, the same motivational neutrality is reflected by the criminal sanctions to which the enforcement process can be escalated if necessary.⁷⁵ For corporations and individuals this means a wide range of sanctions which can impose non-financial, as well as, financial loss, such as community service orders and adverse publicity sanctions.⁷⁶

⁷⁰ See Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 30.

⁷¹ See Dellit and Fisse, above n 26, p 577.

⁷² Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 30.

⁷³ Ibid. See also G. Brennan and J. Buchanan, *The Reason of Rules: Constitutional Political Economy*, Cambridge University Press, Cambridge, 1985, p 59. Brennan and Buchanan make a similar point, although they assume that those worst cases will be actors who are rational and bad and thus can be deterred, in contrast to Ayres and Braithwaite's 'pathological' actor who is not rational.

⁷⁴ Ibid.

⁷⁵ Ibid. See also Dellit and Fisse, above n 26, p 577.

⁷⁶ It should be noted that academic opinion on the deterrence value of non-monetary sanctions continues to be divided. While there is the view that monetary penalties provide effective deterrents against the profitability objectives of regulated firms, are cheaper to administer and preferable from a social position since they generate revenue: see R. Posner, “Optimal Sentences for White Collar Crimes” (1979-1980) 17 *American Criminal Law*

Ayres and Braithwaite make the point, that punishment should not be regarded in one-dimensional or static terms, as simply a deterrent measure, but as something which can be structured so as to encourage cooperation.⁷⁷ They advance the idea of ‘super-punishment’,⁷⁸ as a means of motivating a recalcitrant party to become cooperative:

First, super-punishments increase the height of the regulatory pyramid. Furthermore, the threat of the super ‘stick and stick’ punishment preserves scarce regulatory resources by channeling violators to ‘stick and carrot’ punishments (where violators cooperate in implementing self-sanctions). Also, by increasing the credibility of regulatory responsiveness it more effectively channels industry behaviour to more cooperative paths to regulatory compliance. With effective super-punishments, agencies can more credibly deter noncompliance because they can more convincingly say ‘if you violate it is going to be cheap for us to hurt you (because you are going to help us hurt you).’ The notion of escalating super-punishments even further broadens the notion that pyramids can engender cooperation – because super-punishment theory shows that, even within the most punitive portions of the enforcement pyramid, eliciting firm cooperation can enhance the channeling effects of responsive regulation.⁷⁹

Pyramids of enforcement and their design

The strategy of pyramidal enforcement postulates a hierarchy of regulatory responses. As we have seen, this pyramid has at its base the use of less punitive, less costly and less intrusive compliance measures, such as persuasion; as one rises to the apex, these methods become

Review 409, the author favours the approach of Ayres and Braithwaite and other academics, including Coffee: see J. Coffee, “Corporate Crime and Punishment: A Non-Chicago View of the Economics of Civil Sanctions” (1979-1980) 17 *American Criminal Law Review* 419 and Gordon: see R. Gordon, *Business Leadership in the Large Corporation*, Brookings Institute, Washington, 1945, that non-monetary sanctions serve as deterrents against their other objectives, such as the desire for power or prestige. In *Responsive Regulation*, Ayres and Braithwaite argue further that the importance of adverse publicity directed at wrongdoing is not just its deterrent effect, but more importantly, its effect in constituting consciences, in moral education.

⁷⁷ *Ibid*, pp 41-4. See also Dellit and Fisse, above n 26, p 578.

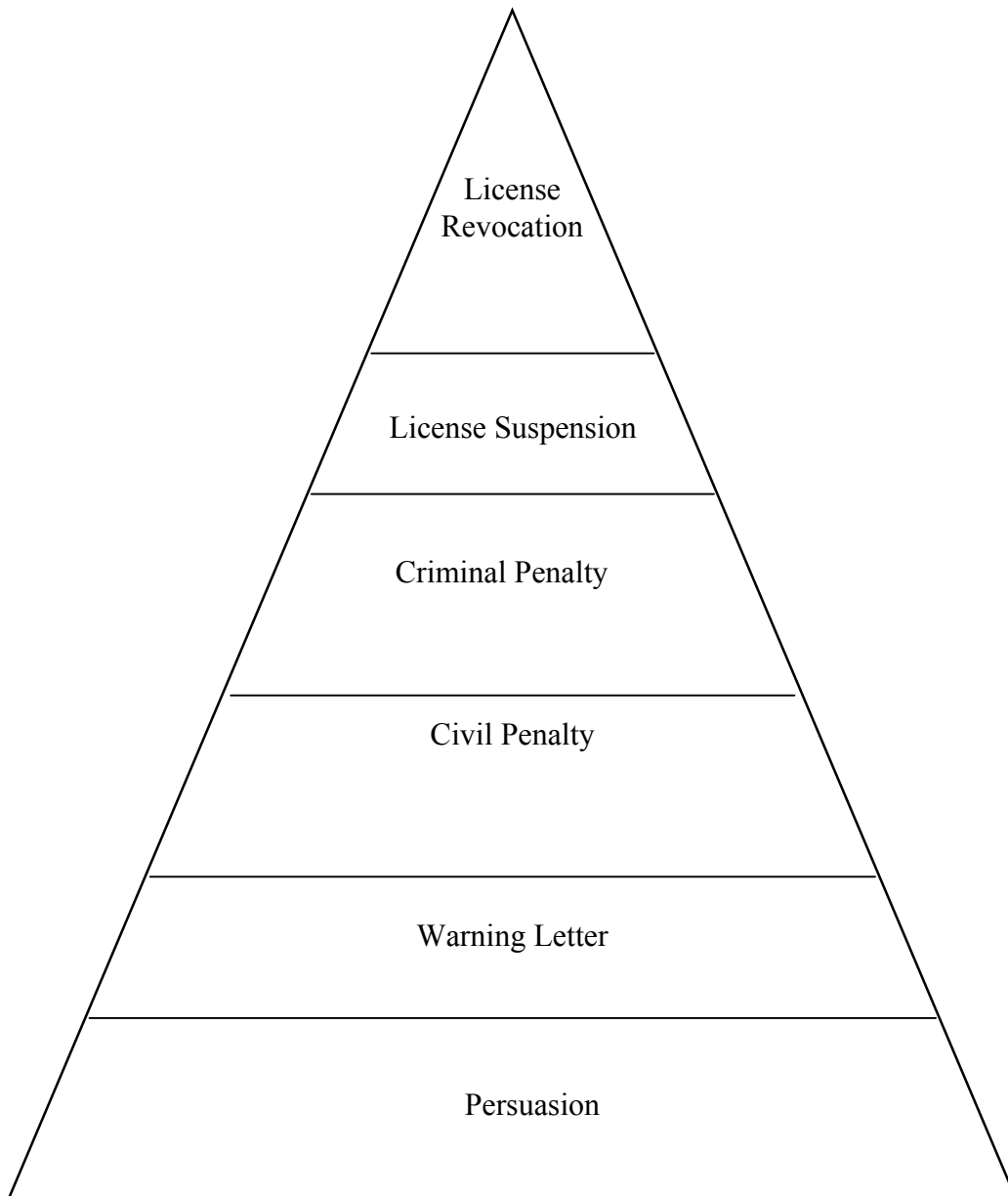
⁷⁸ *Ibid*, p 43-4. Ayres and Braithwaite argue that the ‘stick and carrot’ nature of super-punishment encourages cooperation of the punished firm and even self-punishment because by cooperating, the punished firm can more quickly move from the more painful ‘stick’ to the less painful ‘carrot’: “Super-punishments may be of use to agencies seeking regulatory compliance. By engendering a firm’s cooperation in its own punishment, agencies can radically reduce the costs of punishing. This increases the fiscal feasibility of costly super-punishments in the most extreme cases. This is illustrated by the use of plea bargaining. By cooperating with punishment on one charge, the defendant may get the carrot of immunity from further prosecution on other, more serious, charges. If defendants ‘take their medicine’, they can more quickly move to the carrot period of reintegration. If they do not, instead of stick-carrot, they get stick and more stick – an escalation up the pyramid”.

⁷⁹ *Ibid*, p 44.

increasingly punitive, costly and intrusive. Under this model, the regulator ascends the pyramid through more severe and complex mechanisms, such as warning letters to civil penalties, leading to more costly and stigmatising actions, such as the use of criminal sanctions and to licence suspension and ultimately to license revocation and imprisonment.⁸⁰ There are various examples of enforcement pyramids found in the literature on corporate enforcement. Figure 1 below is one example set out in *Responsive Regulation*.

⁸⁰ See earlier discussion at n 7.

Figure 1: Example of strategic regulation enforcement pyramid⁸¹



⁸¹ See Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 35. This pyramid appears as Figure 2.1.

Different types of sanctioning, however, are suitable for different areas of regulation.⁸² “The form of the enforcement pyramid is the subject of the theory, not the content of the particular pyramid.”⁸³ Indeed, it is the systematic ordering of sanctions in the enforcement pyramid, with its hierarchy of progressively more severe punishments that is fundamental. It must be made clear to the regulated that non-compliance at any level will result in escalation to a higher level of adverse consequences. The regulated must know that defection from cooperation will be a less attractive option when those regulated face a regulator with an enforcement pyramid.⁸⁴

Desirability of this approach for ASIC

Credible escalation and the ‘image of invincibility’?

The pyramidal enforcement model underpinned the introduction of the civil penalty regime found in Pt 9.4B of the *Corporations Act* and the enforcement pyramid supporting it.⁸⁵ Yet, what is the use of having an enforcement pyramid, if, in the first place, the threat of escalation by ASIC to serious levels of response is not credible⁸⁶ and secondly, the pyramid is not projected to all participants?⁸⁷

This paper argues that it is not pyramidal enforcement but ASIC’s implementation of it that is the problem. Although ASIC has been committed to following strategic regulation theory and pyramidal enforcement since 1993, unless it is consistent in its application and consistent in taking enforcement action at appropriate levels in the pyramid, it is in danger of not being regarded as a credible regulator. This is especially the case if serious sanctions, that is, criminal

⁸² Ibid, p 36. The pyramid shown as Figure 1, for instance, might be appropriate for occupational health and safety or nursing home regulation, but it may not be suitable for banking regulation.

⁸³ See J. Braithwaite and T. Makkai, “Testing an Expected Utility Model of Corporate Deterrence” (1991) 25 *Law and Society Review* 7.

⁸⁴ See Ayres and Braithwaite, *Responsive Regulation*, above n 8, pp 35-8.

⁸⁵ See author’s previous work for a detailed discussion of the introduction of Pt 9.4B and the regulatory framework underpinning it: V. Comino, “The enforcement record of ASIC since the introduction of the civil penalty regime” (2007) 20 *Aust Jnl of Corp Law* 183 at 188-191.

⁸⁶ See also Dellit and Fisse, above n 26, p 580.

⁸⁷ Ibid, p 593.

sanctions, are never or rarely used, particularly against high profile wrongdoers.⁸⁸ A recent example concerns ASIC's failure to prosecute Stephen Vizard for insider trading.

Vizard

On 4 July 2005, ASIC announced that it had commenced civil penalty proceedings, rather than criminal proceedings, against Vizard, "celebrity businessman, impresario, lawyer and one-time television presenter"⁸⁹. ASIC alleged that, in 2000, Vizard had breached his duty as a director of Telstra Corporation Limited (Telstra) by improperly using secret boardroom information to trade shares in three listed public companies in which the telco had an interest to gain an advantage for himself and/or others.⁹⁰ Just two days later, an article condemning ASIC's decision not to launch criminal proceedings appeared on the front page of *The Australian*. The headline read "Vizard was 'too well connected' for jail".⁹¹ Even though ASIC defended itself, claiming that it was "a without-fear-or-favour regulator",⁹² such a condemnation of its decision not to prosecute such a high profile wrongdoer attests to the widely held perception that the criminal law is the most appropriate way to deal with corporate misconduct and that corporate wrongdoers should not be treated any differently from street criminals.⁹³ A number of academics⁹⁴ also believe that corporate crime⁹⁵ is more serious than conventional crime. Apart from the financial costs of

⁸⁸ To date, the only high profile cases in which ASIC has taken criminal action concern the HIH collapse, which followed civil penalty proceedings: see discussion below, nn 101-102 and the Westpoint property collapse.

⁸⁹ See A. Cornell, E. Johnston and D. Hughes, "Steve Vizard quits over share trading offences", *AFR*, 5 July 2005, p 1.

⁹⁰ See ASIC, "ASIC commences civil proceedings against Stephen Vizard", *Media Release 05-190*, 4 July 2005. See also *ASIC v Vizard* (2005) 54 ACSR 394. ASIC commenced civil penalty proceedings against the defendant, seeking a declaration that the defendant's conduct had contravened *Corporations Act*, s 183 (formerly *Corporations Law*, ss 232(5) and 183).

⁹¹ J. Sexton, 'Vizard was 'too well connected' for jail', *The Australian*, 6 July 2005, pp 1-2.

⁹² Sexton, above n 91, p 2.

⁹³ In the academic literature a distinction is usually made between regulatory offences and 'real crimes' that is 'such taken-for-granted unacceptable behaviours and serious criminal offences as murder and robbery'. Those who deny the criminal status of regulatory offences argue the opposite. They contend that regulatory offences are 'lesser matters' which people do not regard in the same way as traditional crimes so that their criminalisation is inconsistent with public morality. For a brief but good discussion of the legal debate about the use of the criminal law as a regulatory measure: see eg B. Hutter *The Reasonable Arm of the Law: The Law Enforcement Procedures of Environmental Health Officers* (Clarendon Press, Oxford, 1988, pp 30-34).

⁹⁴ See discussion below at n 98.

⁹⁵ For the purposes of this paper, the term 'corporate crime' is used simply to refer to serious corporate misconduct or wrongdoing. It is not used in a technical sense. Nor is it used to make the distinction often found in the academic literature between 'corporate crime' (violations of the criminal law) and 'illegal corporate behaviour' (violations of administrative and civil law): see, eg, M. Baucus and T. Dworkin, "What is Corporate Crime? It is not Illegal Corporate Behaviour" (1992) 13 *Law & Policy* 231.

corporate crime to the community,⁹⁶ which some members of the judiciary also acknowledge,⁹⁷ it has the capacity to undermine faith in our social institutions.⁹⁸

Despite the increasing use of the civil penalty regime by ASIC, most recently against James Hardie⁹⁹ and the Australian Wheat Board (AWB)¹⁰⁰ and its success in recent years in using the civil penalty regime against directors involved in high profile corporate collapses, such as those

⁹⁶ For a discussion of these costs see eg H. French *Guide to Corporations Law* (4th ed), Butterworths, Sydney, 1994, p 348.

⁹⁷ See, eg, Federal Court Judge, Finkelstein J in *ASIC v Vizard* (2005) 54 ACSR 394 at 401[25]. Although Vizard did not profit from his wrongdoing in the particular circumstances of this case which was due completely to the fortuitous decline in the share market, Finkelstein J alluded generally to the high cost of such crime, causing many people to suffer greatly, giving the example of creditors and shareholders in various cases, including the Pyramid Group and Estate Mortgage in Victoria, and of HIH and One.Tel in New South Wales.

⁹⁸ See J. Farrar "The ASC and the criminal process" (1993) 67 LIJ 603 at 603-604. Professor Farrar, however, also defends ASIC's litigation program of enforcing the law through civil criminal and administrative actions claiming that: "[i]n the past Australia has made too much of criminal sanctions in its corporate laws" See also French, above n 96, who believes that the social costs are unquantifiable and that corporate crimes have the capacity to destroy countries not only economically but socially and politically.

⁹⁹ See ASIC, "ASIC commences proceedings relating to James Hardie", *Media Release 07-35*, 15 February 2007.

In February 2007, ASIC filed civil penalty proceedings in the Supreme Court of New South Wales relating to disclosure by James Hardie Industries Limited (JHIL, now called ABN 60 Pty Ltd) in respect of the adequacy of the funding of the Medical Research and Compensation Foundation (MRCF) for asbestos victims. The action also seeks declarations that JHIL and James Hardie Industries NV (JHINV) made misleading statements and contravened continuous disclosure requirements. In addition, ASIC alleges that JHINV failed to act with the requisite care and diligence concerning its then subsidiary, JHIL. ASIC also commenced civil penalty proceedings against a number of former directors and former officers of these companies, seeking pecuniary penalties and orders banning them from acting as company directors. The defendants include Peter Macdonald, former director and Chief Executive Officer of JHIL and JHINV, against whom the most serious allegations have been levelled of breaching his duty to act in good faith when he made misleading statements that the compensation fund was able to meet all future claims and of not acting with due care, Meredith Hellicar, former director of JHIL, who has since also resigned from membership of the federal government's Takeovers Panel, Peter Wilcox, a former director of JHIL, Telstra and the Chairman of the CSRIO (although he has since stepped aside as CSRIO Chairman pending the outcome of the proceedings), and former Brierley Investments representatives, Geoffrey O'Brien and Greg Terry, who were former directors of JHIL: see ASIC website www.asic.gov.au to view details of the civil proceedings taken against these defendants and also the second further amended statement of claim filed in the New South Wales Supreme Court on 19 November 2007. These proceedings have been taken as a result of ASIC's investigations which commenced in late 2004, following the Special Commission of Inquiry headed by David Jackson QC, handing down its report (the Jackson report). That report recommended both civil and criminal action against former James Hardie directors and executives, including criminal proceedings against Macdonald over the asbestos compensation scandal.

Unfortunately, even though ASIC investigated the bringing of criminal proceedings, on 5 September 2008, it announced that no criminal action would be taken. ASIC has said that: "While there may be a concern in some sectors of the broader community about this outcome, because of the nature of asbestos and what transpired, a careful and independent review has concluded that there was insufficient basis to commence any criminal proceedings": see ASIC, "James Hardie Group civil action", *Media Release 08-201*, 5 September 2008.

¹⁰⁰ In December 2007, ASIC commenced civil penalty proceedings against six former AWB employees, including former Managing Director, Andrew Lindberg, and former Chairman, Trevor Flugge, pertaining to the \$290 million rorting of the United Nations oil-for-food program by the wheat exporter. This case is the first action since the

of HIH¹⁰¹ (although criminal proceedings have also been instituted)¹⁰² and Water Wheel,¹⁰³ civil penalties are generally regarded as a second-rate penalty regime, that, while acknowledging that a contravention has occurred, do not deliver the same element of moral culpability that is the case with criminal sanctions.¹⁰⁴

Commission of Inquiry headed by former Federal Court Judge, Terrence Cole, handed down its report (the Cole report) in November 2006. That report also recommended civil and criminal charges against a number of individuals, including charges against former BHP executive, Norman Davidson Kelly, who was described as a “thoroughly disreputable man with no commercial morality”. An ASIC Special Taskforce is still investigating the issuing of criminal proceedings in this matter: see T. Lee and M. Drummond, “ASIC sues former AWB directors”, *AFR*, 20 December 2007, p 1.

¹⁰¹ In *HIH Insurance Ltd (in prov liq) v Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72; 20 ACLC 576, ASIC obtained pecuniary penalties: banning orders and compensation against Rodney Adler: a former director of HIH Insurance Limited (HIH), and Ray Williams, its former Chief Executive Officer, as well as, compensation against Dominic Fodera, its former Chief Financial Officer. Adler, for instance, was disqualified for twenty years and ordered to pay approximately \$7 million compensation jointly with Adler Corporation Pty Limited and Williams in addition to a pecuniary penalty of \$450,000. On appeal: the NSW Court of Appeal upheld the disqualifications, pecuniary penalties and compensation ordered against the defendants: see *Adler v ASIC* (2003) 46 ACSR 504; 21 ACLC 1810. Leave to appeal to the High Court was refused in May 2004.

¹⁰² In the subsequent criminal proceedings issued against the defendants, both Adler and Williams pleaded guilty. Adler was sentenced to four and a half years imprisonment with a non-parole period of two and a half years, while Williams was also sentenced to four and a half years but with a non-parole period of two years nine months: see *R v Adler* (2005) 53 ACSR 471 and *Adler v R* (2006) 57 ACSR 675, where Adler’s appeal against this sentence was dismissed by the NSW Court of Criminal Appeal and *R v Williams* (2005) 216 ALR 113; 53 ACSR 434. More recently, on 7 June 2007, Fodera was sentenced to three years imprisonment commencing on 10 June 2007, following his conviction on criminal charges brought by ASIC of authorising the issue of a prospectus from which there was a material omission. On 6 November 2007, Fodera was also sentenced to three years and four months imprisonment for breaching his duties as an officer of HIH, which Justice Bell of the NSW Supreme Court directed be partly concurrent with the sentence he is presently serving on the prospectus charge: see ASIC, “Former HIH executive jailed”, *Media Release 07-155*, 7 June 2007 and ASIC, “Former HIH Chief Financial Officer sentenced on charges”, *Media Release 07-289*, 7 November 2007.

¹⁰³ In *ASIC v Plymin and Others* (2003) 46 ACSR 126; (2003) 21 ACLC 700, ASIC obtained banning orders, pecuniary penalties and compensation against Bernard Plymin, John Elliott and William Harrison in relation to their conduct as directors of Water Wheel and its subsidiary Water Wheel Mills Pty Ltd in allowing the companies to incur further debts after they became insolvent.

¹⁰⁴ See discussion, below at n 135. The author also acknowledges, however, that concerning contraventions of a civil penalty provision where pecuniary penalties are being sought, the case law suggests that to satisfy the test of “seriousness” under the *Corporations Act*, s 1317G, so as to enable the court to order payment of such penalties, the defendant’s conduct must involve a measure of moral wrongdoing: see, eg, *ASIC v Adler (No 5)* (2002) 21 ACLR 1810; 42 ACSR 80. See also discussion by Finkelstein J in *ASIC v Vizard* (2005) 54 ACSR 394 at [27], [29] and [44]. Even though Finkelstein J states that: “Sections 232 and 183 [Corporations Law (now *Corporations Act*, s 183)] can on one level be regarded as prohibiting conduct that is not regarded as serious” (He says this since the maximum penalty that can be imposed for the contravention of these and other civil penalty provisions is only \$200,000 noting that a contravention holds great potential for profit and may cause extensive harm), he also believes that these provisions have another important purpose. “They seek to establish a norm of behavior that is necessary for the proper conduct of commercial life and so that people will have confidence that the running of the marketplace is in safe hands. For this reason a contravention of ss 232 or 183 carries with it a degree of moral blameworthiness. There is moral blameworthiness because a contravention involves a serious breach of trust.” Finkelstein J made these comments in the course of departing from the penalties ASIC sought to be imposed on Vizard, namely a penalty of \$130,000 for each breach and a five-year ban on managing companies. Although Vizard cooperated with ASIC’s investigations and admitted his wrongdoing prior to the institution of proceedings, which is the reason that ASIC, in particular, requested just a five-year disqualification, Finkelstein J considered the

In contrast, its United States counterpart, the Securities and Exchange Commission (SEC) focusses on promptly bringing criminal indictments against suspected major corporate wrongdoers.¹⁰⁵ The SEC's successful criminal prosecutions, particularly those against former Enron Chief Executive Officer, Jeffrey Skilling and its late Chairman and founder, Kenneth Lay for fraud, conspiracy and insider trading on 26 May 2006,¹⁰⁶ will see at least one of the chief architects of this spectacular case of corporate fraud effectively spend the rest of his life in jail.¹⁰⁷ On 23 October 2006, Skilling, 52, was sentenced to twenty-four years and four months imprisonment and ordered to forfeit \$45 million of illegal gains during his time at Enron.¹⁰⁸ Interestingly, the press reports relating to their guilty verdicts also contrast markedly with the adverse press and perceptions surrounding ASIC's failure to prosecute Vizard.¹⁰⁹ Those reports typically stated: "Our criminal laws will be enforced just as vigorously against corporate executives as they will street criminals"¹¹⁰ and "The jury has spoken and sent an unmistakable message to boardrooms across the country...No matter how rich and powerful you are, you have to play by the rules".¹¹¹ Accordingly, ASIC should be buoyed by this victory¹¹² to pursue criminal cases against high profile wrongdoers in serious cases as it seems that the community wants criminal sanctions to be imposed on corporate criminals just as they are on street

proposed penalties put forward by ASIC, and the proposed period for disqualification, to be low. His judgment is important in that the four principles that underlie sentencing and determination of civil penalties are outlined—general deterrence and personal deterrence (where punishment is imposed to avert future harm), and rehabilitation and retribution (where punishment is imposed simply because the offender deserves it), as well as providing an understanding of the way these principles guided his decision on the penalties he ultimately imposed on Vizard, whose contraventions he viewed as "within the category of a worst case for an offence of this type".

¹⁰⁵ But see later discussion, *Settlements*. SEC enforcement also heavily relies on encouraging settlements, undertakings, and consent injunctions, which approach has become an established and generally admired feature of its regulation.

¹⁰⁶ See R. Guy, New York, 'Jury's still out on Enron's impact', *The Weekend AFR*, 27-28 May 2006, p 29.

¹⁰⁷ Although Skilling's co-defendant, La, was convicted of 10 counts of conspiracy and fraud, those charges were vacated and the indictment against him dropped after he reportedly died of a heart attack on 5 July 2006.

¹⁰⁸ See R. Guy, New York, 'Skilling sentenced for Enron collapse' and A. Barrionuevo, New York, 'Enron scandal stalks Skilling', *AFR*, 25 October 2006, pp 19 and 68.

¹⁰⁹ See earlier discussion at nn 91-93.

¹¹⁰ See Guy 'Jury's still out on Enron's impact', n 106 quoting Paul Mc Nulty, former US deputy Attorney General.

¹¹¹ See R. Guy 'New York' Guilty verdicts for Enron bosses' *The Weekend AF*, 27-28 May 2006, p8, quoting prosecutor, Sean Berkowitz.

¹¹² See J. Durie J Chanticleer *The Weekend AFR*, 27-28 May 2006, p 64. Durie claims that Enron has a lot to answer for. Still it is rare for corporate regulators to have had such a complete victory. In the aftermath of Enron's collapse not only was its top brass been snared but the reputations of investment banks such as Merrill Lynch (later taken over by the Bank of America) and Citigroup were tarnished while the accounting firm Arthur Anderson was destroyed because of its close relationship to Enron. Its collapse also set the anti-business climate for the introduction of the *Sarbanes-Oxley Act* which holds companies to much higher legislatively based governance rules than was previously the case.

criminals. Further, the sentencing of Skilling should lead to calls in Australia to increase the maximum jail time for corporate offences under the *Corporations Act*.¹¹³

Importantly, it should also be noted that notwithstanding that the SEC has recently come under criticism for being ‘asleep at the wheel’ in the light of corporate failings and fallout from the current financial crisis,¹¹⁴ as the initial shock of these events recedes, criminal action is likely to follow as law enforcement officials have swiftly swung into action as in the past.¹¹⁵ In October 2008, federal prosecutors, for example, issued subpoenas to at least twelve current and former executives of Lehman Brothers, including Lehman chief executive officer, Richard Fuld, former chief financial officer, Erin Callan and former president, Joseph Gregory, as they investigate whether securities laws were broken before Lehman’s failure on 15 September 2008.¹¹⁶

The need for the criminal law-

Deterrence

In the area of corporate crime, criminal sanctions are motivated by the desire for appropriate punishment and to serve as an effective general deterrent. Champions of the criminal justice system claim that the criminal process offers a greater deterrent for corporations and managers than other control mechanisms.¹¹⁷ A criminal conviction results in a loss of liberty by imprisonment,¹¹⁸ a criminal record and damages the defendant’s image and reputation. The bad

¹¹³ See later discussion at nn 150- 152.

¹¹⁴ See, eg, A. Berenson, “SEC was told nine years ago”, *AFR*, 18 December 2008, p 16. Berenson reports on the failure of the SEC to discover what may be the largest financial fraud in history, namely Bernard Madoff’s Ponzi scheme where losses could run as high as \$US50 billion.

¹¹⁵ See, eg, A. Hughes, “Law reaches out for Lehman”, *AFR*, 20 October 2008, p14.

¹¹⁶ *Ibid.* As far as violations of US securities laws are concerned, the US Department of Justice is responsible for criminal enforcement of these laws. The SEC and Department of Justice cooperate in this area, where many criminal cases brought by the Department begin as referrals from the SEC. See also P. Hurtado, “Fallen high-flyers rush for representation”, *AFR*, 28 October 2008, p 15. Hurtado reports on the SEC having more than fifty investigations open and generally on the rising number of defendants and suspects in government probes of collapsed financial firms, including four former executives of Credit Suisse and Bear Stearns who have been charged with fraud.

¹¹⁷ See, eg, J. Braithwaite, “The limits of Economism in Controlling Harmful Corporate Conduct”, (1981-82) 16 *Law & Society Review* 481.

¹¹⁸ Australian Law Reform Commission (ALRC), *Securing Compliance Discussion Paper: Civil and Administrative Penalties in Australian Federal Regulation*, Discussion Paper No 65, April 2002 at [17.39].

publicity and stigma of a conviction¹¹⁹ far outweighs the label attached to an adverse decision in civil proceedings and/or the making of civil penalty orders.¹²⁰

The traditional deterrence model, which assumes that fear of legal sanctions keeps persons law-abiding,¹²¹ thus provides the main justification for criminal sanctions and calls for the criminal justice system to play a larger role in the war against corporate crime.

In the United States, this is certainly the position. Criminal sanctions have been used in a number of high profile cases,¹²² just as it appears they will be in the future, especially as investigations

¹¹⁹ See Baucus and Dworkin, above n 95, pp 237-238. This view is also consistent with the recommendations made by the Senate Standing Committee on Legal and Constitutional Affairs, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* AGPS, Canberra, 1989 (the Cooney Committee), which considered the vital issue of sanctions for directors who breached their duties and whose recommendations were instrumental to the introduction of Pt 9.4B of the *Corporations Act* and the enforcement pyramid supporting it. The Committee argued that civil penalties, with the benefit of the civil standard of proof and without the draconian consequences of criminal enforcement such as the stigma of criminal conviction, be available as a 'complementary approach' to take enforcement action in relation to misconduct by directors where 'the conduct falls short of a criminal offence'.

¹²⁰ But note that there is a school of thought that the most effective form of punishment for white collar offenders is shaming (a "process by which citizens publicly and self-consciously draw attention to the bad dispositions or actions of an offender, as a way of punishing him for having those dispositions or engaging in those activities": see D. Kahan and E. Posner, "Shaming White Collar Criminals: A Proposal for Reform of the Federal Sentencing Guidelines" (1999) 42 *Journal of Law and Economics* 365 at 368), which is discussed by Finkelstein J in *ASIC v Vizard* (2005) 54 ACSR 394 at [38]- [40] 404 in the course of his determination of appropriate penalties to be imposed on Vizard. While Finkelstein J states that this is not a school of thought to which he fully subscribes and not surprisingly neither does the author, he explains that the thesis of some of its leading proponents, namely Professors Kahan and Posner, is that shaming is a direct expression of moral condemnation, the equivalent of imprisonment as a symbol of disapprobation. It is their belief that shaming penalties will deter white collar crime, because if the offence is publicised in a way that excites revulsion, people will not deal with the offender. They will not hire them or socialise with them. Professors Kahan and Posner posit that shaming creates strong economic and sociological disincentives against future unlawful conduct. Certainly, although it must be acknowledged that as a result of the civil penalty proceedings ASIC brought against Vizard and the penalties imposed, he has received his fair share of shaming with his counsel, Mr Judd QC, arguing that "the damage to his (the defendant's) reputation has been public and complete", the author maintains that the consequences of criminal enforcement such as a criminal record or the stigma of a criminal conviction would serve as a greater deterrent. See also discussion at n 157.

¹²¹ J. Bentham, *An Introduction to the Principles of Morals and Legislation* with an introduction by L.J. Lafleur, Hafner Publishing Co, New York, 1948.

¹²² Besides Skilling, other shamed former chief executives who have suffered the ignominy of jail time after falsifying accounts, lying to shareholders and plundering the corporate treasury for their personal enrichment, include WorldCom chief executive Bernie Ebbers who will probably die in jail after being sentenced to twenty-five years, John Rigas, founder of cable group Adelphia, sentenced to fifteen years and former Tyco chief, Dennis Kozlowski who will spend a minimum of eight years in jail. Kozlowski was sentenced to eight 1/3 to twenty-five years imprisonment and ordered to pay almost \$US170 million (\$222 million) in fines and restitution for stealing from his former company: see J. Bayot, New York, 'Tyco chief jailed, fined \$222m', *AFR*, 21 September 2005, p 13.

continue into possible sub-prime and other securities fraud in relation to recent collapses.¹²³ Additionally, the shift towards the use of the criminal law with its emphasis on punishment and stigmatisation is evident in many areas, including environmental law, antitrust cases and health care fraud.¹²⁴ In Australia, reliance on criminalisation also seems to be occurring, perhaps most importantly to deal with ‘cartels’. The federal government in November 2008 introduced the long-awaited *Trade Practices Amendment (Cartel Conduct and Other Measures) Act 2008* (Cth), which amends the *Trade Practices Act 1974* (Cth) (*TPA*) and criminalises serious or hard-core cartel conduct.¹²⁵ Further evidence of the shift towards the use of the criminal law can be found in the agreement that the ACCC has struck with the DPP to use criminal prosecutions to seek jail terms for business executives who mislead the Commission in the course of an ACCC investigation.¹²⁶ It is this agreement that the ACCC relied upon to lay criminal charges against

¹²³ See discussion above, nn 115-116.

¹²⁴ For a discussion of the criminalising of the corporate control process in the United States, as well as, a critical examination of that process: see S.Simpson, *Corporate Crime, Law, and Social Control*, Cambridge University Press, New York, 2002.

¹²⁵ In February 2005, the former Treasurer announced his intention to adopt the recommendations of the ‘Dawson Report’ (April²⁰⁰³) that criminal penalties and heavier civil penalties be introduced for hard-core anti-competitive conduct, such as cartels and price-fixing agreements, but the legislation was not enacted by the Howard government. Under the new criminal regime, the penalties are a term of imprisonment for ten years and a fine of \$220,000 for individuals and a fine for corporations that is the greater of \$10 million or three times the gain from the contravention or, where the gain cannot be ascertained, 10 per cent of the annual turnover of the body corporate and all of its interconnected bodies corporate (if any). There are still concerns, however, that the legislation does not go far enough in view of the failure of the Australian Competition and Consumer Commission (ACCC) to obtain convictions in relation to two separate price-fixing cases brought by it against petrol retailers in Geelong and Ballarat. Section 45 of the *TPA* prohibits a “contract, arrangement or understanding” which has the purpose, effect or likely effect of substantially lessening competition or contains an exclusionary provision. While an “understanding” is supposedly less formal than a contract or arrangement, it seems that the court in these cases applied a higher level of evidence than should be required to prove a cartel. Undoubtedly, the biggest and most significant civil penalty action the ACCC has undertaken is that launched in December 2005, against billionaire Richard Pratt’s Visy Industries for alleged cartel conduct in the corrugated fibreboard container market. This ‘landmark’ case was settled in October 2007 when Pratt and executives of his Visy group of companies admitted that they breached the *TPA*. Pratt also admitted to the ACCC’s key claim that he approved the cartel arrangement with former Amcor Chief Executive Officer, Russell Jones: see M. Drummond, ‘Pratt says sorry for price fixing’, *AFR*, 9 October 2007, p 1. It should be noted that these admissions stand in contrast to evidence that Pratt gave to the ACCC in 2005 during an examination under the *TPA*, s 155, during which he denied any knowledge of the cartel, denied a lunch meeting with Jones, and further accused Jones of lying, which gave rise to the criminal charges of perjury later laid against Pratt by the ACCC: see later discussion at nn127-128. Penalties of \$36 million were imposed on Pratt and his Visy group, while further fines of \$1.5 million and \$500,000 were imposed on former executives, Harry Debney and Rod Carroll respectively: see S. Washington, ‘ACCC seeks record fines against instigator: Cardboard scam may cost Visy \$36 m’, *The Sydney Morning Herald*, 17 October 2007, p 27. Significantly, while Graeme Samuel, chairman of the ACCC, said that the \$38 million penalty imposed on Pratt and Visy was the “high watermark” in the enforcement of competition, he conceded that it was a light touch compared to jail time: see M. Drummond, “Jail them, says ACCC”, *The Weekend AFR*, 3-4 November 2007, p 3.

¹²⁶ This shift in enforcement policy does not rely on new laws and is not based on the cartel laws. Instead, it makes stronger use of existing trade practices legislation, which includes rarely used provisions for criminal action. The criminal prosecutions would be based on, eg, *TPA*, s 155, which empowers the Commission to issue formal

Pratt for allegedly giving false evidence to it about his knowledge of the cartel under a s 155 examination conducted in 2005,¹²⁷ which could ultimately see Pratt go to jail.¹²⁸

Conventional crime has historically been dealt with punitively in contrast to corporate misconduct which has been handled through administrative agencies or relatively lenient criminal legislation.¹²⁹ This is consistent with the position found principally in sociological studies of regulation¹³⁰ which distinguish between regulatory offences and traditional crimes and bar the use of the criminal law to regulate conduct that is not regarded as intrinsically ‘immoral’.¹³¹

Nevertheless, this paper argues that the criminal law should be accorded a more important role in ASIC’s armory. Enforcement by criminal sanctions should be the preferred way of dealing with violators in cases involving serious corporate misconduct. At least, it should follow civil penalty proceedings, as has occurred in the case of HIH.¹³² This is because in cases of serious corporate

subpoenas and force individuals to provide information or give evidence under oath, but see s 155(7) on the inadmissibility in evidence in criminal proceedings against the person, which may cause problems.

¹²⁷ See ACCC, ‘ACCC begins criminal prosecution against Richard Pratt for allegedly providing false or misleading evidence’, *Media Release 171-08*, 20 June 2008.

¹²⁸ Providing false evidence at a s155 examination is punishable by 12 months in jail and Pratt faces four counts.

¹²⁹ See Simpson, n 124, p 2. She explains that while corporate sanctions often include a criminal element, research shows that in the past, civil and administrative remedies have been the preferred method of pursuing corporate violators, eg, Richard Posner’s study in the antitrust area for the period 1890 to 1969: R. Posner, “A Statistical Study of Antitrust Enforcement” (1970) 13 *Journal of Law and Economics* 385.

¹³⁰ Broadly speaking, sociological theories of regulation explore regulation as an ongoing social process involving many participants. Keith Hawkins’ 1984 study of the enforcement of regulation by British water pollution control agencies is an example of such a study: see above n 12.

¹³¹ See earlier discussion at n 93. See also Hawkins, above n12, pp 12-13. Hawkins discusses the lack of a “moral mandate” as a major problem for regulatory agencies and their staff, because “their authority is not secured on a perceived moral and political consensus about the ills they seek to control”, which he argues threatens the legitimacy of the regulator as an enforcement authority. He compares water pollution control, the subject of his study, with that of the police to make the point that, in pollution control work “there is none of the sacredness of the policing of the traditional code” and also that, “it is more difficult to dramatise the threat of pollution than to portray the symbolic assaults on the community from criminals, addicts, vandals, and others on the fringe of the moral order”. Despite this problem, however, in the United States, there has been a shift towards criminalising a number of environmental statutes to increase both the number of criminal cases pursued by the Environmental Protection Agency (EPA) and to achieve more punitive outcomes, see discussion at n 124.

¹³² An obvious objection to this latter approach would be the higher costs associated with bringing both civil and criminal proceedings. A bigger concern, however, that adds weight to the author’s argument that ASIC should just bring criminal actions rather than civil penalty ones in cases where the contraventions are clearly not inadvertent or minor, is that, as a result of the case law that has developed from ASIC’s increased use of civil penalty proceedings since 2000, a number of difficulties have emerged that make the running of civil penalty cases for ASIC much harder than it was originally envisaged. Most notably, despite s1317L of the *Corporations Act* providing that ASIC would have the benefit of the civil rules of evidence and procedure in enforcing civil penalty proceedings, the courts

contraventions, the public seem to be more reactive, as evidenced by the adverse publicity and resentment surrounding ASIC's failure to institute criminal proceedings against Vizard.

As Hawkins,¹³³ whose work made a significant contribution to the scholarship on sociological theories of regulation, declares, even though enforcement by punitive sanctions is a strategic tool of last resort where other regulatory measures have failed to secure compliance,¹³⁴ the formal machinery of the criminal law is appropriate and should be applied in cases where there is perceived moral blameworthiness in the actions of the violator, where what is really being sanctioned amounts to a "symbolic assault on the legitimacy of the regulatory authority".¹³⁵ The criminal law should, also, apply in cases where there are 'criminal acts of dishonesty'¹³⁶ leading to personal or corporate benefit. Although Vizard did not benefit as a result of his insider trading activities, his case, where there was deliberate and repeated dishonest conduct, is certainly a case when criminal proceedings should have been brought.¹³⁷ The same is true of the HIH debacle, where criminal proceedings have been brought. Criminal action should also follow the recent civil penalty proceedings ASIC has instituted in the AWB scandal,¹³⁸ just as it should have followed the civil penalty proceedings that have been issued in the notorious James Hardie case. Regrettably, on 5 September 2008, ASIC announced that it would not be taking criminal

since *Rich v ASIC* (2004) 220 CLR 129; 209 ALR 271 (the *Rich* case), in treating civil penalty proceedings more like criminal proceedings by affording defendants the heightened procedural protections of the criminal law is reducing their allure as an enforcement option. For a discussion of this problem, which the author has identified in her previous work: see, eg, V. Comino, "Civil or criminal penalties for corporate misconduct: Which way ahead?" (2006) *ABLR* 428. See also discussion at n 163.

¹³³ Hawkins, above n 12.

¹³⁴ *Ibid*, pp xii- xiii.

¹³⁵ *Ibid*, p 205. Here, Hawkins identifies two types of culpable conduct which invite the regulatory agency's ultimate sanction, namely serious one-off cases and 'the bad' cases, the malicious and the obdurate who have resisted the legitimate efforts of the agency to enforce its legal mandate. This approach is, of course, consistent with strategic regulation theory and pyramidal enforcement with strategic regulation theory forming part of the sociological theories of regulation.

¹³⁶ In the language of the *Cooney* Committee, above n 119, pp 188 and 191, this conduct can be equated with the most serious contraventions, those 'genuinely criminal in nature', that is, where company directors acted 'fraudulently' or 'dishonestly', recommending that criminal sanctions apply in such cases.

¹³⁷ In the words of Finkelstein J in *ASIC v Vizard* (2005) 54 ACSR 394 at [43] 405: "The defendant was a director of Telstra, one of Australia's largest companies. He owed his position to the belief that he was honest and capable. Highly confidential information came his way in his capacity as a director. He used that information for the purpose of benefiting himself and his family. This was both dishonest and a gross breach of trust. Not only that, the defendant well knew that what he was doing was wrong. His breach of trust was carefully concealed and only discovered by chance. Everything was done for personal gain...It was only because of the vagaries of the marketplace that the defendant did not realise his gain."

¹³⁸ See discussion, above n 100.

proceedings against former James Hardie directors and executives over the asbestos scandal.¹³⁹ Interestingly, this decision does not seem to have caused the resentment or criticism surrounding ASIC's failure to prosecute Vizard or the public outrage relating to James Hardie's controversial restructure and disastrous compensation scheme in 2001 that turned out to be under-funded by about \$ 2 billion.¹⁴⁰ Part of the reason could be that provided by ACTU secretary, Jeff Lawrence, who was reported as saying:

While it was 'preferable' that the perpetrators had also faced criminal charges, unions hoped 'substantial penalties' would result from the civil case. *The most important thing is that funding has been secured to asbestos victims*, this has always been the primary focus.¹⁴¹

Vizard

In the Vizard case, the puzzling question must be posed: why wasn't the decision to launch a criminal prosecution made when the evidence seems to support that Vizard was guilty of insider trading? As far as the civil penalty proceedings ASIC issued against him are concerned, Vizard confessed to insider trading.¹⁴²

ASIC has said that the decision not to pursue a criminal case was not theirs, but was "entirely up to the federal Director of Public Prosecutions",¹⁴³ who stated that "it did not have enough

¹³⁹ See discussion, above n 99.

¹⁴⁰ The under-funding by this amount was one of the findings of the 'Jackson report', which is discussed, below n 202.

¹⁴¹ See M. Jacobs, "Civil case only for ex-Hardie people", *The Weekend AFR*, 6-7 September 2008, p 2 (emphasis added).

¹⁴² On 4 July 2005, when ASIC announced its decision to bring civil penalty proceedings, it issued a media release: see *Media Release* above, n 90, stating: "ASIC has filed a Statement of Agreed Facts with the Federal Court of Australia in which Mr Vizard agrees with the facts that give rise to the allegations. Mr Vizard has agreed with ASIC that it is appropriate for the Federal Court to declare that he contravened his duty to Telstra in using the Telstra information". Although Vizard tried to deny his insider trading confession: see B. Speedy, 'Vizard denies insider trading confession', *The Australian*, 18 July 2005, p 29, he later cooperated with ASIC and admitted his insider trading in telecommunications shares: see earlier discussion at n104.

¹⁴³ See Speedy, above n 142. Even though ASIC focusses on serious breaches of corporate law and is the primary investigative body in relation to complex criminal matters involving corporate law with the power to prosecute matters arising under the *Corporations Act*, this is, of course, in accordance with current arrangements between ASIC and the DPP where major offences are generally prosecuted by the DPP: see Memorandum of Understanding (MOU) between the DPP and ASIC dated 1 March 2006, which is available on the ASIC website. This MOU replaces the original MOU between the DPP and ASIC dated 22 September 1992, which is expressed to be "to substantially the same effect".

evidence to institute a criminal charge".¹⁴⁴ The DPP would not prosecute Vizard in the absence of a signed witness statement from his accountant, Greg Lay, who refused to provide one. This is despite the fact that Lay had already given sworn evidence to ASIC concerning Vizard's insider trading activities and could have been compelled to testify against Vizard - although not himself - under the *ASIC Act* 2001 (Cth) (the *ASIC Act*), s 19.

Interestingly, Tony Hartnell, a former ASIC chairman, was reported at the time as saying that:

a major problem is that prosecutors refuse to use that section of the *ASIC Act*. The criminal procedure acts of the various states which do require signed witness statements are not in line with the federal law. The DPP simply ignores the federal legislature. That section about compulsory examination may as well be removed from the Act.¹⁴⁵

This raises an important structural dilemma regarding enforcement for ASIC. While it enjoys a good relationship with the DPP,¹⁴⁶ consideration ought to be given to ASIC, like the SEC,¹⁴⁷ developing its own prosecutorial arm to ensure that a more consistent approach to decision-making, more particularly whether to institute criminal proceedings, could be achieved. It seems that at present, as evidenced by the DPP's refusal to prosecute Vizard in the absence of a signed witness statement, which is consistent with past actions,¹⁴⁸ that the DPP has high prosecution

¹⁴⁴ See J. Hewett, 'Two men and a case to answer', *AFR*, 23-24 July, p 20.

¹⁴⁵ Ibid, quoting Hartnell.

¹⁴⁶ See Gilligan, Bird and Ramsay, above n 4, pp 38-42. Their research found that the relationship at the time (mid-1998) was positive across the regions, although there was some variation. See also J. Farrar, *Corporate Governance: Theories, Principles, and Practice* (3rd ed), Oxford University Press, Melbourne, 2008, pp 315-320. Farrar explains how the differing attitudes of ASIC and the DPP have, in the past, resulted in relations between the two organizations becoming strained, although he believes that the relationship has since settled down. ASIC sees its character as commercial and professional, clearly having an affinity with commerce, which is in contrast to the legal culture of the DPP, whose primary role is criminal law investigations and prosecutions. Tensions reached crisis proportions in September 1992, after Michael Rozenes of the DPP criticised Hartnell, then ASIC Chairman, as the 'gentleman regulator' who preferred to focus upon easier civil actions rather than harder criminal prosecutions, which led to the then Attorney-General, Michael Duffy intervening and issuing a written direction telling both parties to co-operate in the prosecution of serious criminal offences. An MOU was signed, dated 22 September 1992, detailing the close consultative steps involving ASIC and the DPP right from the start of an investigation and making it clear that the decision whether ASIC could lay criminal charges rested with the DPP. This MOU has been replaced by a new MOU: see discussion, above n 143.

¹⁴⁷ But see earlier discussion at n 116 in relation to the enforcement of violations of securities laws in the US, where the SEC and Department of Justice cooperate in this area.

¹⁴⁸ This problem of the DPP's general insistence on a signed witness statement before it will prosecute has been long recognised: see, eg, J. Longo, "ASIC powers -where to from here?" (2001) 21 *Australian Corporate News* 385 at 386. Longo was the National Director of Enforcement of ASIC until March 2000.

standards, essentially requiring proof beyond *any* doubt, not reasonable doubt.¹⁴⁹ The DPP also appears reluctant to prosecute technical corporate offences where the facts are often complex and where the maximum sentence for a successful prosecution is only five years,¹⁵⁰ preferring instead to concentrate its efforts on other types of criminal behaviour that can be dealt with under state laws, which carry longer sentences.¹⁵¹ This also raises a significant issue requiring serious consideration namely, whether there is a need to increase the maximum jail time for corporate crime under the *Corporations Act*? In spite of the opposition that would undoubtedly be mounted by business groups in the community to any increase, Adler's sentencing, for instance, to four-and-a-half years¹⁵² and release from jail after only two years, seems completely inadequate. The punishment does not fit the crime.

Although this issue did not arise in the Vizard case, another important concern regarding criminal proceedings for corporate crime under the *Corporations Act* is the requirement that those proceedings be instituted within a period of five years from the date of the act or omission alleged to constitute the offence, although the Minister has the power to extend that time.¹⁵³ As Alan Cameron, another former ASIC chairman points out:

It is not at all clear what the philosophical justification for such a limitation is in the corporate context when that is just the sort of crime that tends to be discovered later and the proof of such matters eventually turns more on documents and other physical evidence, and where some at least of the putative defendants are the ones who control the documents and have the capacity to cover up their abuses for years.¹⁵⁴

The author agrees that:

¹⁴⁹ It should be noted, however, that Longo has explained that generally the reason that the DPP will not decide to prosecute in the absence of signed statements from material witnesses even where a signed transcript of that person's evidence on oath is available under the *ASIC Act*, s 19, is because it is not in a form that can be included in a hand up brief, since it could contain inadmissible evidence. Accordingly, another solution is to enact reforms to strengthen ASIC's powers to compel any witness who has given evidence in an examination to sign a written statement of that evidence so that it can be used in the prosecution process as were proposed (but not proceeded with) by the *Financial Services Reform Bill 2000* (Cth).

¹⁵⁰ See *Corporations Act*, s 1311 and Sch 3.

¹⁵¹ See, eg, *Criminal Code Act 1899* (Qld), s 408C, which deals with fraud, where offenders may be liable to imprisonment for ten years in certain circumstances.

¹⁵² See ASIC, 'Rodney Adler sentenced to four-and-half years' jail', *Media Release 05-91*, 14 April 2005. See also *R v Adler* (2005) 53 ACSR 471 and *Adler v R* (2006) 57 ACSR 675, where Adler's appeal against this sentence was dismissed by the NSW Court of Criminal Appeal.

¹⁵³ See the *Corporations Act*, s 1316.

¹⁵⁴ See A. Cameron, 'Enforcement, Getting the Regulatory Mix Right' (1994) 4 *Aust Jnl of Corp Law* 121 at 123.

The lack of a statute of limitations ensures in the case of other kinds of crime that there is no reward for those who are capable of successfully concealing their criminal acts or omissions for any period of time. The same should be the case for corporate crime.¹⁵⁵

As far as Vizard is concerned, even though the civil penalty proceedings ASIC brought against him were ultimately successful and resulted in him being banned for ten years from managing a corporation and ordered to pay pecuniary penalties of \$390,000,¹⁵⁶ the overwhelming view seems to be that ASIC and the DPP went soft on Vizard.¹⁵⁷

However, with ASIC maintaining that its insider trading file on Vizard remains open, it will be interesting to see if criminal charges will be laid in the future. Vizard's accountant, Lay, provided evidence as a witness in the civil proceedings that Westpac brought against Vizard's former bookkeeper, Roy Hilliard, to recoup nearly \$3 million it repaid to Vizard.¹⁵⁸ Lay told the

¹⁵⁵ Ibid.

¹⁵⁶ See *ASIC v Vizard* (2005) 54 ACSR 394. On the issue of disqualification, even though ASIC had requested a five-year ban in the light of Vizard's admission of his wrongdoing and the contrition he expressed: see earlier discussion at nn 104 and 142, Finkelstein J at [47]-[48] found that: "disqualification for 5 years is not sufficient. I appreciate that I need not be too concerned with specific deterrence. The defendant's very public disgrace suggests that it is unlikely that he will be given the opportunity of again becoming a director of a sizeable publicly listed company. In any event, it is common ground that he is unlikely to offend again. My real concerns here are with punishment for retributive purposes and general deterrence, but principally the latter. Indeed general deterrence is of primary importance in cases of this kind. A message must be sent to the business community that for white collar crime "the game is not worth the candle", to use the language of a Canadian judge, McDermid JA, in *R v Jaasma* (1976) 1AR 553 at 555". On the other hand with respect to the pecuniary penalties, Finkelstein J at [44]-[45] thought that although Vizard's actions were "within the category of a worst case for an offence of this type. Nonetheless it would be inappropriate to impose something close to the maximum pecuniary penalty (\$200,000) for each contravention. First to impose the maximum penalty would be to ignore those factors that the law says should be taken into account in sentencing. Here the significant factors are the public disgrace which has been suffered by the defendant and his family, the genuine and unreserved contrition expressed by the defendant and the admissions made by him, which in this case certainly saved the time and expense of what might otherwise have been a rather lengthy trial. Second, there is the submission by ASIC, supported as it is by the defendant, that the appropriate penalty for each offence is \$130,000. The cases, including decisions of the Federal Court in *NW Frozen Foods Pty Ltd v Australian Competition and Consumer Commission* (1996) 71 FCR 285; 141 ALR 640 and *Australian Competition and Consumer Commission v Colgate-Palmolive Pty Ltd* (2002) ATPR41-880; [2002] FCA 619, hold that I should not depart from the penalty recommended by the parties unless it is clearly out of bounds". He went on to criticize the proposed penalty as "low" and said that: "Left uninstructed I would have imposed a higher penalty, but not substantially different from that suggested", although he added: "If this penalty is insufficient, parliament should increase the maximum", suggesting that it may require review.

¹⁵⁷ See, eg, J. Mc Cullough, 'One law for rich, another for richer', *The Courier Mail*, 30-31 July 2005, p 27. Mc Cullough wrote: "[H]ere is Steve Vizard, clearly an insider abusing a position of trust, potentially many times - not just once - and he gets a slap on the wrist."

¹⁵⁸ Vizard testified that he trusted Hilliard with his financial affairs, and alleged the bookkeeper embezzled the money by writing unauthorised cheques on his companies' accounts. Hilliard claimed that he was acting on Vizard's instructions to set up a secret stash of cash for his former boss: see, eg, R. Glyas, 'Back off' on Vizard accounts, *The Australian*, 9 September 2006 at <<http://www.theaustralian.news.com.au/story/0.20867.20378989-2702.00html>>.

Victorian Supreme Court on 8 September 2006, that share trading by the vehicle, known as Creative Technology Investments (CTI), was made under instruction from Vizard, thus connecting Vizard to the shelf company that was used to hide his illegal investments in companies connected to Telstra.¹⁵⁹ Further, Lay said that CTI was structured to give Vizard “a level of confidentiality”.¹⁶⁰ Lay’s previous silence and refusal to sign a witness statement had been the reason why the DPP had not originally brought a criminal charge against Vizard.¹⁶¹ Presumably ASIC could now prevail upon Lay to provide similar evidence against Vizard in a criminal case and it should in such a high profile case, where there was deliberate and repeated dishonest conduct, to prove that it is a serious regulator.¹⁶²

James Hardie and *AWB* are undoubtedly other important cases, where the public will be looking very closely, not only at the outcome of ASIC’s civil penalty proceedings, but in the case of *AWB*, whether it also institutes any criminal actions.¹⁶³ This is especially so as ASIC appeared, even before the current financial crisis, to come under mounting pressure to adopt a tougher approach to enforcement. Pressure built as a result of a spate of property developer collapses, namely of Westpoint,¹⁶⁴ Fincorp¹⁶⁵ and Australian Capital Reserve (ACR),¹⁶⁶ although they all

¹⁵⁹ See E. Johnston and Phillips, ‘Lay links Vizard to hidden share deals’, *AFR*, 9-10 September 2006, p 3.

¹⁶⁰ *Ibid.*

¹⁶¹ See discussion, above n 144.

¹⁶² But note the statute of limitations discussed, above n 153, may preclude ASIC from bringing a criminal case. As time progresses, the likelihood of ASIC bringing criminal proceedings against Vizard appears increasingly remote.

¹⁶³ See earlier discussions at nn 99-100. The hearing of the substantive case in the *James Hardie* matter commenced on 29 September 2008 in the NSW Supreme Court before Gzell J and is yet to be concluded. But see, eg, *Macdonald v Australian Securities and Investments Commission* (2007) 65 ACSR 299; [2007] NSWCA 304. Unfortunately, this case involving one of 12 defendants in the civil penalty proceedings brought by ASIC against James Hardie and its former directors and executives does not appear to bode well for ASIC’s use of civil penalties as an effective law enforcement mechanism in dealing with James Hardie or any other matter in the future, providing as it does further evidence since the High Court decision in the *Rich* case of the embrace of the rules of criminal procedure in civil penalty proceedings. For a fuller discussion of this case and its ramifications for ASIC on the use of civil penalty proceedings: see P. Spender, “Negotiating the third way: Developing effective process in civil penalty litigation” (2008) 26 *CASLJ* 249.

¹⁶⁴ Westpoint, which raised funds for property development projects offering high returns to unsophisticated investors, collapsed in February 2006 owing about \$300 million to about 4,000 investors.

¹⁶⁵ Administrators were appointed on 23 March 2007 after the Fincorp group of companies, which specialised in property development and investments and which raised funds from the public to carry out these activities through ‘first ranking notes’ (First ranking notes were notes issued by Fincorp secured over its assets by a floating charge) and ‘unsecured notes’ (Unsecured notes were issued by Fincorp but not backed by any charge or other security) collapsed, owing over \$200 million to note holders. There were about 8,000 investors in Fincorp in first ranking notes and unsecured notes.

¹⁶⁶ ACR, which was placed into voluntary administration on 28 May 2007, was a property development financier that used a similar business model to that of Fincorp, raising money from the public through “Deposit Notes”. Deposit Notes are unsecured notes issued by ACR, the repayment of principal and interest of which rank behind

involved high risk investments, and the spectacular collapse of stockbroking firm, Opes Prime.¹⁶⁷ Commentators hoped for a change in direction under ASIC's new chairman, Tony D'Aloisio, a former ASX Ltd chief executive.¹⁶⁸

ASIC, with D'Aloisio at its helm, should focus its efforts on rigorously enforcing the law rather than continue to allow itself to be exposed to the criticism that it fails to do so, as happened under the chairmanship of Jeffrey Lucy.¹⁶⁹ One of the ways that ASIC can do this is to ensure that it uses the criminal law in the enforcement pyramid, underlying Pt 9.4B, to punish corporate misconduct in serious cases, especially against high profile wrongdoers and thus prove that it is a serious regulator, crucially portraying an 'image of invincibility'.¹⁷⁰

'Image of invincibility'

Ayres and Braithwaite also consider the question of how regulatory agencies, such as ASIC can project an image of invincibility to organisations that may be more powerful than themselves.¹⁷¹ Interestingly, they take the talents of the Australian sheep- dog or cattle- dog, who can exercise "unchallenged command over a large flock of sheep or herd of cattle every member of which is

repayment of secured debt by ACR and equally with other unsecured loans owed by ACR. ACR had issued approximately \$330 million of Deposit Notes to about 7,000 investors.

¹⁶⁷ Opes Prime collapsed in April 2008, where high drama has featured in some of the events surrounding it, which read more like a murder mystery than a corporate collapse, including the visit by notorious underworld figure Mick Gatto (Gatto is a former Carlton crew gang member and was acquitted in 2005 over the shooting of Melbourne hitman Andrew "Benji" Veniamin) who went to Singapore shortly after its collapse to meet with its Singapore-based Opes Prime-related directors, Gordon Browne, Jay Moghe and Raj Maiden in an attempt to recover his unnamed client's millions: see, eg, K. Nicholas, 'It's underwater or underworld: Mick Gatto' *AFR*, 10 April 2008, p 25. While Nicholas reports that Gatto emphasised that none of his money recovery methods involved taking on women and children, as some in Singapore had feared, he (Gatto) said: "There are people that are very nervous and worried. I guess that was the intention we wanted to put across, although we don't intend on causing any harm. But we certainly don't mind them being a little bit nervous because they will be honest and truthful with us and hopefully we will get a result".

¹⁶⁸ See, eg, R. Harley, 'Collapse! Why more investors are taking the fall: Regulators are under pressure as more innocent investors get burned', *The Weekend AFR*, 2-3 June 2007, pp1, 21-23.

¹⁶⁹ See, eg, M. Drummond, "Gentler ASIC steady as he goes", *AFR*, 11 May 2007, p 81.

¹⁷⁰ This expression is used by Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 44. The newly elected Labor government's announcement in February 2008 to reverse its election commitment to cut ASIC funding by \$111 million and maintain enforcement funding for 2007-08 and 2008-09 is good news, which may assist ASIC in this course.

¹⁷¹ See *ibid*, pp 44-7.

bigger than herself”,¹⁷² and who can force the retreat of a man, even a man with a knife- when the man is bigger, more intelligent, and more lethally armed, as their starting-point:

The first point to make about the regulatory accomplishments of the dog is that dogs are delightfully friendly to other creatures who cooperate with them. Second, dogs are convincing at escalating deterrent threats while rarely allowing themselves to play their last card. They bark so convincingly that a bite may seem more inevitable and terrifying than it is. And they know how to escalate interactively - in way that is strategically responsive to the advance and retreat of the intruder. Friendliness can turn to a warning bark, then a more menacing growl, posture and raising of fur transforms her - she is bigger and seems ready to pounce, teeth are bared, slightly at first, the dog advances slowly but with a deliberateness that engenders irrational fears that a sudden rush will occur at any moment. The dog’s remarkable regulatory strategies are based on TFT strategy (the intruder will be extended friendliness when reintroduced as a friend; the sheep will be protected, led to food and drink when they cooperate). The success is also based on finesse at dynamic interactive deterrent escalation, and at projecting an image of invincibility.¹⁷³

Although Ayres and Braithwaite acknowledge the problems which arise in achieving the same degree of finesse in the area of human regulation, they draw on some empirical work for a number of suggestions. The first suggestion results from Hawkins’ important study of British water pollution control.¹⁷⁴ While these water boards were anything but benign big guns in reality, their field officers played a game of regulatory bluff. The fines that flowed from prosecution were actually puny, yet they were dealt with by a degree of misrepresentation of the awful consequences of prosecution and by inspectors alluding to adverse publicity and the humiliation of a court appearance, instead of concentrating on the fines. Accordingly, the image to be built up and reinforced is for regulators “to display the enforcement process as inexorable, as an unremitting process, in the absence of compliance, towards an unpleasant end”, even in cases where there may be a weak relationship between the reality and the image of the enforcement powers of regulatory agencies as benign big guns.¹⁷⁵

¹⁷² Ibid, p44. Ayres and Braithwaite explain that they are not interested in how this is accomplished in terms of the genetic endowments, rational calculation, or human training of the dog, but rather, they are interested in the strategic effects through which it is accomplished.

¹⁷³ Ibid.

¹⁷⁴ See Hawkins, above n 12.

¹⁷⁵ See Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 45. Ayres and Braithwaite refer to the costs of managing such an appearance, including in backsliding and cross-negotiation to extricate the agency from the risk of

As far as ASIC is concerned, however, unlike the British water boards, it has important enforcement powers at its disposal,¹⁷⁶ so it is really a question of examining the way ASIC handles the vital tests of its strength- how it handles its ‘Cuban missile crisis’, its ‘Vietnam’ and how it picks the ‘right case’ to show that the law has ‘teeth’ that is significant in constructing an image of invincibility.¹⁷⁷ Although ASIC has taken action in some important and high profile cases, perhaps most notably the criminal proceedings it has issued in relation to the HIH disaster, its handling of other matters is undermining this image of invincibility. They include the failure to instigate a criminal case against Vizard, the length of time it is taking to deal with John David (Jodee) Rich and Mark Silbermann in the long-running One.Tel proceedings¹⁷⁸ and criticism generally for “being on the backfoot”¹⁷⁹ in failing to act to prevent the collapses of Westpoint, Fincorp and ACR. It is interesting that all this criticism pre-dated the current financial crisis and resulting global meltdown, where now, more than ever, it is important for ASIC to be seen to act appropriately to try to restore confidence in what is the worst financial crisis since the Great Depression.

Projecting the pyramid of enforcement

In addition to ASIC demonstrating that it will escalate to serious levels of response in the enforcement pyramid by using criminal sanctions in appropriate cases and building an ‘image of invincibility’, it is also useful *if* pyramidal enforcement is to guide the design of ASIC’s enforcement strategies and practice to ensure that the pyramid is clearly projected to all participants.¹⁸⁰ Regrettably, the suggestions made by Dellit and Fisse in 1994 about how this could be achieved have largely not been followed. Those suggestions include amending the

an appeal or an unsuccessful prosecution. They also raise the problem of whether a regulatory agency could sustain such a fragile image of invincibility in a more litigious business regulatory culture, such as in the United States.

¹⁷⁶ But note the problems associated with the *ASIC Act*, s 19, discussed above nn 144-145, that bedevilled ASIC’s ability to bring a criminal case against Vizard. Additionally, ASIC’s investigation and enforcement powers are narrower than some of its foreign counterparts, such as the SEC, where there is arguably a case for its powers to be expanded to achieve improved enforcement action: see T. Middleton, “ASIC’s investigation and enforcement powers-current issues and suggested reforms” (2004) 22 *C & S LJ* 503.

¹⁷⁷ See Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 46.

¹⁷⁸ See later discussion at nn 221- 226.

¹⁷⁹ See, eg, J. Collett, “Human cost of ASIC failures”, *The Sydney Morning Herald*, 6 June 2007, p 8; and P. Manning, “Danger do not enter”, *AFR*, 21 July 2007.

¹⁸⁰ See also Dellit and Fisse, above n 26, p 593.

Corporations Act to manifest the pyramid, preferably by adding a new division which outlines an enforcement strategy and which lays down the groundwork for implementing it, and revising the DPP Prosecution Policy so that it also reflects a strategy of pyramidal enforcement, as well as, making sure that the strategy is projected by and within ASIC.¹⁸¹

Problems of moving up and down the pyramid in practice

The importance of having access to a range of sanctions which is, of course, the position under the Pt 9.4B pyramid to achieve responsive regulation is highlighted by Ayres and Braithwaite. If the regulated are being cooperative, the regulator should respond by being cooperative, but if the regulated are being uncooperative, the regulator should escalate up the pyramid. On the other hand, they argue that small-scale punishment of each infringement by fines described as ‘fleabites’ is the least effective means of regulation since it reduces the willingness of the regulated to do the right thing without the regulator having access to effective threats or sanctions.¹⁸² They also argue that there are problems if the regulator is armed with a single enforcement tool, particularly when that tool is potent, for example, the power to withdraw or suspend licenses. When the sanction is such a drastic one, it is politically impossible and morally unacceptable to use it except with the most extraordinary offences so that regulators:

often find themselves in the situation where their implied plea to ‘cooperate or else’ has little credibility. This is one case of how we can get the paradox of extremely stringent regulatory laws causing under-regulation.¹⁸³

Difficulties, however, can arise with the practice of regulators like ASIC. Moving up and down the regulatory pyramid is not as easy in practice as it seems.¹⁸⁴

In its review of the use of civil and administrative penalties in the federal sphere, the ALRC noted Fiona Haines’ argument that “escalation of sanctions, while appearing reasonable to the regulator, can prompt companies to move to reduce their vulnerability to scrutiny and

¹⁸¹ Ibid, pp 593-6.

¹⁸² See Ayres and Braithwaite, *Responsive Regulation*, above n 8, p 49.

¹⁸³ Ibid, p 36.

¹⁸⁴ See also ALRC, Background Paper 7, “Review of civil and administrative penalties in federal jurisdiction”, *Penalties, Policy, Principles and Practice in Government Regulation*, Conference, Sydney, 7-9 June 2001, p. 10.

liability”.¹⁸⁵ But, of greater significance are the approaches of Christine Parker and Malcolm Sparrow. According to Parker, with whom the author agrees, in order to improve the practice of regulation, regulators must appreciate why and how contraventions occur and the practices and constraints that may be used to encourage compliance:¹⁸⁶

A sophisticated compliance analysis of regulation implies a sophisticated understanding of the target population. What will make compliance difficult for them? What will motivate them to want to comply? What technical changes will compliance mean for their business or manufacturing processes? What financial impacts will compliance have? This level of understanding of the target population is unlikely to be achieved without significant consultation with, listening to, and research of members of target populations.¹⁸⁷

In this regard, some interesting comments have been made concerning ASIC’s failure to prevent the property collapses of Westpoint and Fincorp. While there is the view that investors cannot expect to be protected from their own greed or stupidity:¹⁸⁸

the common strand through both these cases is that the securities regulator was on notice that all was not well at the companies involved, and even took action against them.¹⁸⁹ In such cases, it should not be too much to expect ASIC *to keep a closer watching brief*. ASIC also seems to be *quarantined from market intelligence*.¹⁹⁰

The announcement by D’Aloisio on 8 May 2008, relating to the restructure of ASIC following its recent strategic review, aimed at making it “closer to the market”,¹⁹¹ is therefore to be

¹⁸⁵ Ibid, citing F. Haines, *Corporate Regulation: Beyond Punish or Persuade*, Clarendon Press, Oxford, 1997, p 219.

¹⁸⁶ Ibid, citing C. Parker, *The State of Regulatory Compliance: Issues, Trends and Challenges*, PUMA/REG (99) 3 Report prepared for the OECD Public Management Committee, p 51.

¹⁸⁷ Ibid.

¹⁸⁸ See, eg, “Fincorp shows ASIC needs more intelligence”, The Editorial to the *Weekend AFR*, 31 March-1 April 2007, p 62. Westpoint investors were offered a “fixed” return of 6 percentage points above bank deposit rates, a margin that should have reminded them of the old saying that ‘if something sounds too good to be true, it usually is’, while Fincorp was offering up to 8.5per cent on its current debenture issue and up to 10 per cent on past issues to its investors.

¹⁸⁹ For instance, ASIC forced Fincorp to refund \$75 million to investors in 2005 after an argument over the wording of a prospectus. ASIC also put 2 stop notices on another prospectus, but later revoked them in 2006.

¹⁹⁰ “Fincorp shows ASIC needs more intelligence”, above n 188 (emphasis added).

¹⁹¹ See A. Jury, “Chanticleer- Regulator tries to reinvent itself”, *AFR*, 9 May 2008, p 76. Key changes to ASIC include more investment in market research and analysis and the appointment of an external panel drawn from business to advise it on market developments and potential systemic issues. Commenting on the bid by ASIC to bring in fresh talent from the private sector so as to make it “an equally aspirational employer as the SEC, one that bright and promising professionals (such as lawyers and investment bankers or accountants) might be happy to work at for a few years in return for a prized entry in their resumes”, where 54 senior positions have been cut to 41,

commended . Hopefully it should go some way in helping ASIC to better fulfill its role as enforcer and regulator.¹⁹² A number of ‘outwardly focused stakeholder teams’ targeting particular areas, including retail investors and consumers, investment managers, investment banks, superannuation funds and financial advisers, have replaced the former ‘silo directorates’, where the intention has been to replace “cumbersome, bureaucratic, process-oriented units with smaller, flexible customer-centric ones”.¹⁹³ An important part of this has been the creation of eight deterrence (enforcement) teams, each of which is tasked with specific responsibilities such as insider trading, market manipulation and fraud, which have replaced the single large Enforcement directorate.¹⁹⁴

In his work, Sparrow, like Parker, also focusses on regulatory practice, identifying ‘problem solving’ as a fundamental part of regulatory reform.¹⁹⁵ Sparrow contends that regulation is most effective when enforcement operations are based on an explicit ‘risk control’ strategy.¹⁹⁶ This approach involves identifying patterns or risks of non-compliance, emphasizing risk assessment in allocating resources, and developing an organizational culture which allows the regulator to develop creative, ‘tailor-made’ solutions to identified problems and to creatively use an array of tools to procure compliance while recognizing the need to retain enforcement as the ultimate threat.

Importantly, research has found that the effectiveness or threat of a sanction is affected by the size, power and culture of the organization.¹⁹⁷ Negative publicity, for instance, seems to be the

Jury rightly states that this is only possible if the ASIC experience is regarded as “a badge of honour rather than a mark of shame. In other words, the perception of the regulator needs to lift”.

¹⁹² But note that previous attempts by ASIC to improve its workings have not always met with success. The expansion of the Compliance directorate “to give greater emphasis to real-time regulation” in 2006, for instance, did not prevent further or similar collapses. The Compliance directorate was expanded in the aftermath of the Westpoint collapse and criticism that ASIC could have prevented the massive losses from it if it had been more proactive: see ASIC, “Working for Australia: ASIC Annual Report 2005- 06”, *Media Release 06- 378*, 31 October 2006.

¹⁹³ See Jury, above n 191.

¹⁹⁴ Ibid.

¹⁹⁵ M. Sparrow, *The Regulatory Craft: Controlling Risks, Solving Problems and Managing Compliance*, Brookings Institution Press, Washington DC, 2000, p 100. The term ‘problem solving’ is intended to be interchangeable with ‘risk control’ or ‘compliance management’. Besides a problem-solving approach, a focus on real results (ie, not just productivity measures) and investment in collaborative partnerships are the other two main elements of regulatory reform identified by Sparrow.

¹⁹⁶ Ibid, p 269.

¹⁹⁷ See, eg, ALRC, Background Paper 7, above n 184, p13.

most effective sanction as far as large corporations are concerned.¹⁹⁸ This point is well illustrated by what transpired in the James Hardie controversy. At the time when the James Hardie Group restructured in 2001, which resulted in the liability-ridden subsidiaries¹⁹⁹ being cut adrift from the parent company and the group²⁰⁰ and the establishment of a special purpose fund known as the Medical Research and Compensation Foundation (MRCF) to manage the payment of asbestos related claims against the subsidiaries,²⁰¹ and, even later, when it became apparent that the MRCF would not have sufficient funds to pay all likely future claimants, James Hardie was adamant that it had taken all proper steps in establishing the Foundation and that further substantial funds beyond the initial funding of around \$293 million would not be made available to the Foundation. Therefore, without the adverse publicity and public outcry surrounding its corporate reconstruction, the clear under-funding of the Foundation, which led in February 2004 to the New South Wales government setting up a Special Commission of Inquiry, and the negative findings of that Inquiry,²⁰² as well as the involvement of the Australian Trade Union

¹⁹⁸ Ibid. The Environmental Defenders Office expressed to the ALRC that reputation was extremely important to large public companies. Yet, in the area of environmental protection, it reported that many of the worst offences were committed by ‘fly by night’ companies, who offend, get caught and then reappear in different forms: Environmental Defenders Office, *Consultation*, Sydney, 7 December 2000. See also Grabosky and Braithwaite, *Of Manners Gentle*, above n 12, pp 216-7. On a related issue, this study found that one of the main reasons that most Australian regulatory staff believe large firms are more law-abiding than small business is because of their increased sensitivity to publicity. Another reason is that they have the resources to employ compliance personnel. Such findings are not new and have international counterparts: see, eg, J. Black, ‘Managing Discretion’, Conference Paper to ALRC Conference, above n 184, p 12.

¹⁹⁹ The subsidiaries, Amaba Pty Ltd and Amaca Pty Ltd, were the companies in the James Hardie Group that were involved in the manufacture and sale of asbestos, which gave rise to ‘long-tail’ liabilities to asbestos victims.

²⁰⁰ Part of the corporate restructure involved the James Hardie Group entering into a scheme of arrangement to move control from Australia to the Netherlands and set up as a Dutch company that took with it \$1.9 billion in assets from the Group: see discussion in Farrar, *Corporate Governance*, above n 146, p 511, where Farrar also points out that the Netherlands does not have a treaty with Australia for the enforcement of civil court judgments. See also *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549; 7 ACLC 841. This case shows the effect of the doctrine of the separate legal personality of companies, established by *Salomon v Salomon & Co Ltd* [1897] AC 22, on tort claimants. In order for Mr Briggs, who had contracted asbestosis to be able to sue the parent company in circumstances where the subsidiary which employed him was insolvent, he would have been required to pierce the corporate veil separating it from its subsidiary. However, while the New South Wales Court of Appeal raised the possibility that different considerations should apply where the claim arises in tort, in contrast to a person voluntarily agreeing to deal with a company as occurs in cases of breach of contract, unfortunately the court was not required to reach a final decision on this matter.

²⁰¹ MRCF was set up as a separate entity not related by shareholding or in any other way to the other companies in the James Hardie Group.

²⁰² The Special Commission of Inquiry handed down its report in September 2004: see D.F. Jackson, QC, ‘Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation’, September 2004 (the Jackson report). This report is available online at < <http://www.cabinet.nsw.gov.au/hardie/PartA.pdf> > (accessed on 2 June 2005). Significantly, the Jackson report found that: James Hardie had under-funded the MRCF by about \$2 billion; having pocketed the proceeds, James Hardie had the capacity and moral obligation to compensate the victims; James Hardie made misleading and deceptive statements in regard to the establishment of the Foundation;

movement in the matter, it is doubtful that the James Hardie Group would have taken the necessary steps to ensure that asbestos victims would be adequately compensated. This only occurred on 7 February 2007,²⁰³ when the directors proposed to the shareholders of the parent Dutch company, JHINV,²⁰⁴ in general meeting, and the shareholders voted to accept, a plan where the group would provide \$4 billion over the next 40 years to fund claims against the former subsidiaries. The enormous amount of adverse press, no doubt, also, put political pressure on ASIC to take enforcement action against James Hardie and a number of its former directors and officers.²⁰⁵

The same sort of observations might be made of Richard Pratt's willingness to reach a settlement with the ACCC in the highly publicized cartel case against him and Visy. The desire to minimize the reputational damage suffered by him and his company as a result of this litigation seems to have been a very significant factor in settling the civil penalty proceedings and Pratt making a public apology.²⁰⁶ It was not enough, however, to prevent the ACCC pursuing Pratt and

this conduct required investigation by Commonwealth authorities; and serious questions were raised about the conduct of a number of professional firms.

²⁰³ In December 2005, James Hardie Industries NV (JHINV) and James Hardie 117 Pty Ltd had entered into an agreement to provide long term funding for compensation arrangements for victims of asbestos-related diseases in Australia with the New South Wales Government and the Asbestos Injuries Compensation Fund Limited, as trustee for the Asbestos Injuries Compensation Fund, which was amended on 21 November 2006 (Final Funding Agreement). But this agreement, which occurred against a background of a threat by the New South Wales government to pass legislation to unravel the restructuring of the Group if no settlement was reached was also subject to conditions precedent (referred to in JHINV's announcement to the ASX dated 1 December 2005), including shareholder approval.

²⁰⁴ Part of the 2001 corporate reconstruction of the James Hardie Group concerned the transfer of its jurisdiction of incorporation from New South Wales to the Netherlands.

²⁰⁵ See earlier discussion at n 99. Interestingly, it should be noted that ASIC has recently announced, that, in addition, to not bringing any criminal proceedings against former directors or executives of James Hardie it would discontinue its indemnity claim, which was part of the civil action and which sought an order requiring JHINV to execute a deed of indemnity up to a maximum of \$1.9 billion, or such amount as James Hardie Industries Limited (JHIL) or its directors considered necessary to ensure that JHIL remains solvent, for example, as a consequence of incurring liabilities in regard to asbestos related claims. ASIC has stated that the "need for that claim has been superseded by the Final Funding Agreement becoming fully operational", explaining that when it commenced the civil penalty proceedings in February 2007, that it had indicated to the market that if the conditions precedent to the Final Funding Agreement were satisfied which it now believes have been met, that it would not pursue the indemnity claim against JHINV: see ASIC, "James Hardie Group civil action", *Media Release 08-201*, 5 September 2008.

²⁰⁶ But note that when Federal Court Judge, Peter Heeney, imposed the agreed \$36 million penalty on Visy, he slammed its four years of covert price fixing deals with Amcor and criticized Pratt's apology, which claimed that his breaches of the law arose from a "poor appreciation of the complexities" of the *TPA*, as "hardly consistent with a frank admission of wrongdoing": see G. Barker, "How Pratt could lose his honour", *The Weekend AFR*, 10-11 November, p 3.

subsequently laying a criminal charge against him for allegedly providing false information to it in the course of its investigations.²⁰⁷

Indeed, this paper argues that the culture of an organization plays a central role, not just in relation to the effectiveness or threat of a sanction, but to the ultimate success of regulation. In this regard, the comments of Peter Jopling, QC, counsel for the ACCC in the Visy/Amcor cartel case are telling. He said Visy's culture of non-compliance with the *TPA* at the time ran from "the very top down", stating that "knowledge of the overarching understanding appears to have been restricted to the highest executive levels of the two companies. It was concealed and carefully managed".²⁰⁸ This is despite the fact that Visy had a trade practices compliance program in place and that former ACCC chairman, Allan Fels, had been helping Visy with it since 2006.²⁰⁹ In other words, substantive compliance was lacking even though there were formal compliance mechanisms.

Strategic regulation theory fails to deal comprehensively with the problem of enforcement *within* the corporation

This brings us to a major shortcoming of strategic regulation theory, which as a theoretical model of regulation that primarily deals with sanctions and punishment, fails to deal comprehensively with the problem of enforcement *within* the corporation itself.

Tomasic makes similar criticisms of our current approach to enforcing the provisions of the Australian corporations law, when he argues that corporations law enforcement should be a broader concern than merely focussing on (more effective) external regulation of corporations by regulatory agencies, such as ASIC, which generally behave in a reactive rather than a proactive fashion.²¹⁰ The discovery of corporate breaches is often almost accidental. Regulators rely on

²⁰⁷ See discussion, above n 127.

²⁰⁸ See M. Drummond, "ACCC slams 'blatant' price fixing", AFR, 17 October 2007, p 1.

²⁰⁹ Pratt has also commissioned Fels to advise him and Visy on how to comply with the *TPA* in the future.

²¹⁰ See R. Tomasic, "The challenge of corporate law enforcement: Future directions for corporations law in Australia" (2006) 10 *UWSLR* 1 at 22.

citizen complaints or the press to bring such breaches to their notice.²¹¹ Significantly, Tomasic goes on to argue that the current approach has seen “the adoption of a narrow law enforcement or punishment-based model, rather than of a more organic compliance model of enforcement within the corporation itself”.²¹² The author agrees with Tomasic that ultimately, to effectively cope with the issue of enforcement, closer attention should also be focussed on enforcement within the corporation itself.²¹³ In that way, problems will be recognised earlier and the well-known cycle of corporate collapse and related misconduct that has historically characterized corporate activity in Australia²¹⁴ should be reduced.²¹⁵ This broader approach has also been suggested in the new literature on regulation.²¹⁶

Strategic regulation theory trapped in ‘compliance/deterrence’ dialectic

Black makes another criticism of strategic regulation theory namely, that by concentrating mainly on the use of punishment in enforcement, this approach remains trapped in the ‘compliance/deterrence’ dialectic.²¹⁷ She also argues that it does not really progress the basic types of regulatory tools that governments have at their disposal beyond the familiar financial, legal and informational tools (the carrot, the stick and the sermon).²¹⁸ Moreover, Black believes that by continuing to analyse regulatory strategies simply in terms of ‘punish/persuade’, academics and policy-makers have been distracted from developing such important post-

²¹¹ Ibid, p10. But see ASIC Regulatory Guide 52 [RG52] or Policy Statement 52 [PS 52] *Enforcement Action Submissions* available online at the ASIC website, which sets out ASIC’s general policy on the use of enforcement action submissions. RG 52 is available online at the ASIC website.

²¹² Ibid, p 22.

²¹³ Ibid.

²¹⁴ For a general discussion of the history of corporate collapse in Australia: see, eg, F.L. Clarke, G. W Dean and K. G. Oliver, *Corporate Collapse: Regulatory, Accounting and Ethical Failure*, Revised Edition, Cambridge University Press, Melbourne, 2003.

²¹⁵ Tomasic, “The challenge of corporate law enforcement”, above n 210, p 22.

²¹⁶ See, eg, the work of Parker, who has tried to grapple with the issue of supplementing public regulation with more effective or organic enforcement mechanisms within the corporation itself: see, eg, C. Parker et al (eds), *Regulating Law*, Oxford University Press, Oxford, 2004; C. Parker, ‘Is there a reliable way to evaluate organisational compliance programs?’ in R. Johnstone and R. Sarre, *Regulation: Enforcement and Compliance*, Australian Institute of Criminology, Canberra, 2004, pp 106-118; and C. Parker, *The Open Corporation: Effective Self-regulation and Democracy*, Cambridge University Press, Cambridge, 2002.

²¹⁷ See Black, “Managing Discretion”, above n 198, p 21.

²¹⁸ See Black, “Decentering Regulation”, above n 11, p 126, citing J. Bruijn and E. Heuvelhof, ‘Policy Instruments for Steering Autopoietic Actors’ in R. Veld et al (eds), *Autopoiesis and Configuration Theory: New Approaches to Societal Steering*, Dordrecht, 1991, p 161.

regulatory enforcement strategies as education, consultation, capacity-building and meta-evaluation.²¹⁹

“Punishment is expensive; persuasion is cheap”

On the other hand, it has been argued that one of the strengths of strategic regulation theory having a hierarchy of enforcement options is to encourage settlements and help reduce resort to litigation, especially the well-known costs and delays associated with pursuing criminal cases.²²⁰ Yet, when ASIC has chosen to issue civil penalty actions they are proving not to be the timely and cheap enforcement option it was thought they would provide. The civil penalty proceedings ASIC commenced in December 2001 against the former officers of One.Tel are a good example.²²¹ Even though the proceedings against two of the defendants namely, Keeling²²² and Greaves²²³ were settled, the proceedings against Rich and Silbermann are still to be concluded. The proceedings against these defendants have been the subject of many procedural challenges, including an appeal to the High Court²²⁴ and the hearing of the substantive issue was only completed in August 2007 after 232 hearing days.²²⁵ It has been reported that these proceedings cost ASIC an estimated \$20 million as at May 2006, which was before these defendants actually had their defences tested in court and where ASIC had at the time already been granted special funding twice by the government to keep running the case.²²⁶

Another example of the high costs associated with running a civil penalty case are the costs incurred by ASIC in the civil penalty proceedings brought against investment banking giant, Citigroup Global Markets Australia Pty Ltd (Citigroup). In March 2006, ASIC brought a civil

²¹⁹ Black, “Managing Discretion”, above n 198, p 22

²²⁰ See also Dellit and Fisse, above n 26, p 582.

²²¹ For a detailed discussion of these proceedings: see, eg, Comino, “High Court relegates strategic regulation and pyramidal enforcement to insignificance”, above n 85.

²²² See *ASIC v Rich (No 2)* (2003) 21 ACLC 572; 44 ACSR 682. Bryson J of the NSW Supreme Court made orders giving effect to the settlement of ASIC’s case against Keeling, banning him from being a director for ten years and requiring him to pay \$92 million compensation to One.Tel.

²²³ ASIC also reached a settlement of its proceedings against this defendant, where Greaves accepted orders, banning him from being a director for four years and to pay compensation of \$20 million to One.Tel: see ASIC, ‘ASIC reaches agreement with John Greaves in One.Tel proceedings’, *Media Release 04-283*, 6 September 2004.

²²⁴ The *Rich* case (2004) 220 CLR 129; 209 ALR 271.

²²⁵ E. Sexton, “Many unhappy returns”, *The Sydney Morning Herald*, 25 August 2007.

²²⁶ See A. Main, “One.Tel: from Rich dream to costly nightmare”, *AFR*, 29 May 2006, p 6.

penalty application against Citigroup alleging that it had engaged in insider trading and contravened the conflict of interest provisions in the *Corporations Act* but, on 28 June 2007, ASIC's application was dismissed with costs.²²⁷ According to an ASIC media release, ASIC's costs in this litigation alone amounted to close to \$1.5 million, where ASIC was also liable for Citigroup's costs.²²⁸

Other civil penalty actions, such as the proceedings brought against former officers of GIO Insurance Limited demonstrate the long period of time that it is taking to finalise such matters. In this case, while the alleged breaches centering on the actions of these officers in advising GIO Australia Holdings Limited (GIO Australia) and its Due Diligence Committee on the financial outlook for the group's reinsurance business occurred in 1998 at the time of AMP's takeover bid for GIO Australia, ASIC did not commence civil penalty proceedings against these defendants until June 2001.²²⁹ Further, although declarations of contravention were obtained in August 2005,²³⁰ civil penalty orders were not imposed until August 2006.²³¹ Since then, Geoffrey Vines, a former director and Chief Financial Officer of the GIO Group has successfully appealed the case against him to the New South Wales Court of Appeal.²³²

It is also argued that criminal trials of white collar crime usually achieve little or no redress for victims.²³³ Again, however, even when ASIC has selected other enforcement options, such as civil penalty proceedings and succeeded in obtaining civil remedies like compensation orders, the reality seems to be that the actual amount of compensation being paid to victims is anything but significant. This is certainly the case to date with One.Tel and Water Wheel. Despite orders against Keeling and Greaves requiring the payment of substantial compensation,²³⁴ One.Tel's liquidator, Steve Sherman of Ferrier Hodgson, has revealed that Keeling and Greaves, who went

²²⁷ *ASIC v Citigroup Global Markets Australia Pty Ltd* [2007] FCA 953.

²²⁸ See ASIC, 'ASIC v Citigroup', *Media Release 07-193*, 17 July 2007.

²²⁹ See ASIC, 'ASIC commences civil penalty proceedings against former officers of GIO Insurance', *Media Release 01/217*, 20 June 2001.

²³⁰ *ASIC v Vines* [2005] NSWSC738; (2005) 55 ACSR 617; 23 ACLC 37.

²³¹ *ASIC v Vines* (2006) 58 ACSR 298.

²³² *ASIC v Vines* [2007] NSWCA 75.

²³³ See Dellit and Fisse, above n 26, p 582.

²³⁴ See earlier discussion at nn 222-223.

into “Part X” bankruptcy²³⁵ have only provided a little over \$500,000 with it being anticipated that creditors will end up being paid between 22c and 24c in the dollar.²³⁶ If ASIC’s case against Rich and Silbermann succeeds, however, the liquidator may be able to boost that dividend.

In the Water Wheel case, it appears that its creditors fared even worse. Although Elliott was ordered to pay compensation of \$1.428 million,²³⁷ in January 2007 he submitted an application to the Insolvency and Trustee Service Australia,²³⁸ which not only succeeded in extricating him from his bankruptcy early,²³⁹ but resulted in a settlement with creditors of a mere 2.5c in the dollar.²⁴⁰

The prospects of recovery of adequate compensation for the victims of the more recent collapses of Westpoint, Fincorp and ACR also do not seem to be significant.²⁴¹ On 8 November 2007, however, ASIC took the unusual step of announcing that it had commenced an action against former directors and financial planning firms under the little used s 50 of the *ASIC Act* seeking \$380 million in compensation for investors in the failed Westpoint Group, even though a class action had already been commenced in relation to some of the investors and the liquidator had

²³⁵ See *Bankruptcy Act* 1966 (Cth), Pt X (Bankruptcy and Personal Insolvency Agreements). This involved their passing all their assets to a trustee.

²³⁶ See A. Main, ‘One.Tel creditors to get 22c-24c in the dollar’, *AFR*, 25 August 2005, p 6.

²³⁷ See *ASIC v Plymin* (2003) 46 ACSR 126; (2003) 21 ACLC 700. Elliott was ordered to pay this jointly with Plymin.

²³⁸ See L. Wood, “Elliott offers discount deal”, *The Age* 31 January 2007 at <<http://www.theage.com.au/articles/2007/01/30/1169919337140.html>> (accessed on 28 February 2007). The settlement, the bulk of which was likely to come from the Elliott family’s private company, Ebek Pty Ltd, was believed to represent payment of about \$200,000 or 2.5 cents for every dollar. Even though the offer was well below the five-cent offer the Water Wheel creditors rejected two years earlier “as a matter of principle”, this offer was all but guaranteed to succeed due to control of a large block of creditor votes changing hands. Just after Christmas 2006, the Water Wheel creditors sold their position in bankruptcy - and hence their vote - to a third party, believed to be one of Elliott’s children.

²³⁹ His three year bankruptcy, which was due to expire in 2008, was annulled.

²⁴⁰ See M. Drummond, ‘Creditors agree to deal with Elliott’, *AFR*, 2 March 2007, p 5.

²⁴¹ See, eg, T. Perinotto, ‘Don’t blame me, says company founder’, *The Weekend AFR*, 5-6 April 2007, p 7. Besides reporting on Fincorp property and finance company founder, Eric Krecichwost, saying that he was not to blame for the loss of investor funds in the group, Perinotto reported that at a meeting of creditors on 30 March 2007 after Fincorp was put into voluntary administration, the administrator, KordaMentha, advised investors that secured creditors may receive 30c in the dollar, while unsecured creditors would receive nothing. See also ASIC, Updated statements on Westpoint Group of compaies, Fincorp and ACR, 23 August 2007, <<http://www.asic.gov.au>> (accessed on 4 September 2007). These statements update those made by D’Aloisio to the Senate Standing Committee on Economics on 30 May 2007.

commenced action in the name of the relevant companies.²⁴² This action, which seems to have been motivated by ASIC's desire to deflect earlier criticism of its failure to act to prevent the collapse of Westpoint and the other similar property investment schemes may have more success.²⁴³

Settlements

As far as settlements are concerned, ASIC has wide discretion to decide how to deal with suspected non-compliance and is empowered to settle cases rather than embarking on litigation under the incidental power conferred by the *ASIC Act*, s 11(4). Prior to 1 July 1998, however, there was no explicit framework for enforcing settlements reached with ASIC. The current provisions giving ASIC the power to accept enforceable undertakings are contained in the *ASIC Act*, ss 93AA (generally) and 93A (in relation to registered managed investment schemes).

No doubt, the reason the enforceable undertaking provisions were made available to ASIC just as they have been to other regulatory regimes²⁴⁴ is because of the success experienced by the

²⁴² See ASIC, 'ASIC to pursue compensation for Westpoint investors', *Media Release 07-291*, 8 November 2007. See also J. Austin, "Shareholder Class Actions – Sounding the Death Knell for ASIC Section 50 Actions?", Paper presented at the CLTA Conference, *Securities Class Actions, Creditors Rights and Enhanced Corporate Governance: The Dawn of a New Age*, 3-5 February 2008 for an interesting discussion of this case and ASIC Act, s 50, which confers a wide power on ASIC to bring a civil action in the name of the company or shareholders for recovery of damages for corporate misconduct.

²⁴³ But note that in July 2008, ASIC had to recommence compensation proceedings against former directors of Westpoint companies following the decision of Justice Ray Finkelstein that ASIC did not have the power to take over the original proceedings commenced by the liquidator of two companies in the group: see ASIC, 'ASIC recommences compensation proceedings and obtains asset preservation orders against Messrs Carey, Rundle and Beck', *Media Release 08-156*, 8 July 2008. See also Austin, above n 242, p18, who says that the s 50 action may not be completely successful and if it is drawn out and costly which seems very likely given the experience of earlier s 50 cases and the fact that ASIC has been forced to recommence proceedings, it may be attacked as an unnecessary waste of public money. In any case, there is the concern that with ASIC having taken over litigation commenced by the liquidator of the various Westpoint companies and also commencing s 50 action against two financial planning companies that will run parallel with the class actions that have been commenced, this will result in some duplication of investigation and resources absorbing either public funds (in the case of the s 50 proceedings) or funds which could go to the claimants (in the case of the private class action).

²⁴⁴ Eg, the Australian Prudential Regulation Authority (APRA) has been given the power to accept enforceable undertakings under s 262A of the Superannuation Industry (Supervision) Act 1993 (Cth). The Financial Services Sector Legislation Amendment Act (No 1) 2000 provided the enforceable undertaking provisions to APRA with item 36 of this Act inserting a provision that permitted this regulator to accept enforceable undertakings: see M. Nehme, "Enforceable Undertakings in Australia and Beyond", (2005) 18 *Aust Jnl of Corp Law* 68. Nehme discusses how the enforceable undertaking option is widely used in the regulatory community, allowing as it does regulators to reach plausible solutions to alleged offences without spending the resources of their agencies or the resources of the courts.

ACCC in using its power to obtain legally enforceable undertakings to redress breaches of the *TPA*, contained in the *TPA*, s 87B.²⁴⁵ The ACCC has had this power since 1993, but even before this, the ACCC had a strong track record regarding the use of settlements,²⁴⁶ akin to that of the SEC in actively encouraging and publicizing its successful use of them.²⁴⁷ This is in contrast to ASIC's approach to settlements, that in the past, have generally not been openly promoted nor actively sought.²⁴⁸

Today, ASIC is guided by Regulatory Guide 100: *Enforceable Undertakings* (RG100), which it issued in March 2007 setting out its approach to accepting enforceable undertakings and which replaced Practice Note 69: *Enforceable Undertakings* (PN 69).²⁴⁹ Important aspects of enforceable undertakings are publicity and public access to them.²⁵⁰ ASIC will not accept undertakings in confidence. Its practice is to issue a media release when an enforceable undertaking is agreed upon. ASIC also maintains a register on its website that lists all the enforceable undertakings accepted by it. The existence of the register not only makes it easier for the public to access the undertakings, but ensures disclosure and transparency, that have undoubtedly contributed to public confidence in ASIC's use of them with the result that it seems

²⁴⁵ See C. Parker, "Restorative Justice in the Business Regulation? The Australian Competition and Consumer Commission's Use of Enforceable Undertakings", (2004) 67 *The Modern Law Review* 209 at 210.

²⁴⁶ See Dellitt and Fisse, above n 26, pp 600-602 for a discussion of the extensive use of negotiation and bargaining by the ACCC (then the TPC) to settle cases without going to court, notably in the *Toshiba* case in 1990 and some large consumer protection cases, including the *Colonial Mutual Assurance Society (CML)* case. *CML* was one of a number of insurance companies involved in selling insurance policies to people living in remote Aboriginal communities in North Queensland which engaged in a widespread and systemic pattern of deceptive or unconscionable conduct, that the ACCC exerted pressure on to enter into deeds of compliance that required the payment of compensation, taking internal disciplinary action, and revising operating procedures to try to prevent repetition.

²⁴⁷ *Ibid*, pp 599-600 for examples of major cases which have been settled by the SEC on a remedial basis or subject to the imposition of penalties. They include the Gulf Oil case, where during the SEC campaign against foreign bribery in the mid-1970s, many companies agreed to prepare investigative reports. The Gulf Oil report was prepared by outside counsel, John McCloy, where its revelations were picked up by the press and the report re-published as a best-selling paperback.

²⁴⁸ *Ibid*, pp 596-599 for criticisms of ASIC's past approach, although Dellitt and Fisse, writing in 1994, provide examples of ASIC's successful use of settlements in the more recent past, namely in the Advance Investment Advisory Services Pty Ltd (AIAS) case in 1993 and the Jubilee Gold Mines case in 1994. It is noteworthy that both these cases were reported, where publicity ensures disclosure and transparency, which are important factors in the integrity of the regulator and public confidence in regulatory processes to achieve compliance: see later discussion at nn 250-251.

²⁴⁹ RG100 is available online at the ASIC website.

²⁵⁰ RG100, paras 3.4 - 3.7. See also ASIC Regulatory Guide 47 [RG 47] or Policy Statement 47 [PS 47] *Public Comment* available online at the ASIC website, which contains ASIC's approach to public comment on enforcement action once ASIC takes action. As a general principle, ASIC believes there is significant public interest in ensuring that consumers, industry and the broader community are aware of and informed about enforcement action it takes.

to be making good and increasing use of this regulatory mechanism.²⁵¹ This is unlike the ‘closed door’ deals that characterized the commercial settlements struck by Henry Bosch when chairman of the NCSC, which led to distrust of it and contributed to the NCSC’s lack of credibility generally.²⁵²

While there are many advantages of settlements under pyramidal enforcement,²⁵³ problems associated with a more settlement-oriented approach to enforcement have also emerged.

An oft-heard concern at various times over the years when ASIC has adopted such an approach is that it is “too soft” and therefore unable to achieve the measure of deterrence required for effective regulation.²⁵⁴ This has been the case especially when corporate collapses have occurred, such as those discussed earlier of Westpoint and other similar property investments when ASIC’s approach under Lucy was criticized.²⁵⁵ Notwithstanding these criticisms of ASIC, certainly there is no question today of settlements displacing criminal prosecutions like the days of the earlier cooperative scheme, where ASIC’s forerunner, the National Companies and Securities Commission (the NCSC) was not prosecution orientated.²⁵⁶

Conclusion

If ASIC wishes to retain its reputation as a credible regulator, it must act to implement pyramidal enforcement and be prepared to take action at the criminal level in serious cases, especially

²⁵¹ A review of ASIC’s Annual Reports from 1998 shows a general increase in the number of enforceable undertakings accepted by ASIC, eg, in the year 2003-2004, the number increased to 44 from 31 in the year 2002-2003, although the number fell in the year 2005-2006 to 16.

²⁵² See discussion below, n 256.

²⁵³ See Dellit and Fisse, above n 26, pp 602- 605 for a discussion of these advantages. Among them are the well recognised ones that negotiated settlements save time, emotional energy, financial costs and court resources, permit compromise, flexibility and the opportunity for change, encourage learning, allow defendants a say in the outcome, strengthen an organisation’s internal control systems, assist SROs toward regulatory cooperation, allow internal discipline systems to work and give enforcement agencies a chance to recover their investigation and/or legal costs as well as compensation for aggrieved parties.

²⁵⁴ Ibid, p 606.

²⁵⁵ See earlier discussion at nn 169 and 179.

²⁵⁶ The NCSC under Henry Bosch in particular, had sought compliance with the law by negotiating settlements rather than pursuing prosecutions. This caused uncertainty and distrust, which contributed to the regulatory failure of the NCSC. It did not prevent the so-called “excesses of the 1980s”. The subsequent high profile corporate collapses, such as Rothwells Ltd, Tricontinental and the Bond and Qintex Groups, are its legacy. See also Dellit and Fisse, above n 26, p 607.

against high profile violators.²⁵⁷ Otherwise, as Dellit and Fisse also point out there is the perception that there is ‘justice for sale’ for those wrongdoers with deep pockets who are able to foot the bill, with the non-prosecution of corporate fraudsters discriminating in their favour and against ‘street’ offenders.²⁵⁸

Another closely related concern is possible abuse by ASIC of its range of enforcement options and power to negotiate settlements under pyramidal enforcement resulting in injustice.²⁵⁹ Questions are raised when some defendants are prosecuted, while others who have committed the same type of contravention are only visited with civil penalties or a settlement.²⁶⁰ The danger also exists that a particular settlement arrived at through negotiation may be too harsh or too lenient in comparison with another.²⁶¹ Accordingly, ASIC must seek to be more consistent in its application of pyramidal enforcement and consistent in taking enforcement action at appropriate levels in the pyramid, which in regard to criminal prosecutions Dellit and Fisse argue can be achieved by such measures as closer monitoring of the exercise of prosecutorial discretion, and liaison between ASIC and the DPP to ensure that serious cases dealt with by ASIC that warrant prosecution are not

²⁵⁷ See earlier discussion, *Credible escalation and the ‘image of invincibility’*.

²⁵⁸ Dellit and Fisse, above n 26, p 608. But also see pp 608-609 for some interesting comments on the question of whether the more selective use of criminal prosecutions, that arguably may result under pyramidal enforcement, where those who commit serious offences remain subject to prosecution but where those who commit less serious offences may conceivably be dealt with otherwise than by prosecutions, would to that extent, unjustifiably create “two systems of justice” which violate the principle of equality before the law. Those comments concern more monitoring of prosecutorial discretion and liaison between ASIC and the DPP to ensure that those cases handled by ASIC that are serious enough to warrant criminal prosecution are not settled or dealt with so as to hinder prosecution; the use of settlements as a way of encouraging minor participants to provide evidence needed to prove a criminal case against a major target (In Australia, settlements have enabled crucial prosecutions of former corporate officers of HIH, just as “plea bargaining” has against former officers of, eg, Enron in United States); and avoiding the bias against street offenders, not by increasing the use of the criminal law against white-collar offenders, but by extending the use of civil methods of disposition to street offenders in the context of property offences (These offences, of course, exclude those property offences traditionally classified as offences against property which are more obviously offences of violence, such as robbery). Regarding the comments of Dellit and Fisse on the more effective use of limited resources, involving more reliance on civil penalty proceedings than criminal ones for less serious offences, these comments are based on the assumption that civil penalty litigation would provide a flexible and less costly enforcement option for ASIC, but this is proving not to be the case: see earlier discussion, *“Punishment is expensive; persuasion is cheap”*.

²⁵⁹ Ibid, p 583.

²⁶⁰ Ibid. See, eg McCullough, “One law for rich, another for richer”, above n 157. This article reported on the apparent injustice of ASIC’s treatment of Vizard in failing to bring criminal proceedings against him when there was evidence of deliberate and repeated dishonest conduct, whereas other defendants who were guilty of the same sort of conduct faced criminal actions.

²⁶¹ Ibid. See, eg, earlier discussion at n 104, where ASIC was criticised by the court for requesting only a five-year ban on managing companies against Vizard.

settled or handled in such a fashion as to hinder prosecution.²⁶² The author is not convinced that this is the answer and believes that ASIC developing its own prosecutorial arm to achieve a more consistent approach to decision-making should be considered.²⁶³

In all, strategic regulation theory is to be supported to shape ASIC's regulatory design and practice, but as this paper contends the difficulty for ASIC is the implementation of this approach to enforcement. ASIC must strive to be consistent in the enforcement action it chooses to take and it must be prepared to take action at the appropriate level in the pyramid, especially to rely on criminal sanctions in serious cases of corporate wrongdoing to ensure that its reputation as an effective regulator is not undermined.

²⁶² See earlier discussion at n 258.

²⁶³ See earlier discussion at n 147.