RESEARCH REPORT

REGULATING DIRECTORS' DUTIES - HOW EFFECTIVE ARE THE CIVIL PENALTY SANCTIONS IN THE AUSTRALIAN CORPORATIONS LAW?

George Gilligan
Helen Bird
Ian Ramsay

Centre for Corporate Law and Securities Regulation
The University of Melbourne

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Dr George Gilligan
Research Fellow
Centre for Corporate Law and Securities Regulation
The University of Melbourne

Ms Helen Bird
Lecturer in Law and Member of the
Centre for Corporate Law and Securities Regulation
The University of Melbourne

Professor Ian Ramsay
Harold Ford Professor of Commercial Law and
Director of the Centre for Corporate Law and Securities Regulation
The University of Melbourne

Centre for Corporate Law and Securities Regulation
The University of Melbourne

Published by the Centre for Corporate Law and Securities Regulation

The Centre for Corporate Law and Securities Regulation
Faculty of Law
The University of Melbourne
Parkville Vic 3052
Australia

Phone: 61 3 9344 5281
Fax: 61 3 9344 5285
Email: cclsr@law.unimelb.edu.au
Website: http://www.law.unimelb.edu.au/centres/cclsr/index.html

Bird, Helen, Gilligan, George and Ramsay, Ian
Regulating Directors' Duties - How Effective are the Civil Penalty Sanctions in the Australian Corporations Law?

ISBN 0 7340 1626 3

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EXECUTIVE SUMMARY

I. OVERVIEW OF CIVIL PENALTIES

- The regulation of directors' duties in Australia was fundamentally reformed in 1993 with the introduction of civil penalties which substantially reduced the role of criminal law.

- The civil penalty provisions in the Corporations Law include the basic duties of directors and other officers of companies, such as the duty to:

  ◊ act honestly;

  ◊ exercise reasonable care and diligence;

  ◊ not make improper use of information or position; and

  ◊ not have the officer's company trade while it is insolvent.

- Other civil penalty provisions include contraventions in relation to company accounts, contraventions in relation to certain share capital transactions and contraventions in relation to the management of managed investment schemes. The focus of this research report is on the civil penalty provisions which apply to directors' duties.

- Where a civil penalty provision in the Corporations Law is breached, the consequences include the court:

  ◊ disqualifying the person who breached the civil penalty provision from managing a corporation for a specified period of time; and/or

  ◊ imposing a pecuniary penalty on the person for an amount not exceeding $200,000.

- Where the person breached the civil penalty provision knowingly, intentionally or recklessly and (i) was dishonest and intended to gain an advantage or (ii) intended to deceive or defraud someone, criminal sanctions can apply. These sanctions are a fine of up to $200,000 and/or imprisonment for up to five years.

- A breach of a civil penalty provision allows the corporation to sue the person who contravened the provision for any loss suffered by the corporation or for any profit made by the person or anyone else.

II. THE EMPIRICAL STUDY

- The research project examines how the Australian Securities and Investments Commission (ASIC) uses civil penalties as an enforcement tool against company directors. It identifies and critically evaluates the factors which impact upon ASIC enforcement decisions regarding civil penalties.

- The methodology employed for the research involved collection of data about the use of civil penalties and a series of semi-structured interviews with senior ASIC enforcement personnel from regional offices around Australia. Those interviewed included: National Director, Enforcement; Regional Commissioner; Regional Director, Enforcement; Regional Assistant Director, Enforcement; and Regional General Counsel.

III. KEY FINDINGS OF THE STUDY

- Civil penalties were introduced by the Federal Parliament in 1993 with the expectation that they would be a significant enforcement tool. On 1 July 1998, the Federal Parliament extended the application of civil penalties under the Corporations Law to a number of additional statutory provisions including provisions involving share capital transactions and the management of managed investment schemes.

- However, our research has found that ASIC has commenced only 14 civil penalty applications relating to 10 case situations since civil penalties were introduced in 1993. The research identifies a number of reasons for this:

  - Civil penalties are seen by many of those interviewed as being inflexible and having limited utility as an enforcement option.

  - There are a number of alternative remedies which, from ASIC's point of view, appear to be more viable than civil penalties. In particular, there are injunctions which provide a "real time" remedy as well as section 600 of the Corporations Law which allows ASIC, in certain circumstances, to ban a person from managing a corporation. Section 600 is an effective remedy according to many of those who we interviewed as it does not require ASIC to bring court proceedings although the person banned may challenge the ASIC banning order in court. In order to ban a person from managing a corporation for breach of a civil penalty provision, ASIC must bring court proceedings.

  - A number of those interviewed expressed reservations about delays associated with use of the courts in the area of enforcement and, in addition, some of the difficulties of interpretation that have resulted from certain judgments of courts. These uncertainties in the interpretation of basic statutory provisions regulating directors' duties (which are civil penalty provisions) reinforce the trend to use alternative enforcement mechanisms.

  - There was some indication that many of those in the enforcement section of ASIC come from a criminal law background and therefore have a tendency to prefer

criminal actions rather than civil penalties. The suggestion was that this would change over time as the personnel of ASIC changed.

◊ Those interviewed indicated that the requirement to liaise with the Director of Public Prosecutions (DPP) over significant enforcement matters adds another level of complexity to the decision-making process. The consequences resulting from the requirement to liaise with the DPP was a recurring theme in the interviews. These consequences include (i) the requirement means that the DPP effectively has a veto over the use of civil penalties; (ii) the need for the DPP to satisfy itself that there is no criminal element in a matter may result in delay that can undercut the opportunity for a civil penalty action; and (iii) ASIC and the DPP have different enforcement objectives. The role of the DPP is to prosecute criminal breaches of the law while ASIC has broader objectives which include using civil remedies. These different objectives can impact upon the likelihood of civil penalties being pursued.

◊ Unclear drafting of the civil penalty provisions, particularly regarding the elements that must be proved to satisfy the court that a breach of a civil penalty provision has occurred, limits the use of civil penalties. Where the same conduct may breach both a civil penalty provision and a provision in a State Criminal Code, there is an incentive to frame the legal action as a breach of the Criminal Code because of the uncertainty surrounding the civil penalty provisions.

REGULATING DIRECTORS DUTIES - HOW EFFECTIVE ARE THE CIVIL PENALTY SANCTIONS IN THE AUSTRALIAN CORPORATIONS LAW?

I. BACKGROUND TO THE RESEARCH STUDY[1]

The regulation of directors' duties in Australia is primarily governed by the Corporations Law,[2] which is administered and enforced by ASIC - the Australian Securities and Investments Commission.[3] The regime of sanctions relevant to directors' duties was fundamentally reformed in 1993,[4] when new measures centred on civil penalty mechanisms were introduced which drastically reduced criminal law oversight of directors' duties. Previously, contraventions of the statutory duties of directors were criminal offences, punishable by criminal sanctions. Now only the most serious contraventions merit criminal sanctions and the vast majority of contraventions attract civil penalty sanctions.[5]

Civil penalties are hybrid sanctions combining both civil and criminal remedies. Civil penalties as they apply to directors' duties in Australia are given force by Part 9.4B of the Corporations Law in sections 1317DA to 1317JC. Under s 1317DA designated civil penalty provisions were, until 30 June 1998:

- s 232(2) - duty of a company officer to act honestly;
- s 232(4) - duty of a company officer to exercise reasonable care and diligence;
- s 232(5) - duty of a company officer not to make improper use of information;
- s 232(6) - duty of a company officer not to make improper use of position;
- s 243ZE - giving prohibited benefits to a related party of a public company;
- s 318(1) - contraventions in relation to company accounts (section 318(1) became, with some modifications, s 344(1) on 1 July 1998); and
- s 588G - duty of company director not to have company trade while insolvent.

On 1 July 1998, by reason of amendments introduced by the Company Law Review Act 1998, the application of civil penalties was extended to:

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[1] The research for the study was funded by a grant from the Criminology Research Council. The views expressed are not necessarily those of the Council. Although done in cooperation with ASIC this report is an independent analysis by the research team of the issues discussed. The views of ASIC staff set out in this report are the views of individual case officers and not necessarily the views of ASIC. The conclusions drawn from the information provided by ASIC case officers represent the views and findings of the research team and should not be seen as the views or policies of ASIC.

[2] The Corporations Law is the principal statute regulating Australian corporations.

[3] On 1 July 1998 the Australian Securities Commission became the Australian Securities and Investments Commission (ASIC). The establishment of ASIC is part of a significant restructuring of the Australian financial regulatory system based on a "twin peaks" policy approach, as recommended by the *Financial System Inquiry* (1997). The other regulatory twin peak is a new body - the Australian Prudential Regulatory Authority (APRA), which regulates the banking industry. APRA was also established on 1 July 1998, but by a separate statute, the Australian Prudential Regulatory Authority Act 1998.

[4] The civil penalty regime was integrated into the Corporations Law by the Corporate Law Reform Act 1992 effective on 1 February 1993.

[5] The new regime implemented the recommendations of the Senate Standing Committee on Legal and Constitutional Affairs 1989 report *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* (referred to hereafter as the *Cooney Report* as the chairman was Senator Barney Cooney). The report had criticised the former regime, considering its criminal sanctions too severe, and its fines system too lenient. In the Committee's view, lawbreakers were not sufficiently deterred, and the system lacked credibility with both the regulated and regulators.

- s 254L - contravention of requirements regarding redemption of redeemable preference shares;
- s 256D - contravention of requirements regarding capital reductions;
- s 259F - contravention of restriction on company acquiring its own shares and taking security over its own shares;
- s 260D - contravention of restriction on company providing financial assistance in connection with the acquisition of its shares; and
- ss 601FC, 601FD, 601FE, 601FG and 601JD - contravention of duties and obligations imposed on those involved in the management of managed investment schemes.

The civil penalty regime was debated at length by the Cooney Committee and there were high expectations about its prospective utility to Australian regulators and potential deterrent effect in the marketplace. The regime arose from two key recommendations of the Cooney Committee. These were that:

- criminal liability under company law not apply in the absence of criminality; and
- civil penalties be provided for breaches by directors where no criminality is involved.[6]

Civil penalties have been in place for six years now, so it is timely to evaluate the relative success of the regime and engage those responsible for its application in that process of analysis.[7] This is the central purpose of the research study.

II. RESEARCH QUESTION AND METHODOLOGY

A. Research question

The project examines how ASIC uses civil penalties as an enforcement tool against company directors. It aims to identify and critically evaluate the factors which impact upon ASIC enforcement decisions regarding civil penalties and to understand how the civil penalty regime is perceived by those involved in applying the Corporations Law.

The project is underpinned by strategic regulation theory, an economic theory of regulation.[8] The goal of enforcement tools is to secure compliance and strategic regulation theory offers insights into how regulatory compliance can be most effectively secured. The theory is employed widely, including by researchers in the fields of occupational health and safety[9] and environmental regulation.[10] Strategic regulation theory is outlined in Part IV of the report.

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6 Cooney Committee, ibid at 190-191. See also on the history and theory of civil penalties in Australian company law, H Bird, "The Problematic Nature of Civil Penalties in the Corporations Law" (1996) 14 *Company and Securities Law Journal* 405 and M Gething, "Do We Really Need Criminal and Civil Penalties for Contraventions of Directors' Duties?" (1996) 24 *Australian Business Law Review* 375.

7 ASIC has been supportive of the research project, making available a sample of senior personnel from regional offices across Australia to contribute their analysis on the effectiveness of civil penalties.

8 Academic proponents of strategic regulation theory include: J Scholtz, 'Deterrence, Cooperation and the Ecology of Regulatory Enforcement' (1984) 18 *Law & Society Review* 179; I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (1992); C Dellit and B Fisse, 'Civil Liability under Australian Securities Regulation: The Possibility of Strategic Enforcement' in G Walker and B Fisse (eds), *Securities Regulation in Australia and New Zealand* (1994).

9 See, for example, F Haines, *Corporate Regulation: Beyond "Punish or Persuade"* (1997); N Gunningham and R Johnstone, *Regulating Workplace Safety: Systems and Sanctions* (1999).

10 G Richardson, A Ogus and P Burrows, *Policing Pollution: A Study of Regulation and Enforcement* (1983); K Hawkins, *Environment and Enforcement* (1984).

B. Project methodology

The research project involved an empirical study, namely, a series of semi-structured interviews with senior ASIC enforcement personnel from regional offices around Australia. The interviews provide a rich primary source of information on ASIC decision-making processes drawn from a sample of senior enforcement personnel (totalling fourteen), from ASIC's Head Office and each of the Regional Offices. Positions held by the respondents include: National Director, Enforcement; Regional Commissioner; Regional Director, Enforcement; Regional Assistant Director, Enforcement; Regional General Counsel; Regional Director of Operations; Regional Executive Director of Operations; Senior Lawyer; and Lawyer (Level 2). The interviews took place in mid-1998 and accordingly reflect the experience of ASIC case officers at that time. Where there have been significant changes to ASIC's practices or policies, the research team has endeavoured to include those in the report.

The selection of the sample was via a consultation process between ASIC's National Director, Enforcement (NDE) and the research team. Due to the sensitive nature of many of the issues that are the subject of discussion and the obligations imposed on ASIC by section 127 of the ASIC Law (which imposes obligations of confidentiality upon ASIC regarding certain information), the NDE and the research team felt that only more senior and experienced ASIC enforcement personnel were appropriate candidates for the interviews. The NDE facilitated a national meeting of senior enforcement personnel in which the rationale of the research was explained and individuals indicated their desire to participate in the study.

These procedures obviously do not conform to the criteria of random selection, but in this case a random bias is not really suitable and a stratified sample is more appropriate. The focus of the research is the civil penalty regime and its role in ASIC enforcement. The small amount of data that is available indicates that there have been very few civil penalty actions since 1993. It is therefore necessary for a project of this nature to involve persons who have had practical enforcement experience with civil penalties and/or have been involved in decision-making processes about whether civil penalties should be sought . Identification of such individuals is unlikely to be achieved by an external source operating from a random selection perspective. Informed judgment from knowledgeable persons with an overview of the organisation's operations are more likely to succeed in this regard. Application of these criteria meant that, out of all ASIC personnel who deal in some way with enforcement issues, only a relatively small number were qualified to be interviewed for this research project.

The underlying structure of the interviews was provided by a designated interview schedule constructed by the research team.[11] Copies of this schedule were sent to the NDE and respondents several weeks before the interviews took place. This permitted the respondents sufficient time, given their busy schedules, to reflect on the specific issues raised by the various questions and relate them to their own experience within ASIC.

The interview schedule itself comprised fourteen questions, spread across two sections:

- current enforcement regimes; and
- decision-making processes.

[11] See Appendix A for the interview schedule.

The major topics addressed by the interview questions in the "current enforcement regimes" section were:

- the perceived value of civil penalties in theory and practice;
- enforcement constraints within the Corporations Law;
- value and incidence of other civil enforcement mechanisms;
- the impact of judicial mechanisms on ASIC enforcement; and
- logistical factors impeding ASIC enforcement processes.

The "decision-making processes" section focused on:

- the specific influences and processes that shape the case management of a matter as it moves through various ASIC administrative and investigative procedures; and
- the nature of ASIC's working relationships with other relevant agencies, in particular, the Director of Public Prosecutions (DPP).

All the interviews were conducted at the Victorian Regional Office of ASIC by members of the research team. Six of the respondents were interviewed in a face to face situation and the other eight using ASIC's tele-conferencing network facilities. The duration of the interviews ranged from ninety to one hundred and eighty minutes and they all permitted substantial discussion of the issues under review. Following transcription, research team members undertook a data collation process and identified the key factors which influence how ASIC uses and perceives the civil penalty regime. The factors are:

- ASIC's enforcement philosophy and culture;
- ASIC's resource constraints, including financial, geographical and personnel contraints;
- ASIC's relationship with other regulatory agencies, including the DPP and the courts;
- the availability of alternative enforcement mechanisms to civil penalties; and
- legal issues, including the unclear nature of parts of the Corporations Law and its regulatory praxis.

This report explores and analyses these factors in Parts VI to X. Before turning to that discussion, the report provides a background briefing on the operation and history of civil penalties in the Corporations Law (Part III), strategic regulation theory (Part IV) and the role and functions of ASIC as the corporate regulator (Part V).

III. HISTORY AND OPERATION OF CIVIL PENALTIES

A. Overview

This Part outlines the operation of the civil penalty regime in Part 9.4B of the Corporations Law and the regulatory policy behind its introduction.[12] Part 9.4B will be rewritten as part of the Corporate Law Economic Reform Program Bill (Cth) 1998, which was introduced into the Federal Parliament on 3 December 1998. A summary of these proposed changes is contained in Appendix B.

[12] For a more detailed analysis, see Bird, supra n 6, at 413-420.

B. Operation of civil penalty regime

1. Civil penalty provisions

Civil penalties are given force by sections 1317DA to 1317JC in Part 9.4B of the Corporations Law. The designated civil penalty provisions were outlined in Part I of the report. They include contraventions of a range of duties of company officers; giving prohibited benefits to a related party of a public company; contraventions in relation to company accounts; contraventions of certain share capital transaction requirements; and contraventions of duties and obligations imposed on those involved in the management of managed investment schemes.

The share capital transaction provisions (ss 254L, 256D, 259F and 260D) and the managed investment provisions (ss 601FC-601FG and 601JD) became civil penalty provisions on 1 July 1998, as a result of amendments introduced by the Company Law Review Act 1998. The focus of this report is on the longer standing civil penalty provisions which apply to directors' duties in Australia (principally, ss 232(2), (4), (5), (6) and 588G).

2. Summary of consequences of breach of a civil penalty provision

This section briefly summarises the consequences of breaching a civil penalty provision. These consequences are discussed in greater detail in the following sections.

Where a provision in the Corporations Law is a civil penalty provision, the following consequences arise where that provision is breached:

(1) only ASIC, its delegate or a person authorised by the Attorney-General may apply to a court for a civil penalty order (s 1317EB);
(2) upon application by ASIC, its delegate or a person authorised by the Attorney-General, the court may make a civil penalty order under s 1317EA in respect of the contravention;
(3) a civil penalty order may declare that a contravention has occurred, or disqualify a contravener from managing a corporation, or impose a pecuniary penalty;
(4) a pecuniary penalty in an amount not exceeding $200,000 may be imposed only if the court is satisfied that the contravention is a serious one (s 1317EA(5));
(5) proceedings for a civil penalty are treated as civil proceedings for the purposes of the application of rules of evidence and procedure (s 1317ED), and consequently the standard of proof is proof on the balance of probabilities rather than proof beyond reasonable doubt;
(6) the court may make a compensation order at the same time as a civil penalty order (s 1317HA);
(7) a civil penalty order may be made against the person who contravenes the civil penalty provision, and any other person involved in the contravention (s 79);
(8) contravention of a civil penalty provision is not itself an offence, but an offence arises where the contravener has acted or omitted to act knowingly, intentionally or recklessly and, in addition, the contravener either:
    (i) was dishonest and intended to gain an advantage for the contravener or any other person; or
    (ii) intended to deceive or defraud someone (s 1317FA);

(9) the maximum penalty for such an offence is $200,000 or 5 years imprisonment or both, and a person found guilty is prohibited from managing a corporation for 5 years unless the leave of the court is obtained (s 229(3));

(10) the corporation in relation to which there has been a contravention of a civil penalty provision has a statutory cause of action to sue the contravener for any profit made by the contravener or anyone else because of the act or omission constituting the contravention (s 1317HD), and for any loss suffered by the corporation;

(11) relief from liability for contravention of a civil penalty provision may be given by the court (s 1317JA).

3. Civil penalty contraventions

Civil penalty provisions serve penal, protective and remedial goals.[13] Remedial consequences are noted here, with the penal consequences explored in subsequent sections. Part 9.4B preserves a company's general law remedial rights against a director who breaches his or her duties to the company.[14] Also it allows a statutory remedy of compensation to a company against a director who contravenes a civil penalty provision.[15] The company may seek compensation as part of the penalty proceedings brought by ASIC (or the DPP if criminal penalties are involved) or separately from any such proceedings.[16] Part IV of this Report explains how civil remedies, such as these statutory compensation rights, have the potential to play a strategic role in enforcement of the Corporations Law.

4. Penal consequences

Part 9.4B provides for two types of penal consequences: civil penalties and criminal penalties. Two kinds of civil penalties are prescribed: a pecuniary penalty of up to $200,000[17] and/or an order banning a person from managing a corporation for an unspecified period.[18] Criminal penalties comprise a fine of up to $200,000 or 5 years imprisonment or both.[19] Criminal penalties are only imposed where a person contravenes a civil penalty provision knowingly, intentionally or recklessly and the person:

- was dishonest and intended to gain an advantage for the contravener or any other person; or
- intended to deceive or defraud someone.[20]

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13 Remedial proceedings here being those instituted to recover loss or damage arising from non-compliance with the Corporations Law.

14 Corporations Law, ss 1317HE.

15 See generally Corporations Law, ss 1317HA-1317HE.

16 This form of enforcement action is most likely to be commenced by a liquidator. The role of liquidators in enforcing directors' duties standards is part of our ongoing research agenda in this area.

17 Corporations Law, s 1317EA(3)(b). This power is limited by the requirement that the contravention must be a serious one: s 1317EA(5). A pecuniary fine cannot be ordered where the person has already been ordered to pay punitive damages: s 1317EA(6). If made, the order is enforceable as a judgment: Corporations Law, s 1317EG. If the order results from an ASIC investigation, the court may also order payment of ASIC's expenses: Australian Securities and Investments Commission Act 1989, s 91.

18 Corporations Law, s 1317EA(3)(a). The court is not to make an order under s 1317EA(3)(a) if it is satisfied that, despite the contravention, the person is a fit and proper person to manage a corporation: s 1317EA(4). The expression 'managing a corporation' is defined in s 91A. Criminal consequences are attracted if the person subsequently fails to comply with the order not to manage the corporation: s 1317EF.

19 Corporations Law, ss 1317FA(1) and 1311(2)-(3). Corporations Law, Third Schedule, Penalties.

20 Corporations Law, s 1317FA(1).

The civil and criminal penalty regimes operate as alternate regimes, determined by separate proceedings.

The election to bring criminal or civil penalty proceedings is a crucial one because a civil penalty proceeding precludes later criminal proceedings.[21] The "bar" on subsequent criminal proceedings was introduced to address double jeopardy concerns[22] but is the subject of much criticism by ASIC enforcement personnel.[23] Civil penalty proceedings involve a lower evidentiary burden than criminal prosecutions because they are conducted using civil rules of evidence and procedure.[24]

5. Prosecutions under Part 9.4B

Civil penalty proceedings under Part 9.4B can be brought by ASIC or an authorised ministerial delegate.[25] However, criminal prosecutions are brought by the DPP, pursuant to a memorandum of understanding between ASIC and the DPP.[26] A general defence of honesty and fairness is available to defendants in civil penalty proceedings, but not criminal proceedings.[27] The current drafting of Part 9.4B creates a number of evidentiary problems for both civil and criminal proceedings which are further discussed as part of reform issues in Part X.[28]

C. Historical background

1. Previous regime of sanctions

Part 9.4B commenced operation on 1 February 1993. Comparing the Corporations Law preceding Part 9.4B's introduction highlights the impact of the reforms. Prior to Part 9.4B, contraventions of statutory duties owed by corporate officers were deemed to be offences, attracting both criminal sanctions and civil remedies. The range of criminal sanctions consisted of a variable fine and imprisonment.[29] Civil remedies enabled recovery of loss or damage resulting from contravention.[30] There was a distinct divide between the two enforcement measures, reflecting their bipolar purposes. Criminal sanctions, reflecting their traditional paradigm, meant to punish. Civil remedies sought to compensate.[31]

2. Reform impetus

Part 9.4B resulted from three reforms proposed by the Senate Standing Committee on Legal and Constitutional Affairs in its report titled *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*.[32] They were that:

- criminal liability under company law not apply in the absence of criminality;[33]

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21 Corporations Law, s 1317FB. The reverse is not the case. See Corporations Law, ss 1317GC-GD.
22 To address the concern that a defendant is not exposed to both civil and criminal penalties for the same contravention.
23 See Part VI below.
24 Corporations Law, s 1317ED(1). Issues concerning civil proceedings are further discussed in Part III below.
25 Corporations Law, s 1317EB.
26 See the discussion in Part V.
27 Corporations Law, s 1317JA.
28 See also Bird, supra n 6, 413-420.
29 Companies Code, s 570, Corporations Law, s 1311.
30 Companies Code, ss 229(6), (7) and (10), Corporations Law, ss 232(7), (8) and (11).
31 K Mann, 'Punitive Civil Sanctions: The Middle Ground Between Criminal and Civil Law' (1992) 101 *Yale Law Journal* 1795, 1798.
32 Supra n5.

- the statutory duty of honesty imposed upon corporate officers be amended so that criminal liability arising from contravention would only apply where conduct was genuinely criminal in nature;[34] and
- civil penalties be provided in companies legislation for breaches by directors where no criminality is involved, and in appropriate circumstances, people suffering loss as a result of a breach be able to claim damages in the proceeding to recover the loss.[35]

The Cooney Committee's proposals sought to construct a pyramid of enforcement measures supporting the regulation of corporate officers by the Corporations Law.[36] This concept reflects the influence of strategic regulation theory, which also underpins this research project.[37] The theory provides a means of ordering the sanctions which can be imposed under the Corporations Law, from the least to most severe sanctions. The first and second proposals confined criminal sanctions to extreme contravention situations, being those "genuinely criminal in nature".[38] The intention was to realign, but not remove criminal sanctions, which formerly applied to all contraventions deemed to be offences by the Corporations Law. The Cooney Report firmly discouraged the wholesale removal of criminal sanctions.[39]

The third recommendation had two parts: the introduction of civil penalties and the expansion of civil remedies to include new compensation rights in civil penalty proceedings.[40] Civil penalties would be both monetary and non-monetary in nature. Their purpose was to sanction misconduct falling short of a criminal offence.[41] The provision of civil remedies in civil penalty proceedings, preserved the availability of civil remedies in all contravention cases. The resulting product was a hierarchy of enforcement measures with three essential building blocks: civil remedies at its base, criminal sanctions near its top and civil penalties in between.[42] This hierarchy enables a strategic approach to regulatory enforcement, as explained next in Part IV.

IV. THEORETICAL INFLUENCES ON THE STUDY

A. Overview

This Part discusses the theoretical premise of this report - strategic regulation theory.[43] As Part III has already explained, strategic regulation theory was instrumental in the introduction of civil penalties in the Corporations Law. This Part defines what is strategic regulation theory, describes how the theory can be applied to the enforcement provisions in the Corporations Law which apply to directors' duties, and explains the part which it plays in the empirical element of the research project.

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33 Ibid, 190.
34 Ibid, 191.
35 Ibid, 190. A further recommendation concerning 'on-the-spot' fines was also made: ibid, 192.
36 Ibid.
37 See Part IV.
38 Supra n 5, 190.
39 Ibid, 188.
40 Ibid, 191.
41 Ibid, 80.
42 Ibid, 190-191. Dellit and Fisse, supra n 8, 583-592.
43 See the commentaries cited in n 8, supra.

B. Strategic regulation theory[44]

Strategic regulation theory provides a macro perspective on the role of enforcement sanctions in securing regulatory compliance. The theory advocates regulatory compliance as best secured by persuasion, rather than legal enforcement because legal proceedings are expensive, while co-operation between the regulator and the persons regulated is cheap. For persuasion to be effective, generally a threat of punishment must lie behind the regulator's conciliatory actions or gestures. The threat of punishment should take the form of a set of integrated sets of sanctions which can be threatened by the regulator where contravention takes place. The sanctions should escalate in severity in response to more serious contraventions of the law. This process is usually graphically represented by the pyramid model, with incapacitation at the apex of the enforcement pyramid.[45] Incapacitation can be achieved through both civil and criminal measures. For the natural person, criminal sanctions are viewed as the ultimate penalty.

At the base of the pyramid are methods of education and persuasion. This level is usually sufficient for most of those regulated, including those who commit minor acts of non-compliance. The remaining levels are necessary when dealing with others such as the incompetent, the irrational and those rational calculating citizens who believe that it is not in their self interest to comply and only respond when the costs outweigh the benefits.[46] The appropriate sanctions may be letters of warning; followed by civil penalties and other civil legal mechanisms. Continued failure to comply or more egregious contraventions will activate criminal sanctions. The severity of a sanction is graphically represented by its proximity to the apex of the pyramid.[47] Civil penalties should inhabit the middle to lower-upper levels of the pyramid and in ideal conditions will be closely integrated with other regulatory sanctions.

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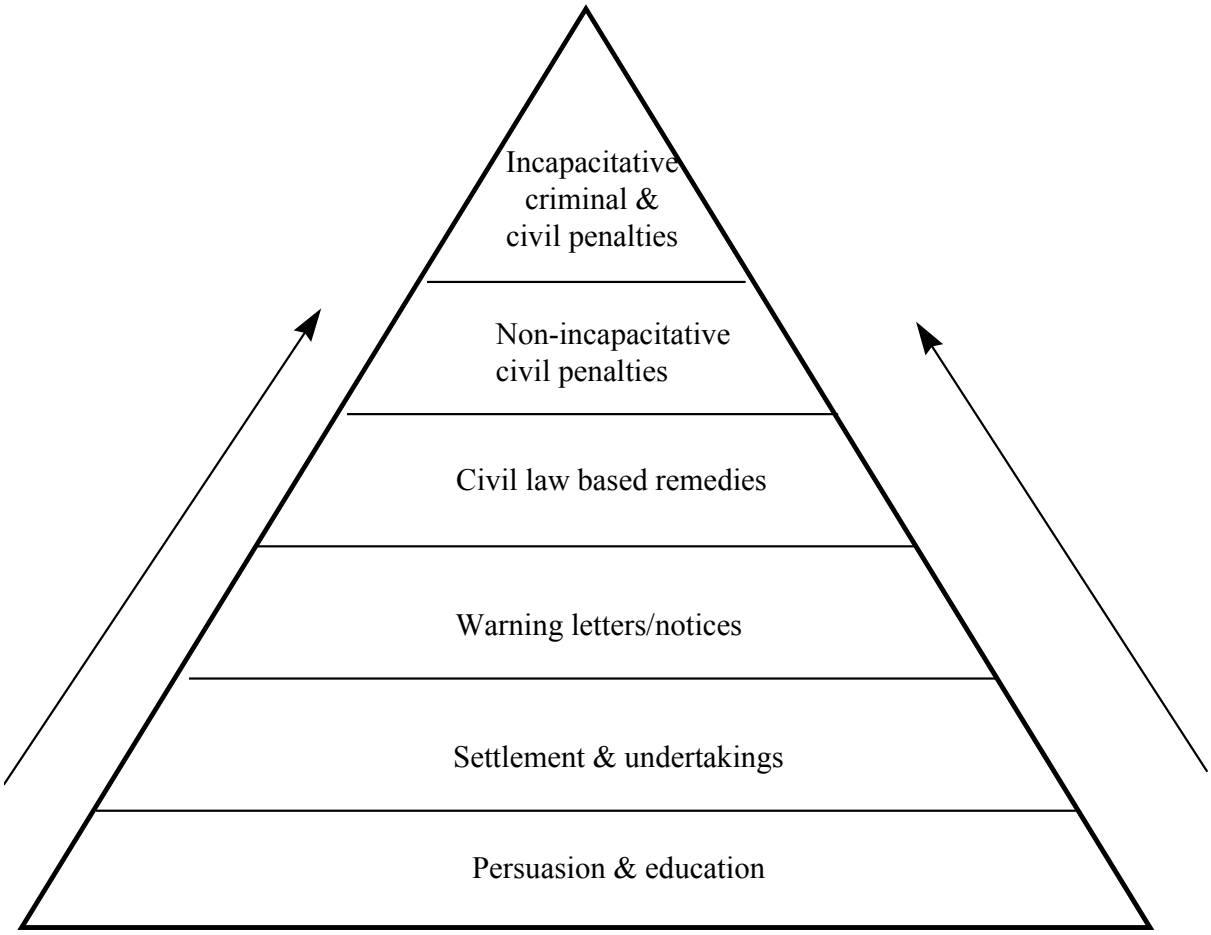
44 Ibid.

45 Professor Braithwaite formulated and developed the enforcement pyramid in a number of his publications: see, for example, J Braithwaite, *To Punish or Pursuade: Enforcement of Coal Mine Safety* (1985); Ayres and Braithwaite, supra n 8.

46 Ayres and Braithwaite, supra n 8. These views reflect the "game" theory of regulation which argues that regulation is a game of negotiation and interaction between the regulator and the persons regulated. Those regulated are presumed to be rational, single actors who determine whether to comply with regulation by assessing the costs and benefits which compliance produces for them at a particular time. See Scholtz, supra n 8.

47 P Grabosky, "Discussion Paper: Inside the Pyramid: Towards a Conceptual Framework for the Analysis of Regulatory Systems" (1997) 25 *International Journal of the Sociology of Law* 195, 196.

Figure 1: Enforcement pyramid[48]



The goal of the pyramid is to stimulate maximum levels of regulatory compliance. Regulators start by assuming that the regulated are willing to comply voluntarily (whether in a self-regulatory or public agency environment). In an ideal world the regulated would not need any inducement or threat from the regulator. However, the regulator must provide for the possibility that this assumption cannot be made by being prepared to move up the enforcement pyramid with increasing degrees of regulatory response. The rationale of strategic regulation theory and its pyramid model is that those regulated will comply sooner or later through a combination of normative desire and instrumental deterrence. Ayres and Braithwaite argue that if the regulator can plausibly threaten to meet the regulated's non-compliance by moving successively up the pyramid, then most of the regulator's work can get done effectively at the bottom layers of the pyramid. This is because the "bigger the sticks at the disposal of the regulator, the more it is able to achieve its results by speaking softly."[49]

Pursuant to strategic regulation theory and especially in the context of directors' duties, sanctions should serve three functions. They should:

- protect against actual and/or potential contraventions of the law ('the protective function');

[48] This representation of the enforcement pyramid is based upon the work of Ayres and Braithwaite, supra n 8; Dellit and Fisse, supra n 8; Fisse and Braithwaite, *Corporations, Crime and Accountability* (1993), 142.

[49] J Braithwaite, "Responsive Business Regulatory Institutions" in C Cody and C Sampford (eds), *Business, Ethics and Law* (1993), 88.

- impose punishments against persons committing contraventions of the law ('the enforcement function'); and
- deter people from contravening the law ('the preventative function').

The research project tests, amongst other things, whether the use of civil penalties by ASIC is consistent with these desired regulatory outcomes.[50]

C. The enforcement pyramid in the Corporations Law

It has already been observed that civil penalties were introduced into the Corporations Law as part of a strategy to construct a pyramid of enforcement mechanisms in the Corporations Law supporting the regulation of directors.[51] The following discussion describes that pyramid in more detail and analyses the role of civil penalties within it. Figure 2 depicts the pyramid of enforcement to be discussed. The discussion draws together a wide range of enforcement mechanisms available to ASIC, as regulator, for securing compliance by directors with their statutory duties. Some of the procedures are not in the "conventional" mould of enforcement sanctions. However, they have been included because of their significant deterrent effects and in order to give a fuller profile of the enforcement tool kit available to ASIC.

A number of observations should be kept in mind in the following discussion:

1. The pyramid constructed here applies only to directors' duties. Similar pyramids could be constructed for other substantive areas of the Corporations Law, such as enforcement relating to takeovers and prospectuses.

2. The list of sanctions and procedures highlighted in the discussion should not be viewed as exhaustive, but as a subset of those available to ASIC in its enforcement work involving directors' duties. That list would obviously change for enforcement activity in other areas of the Corporations Law.

3. Most of the sanctions to be discussed are imposed by the Corporations Law. However, to give a more comprehensive picture of enforcement, the discussion will also refer to sanctions and enforcement procedures imposed by the ASIC Act and related crimes legislation.[52]

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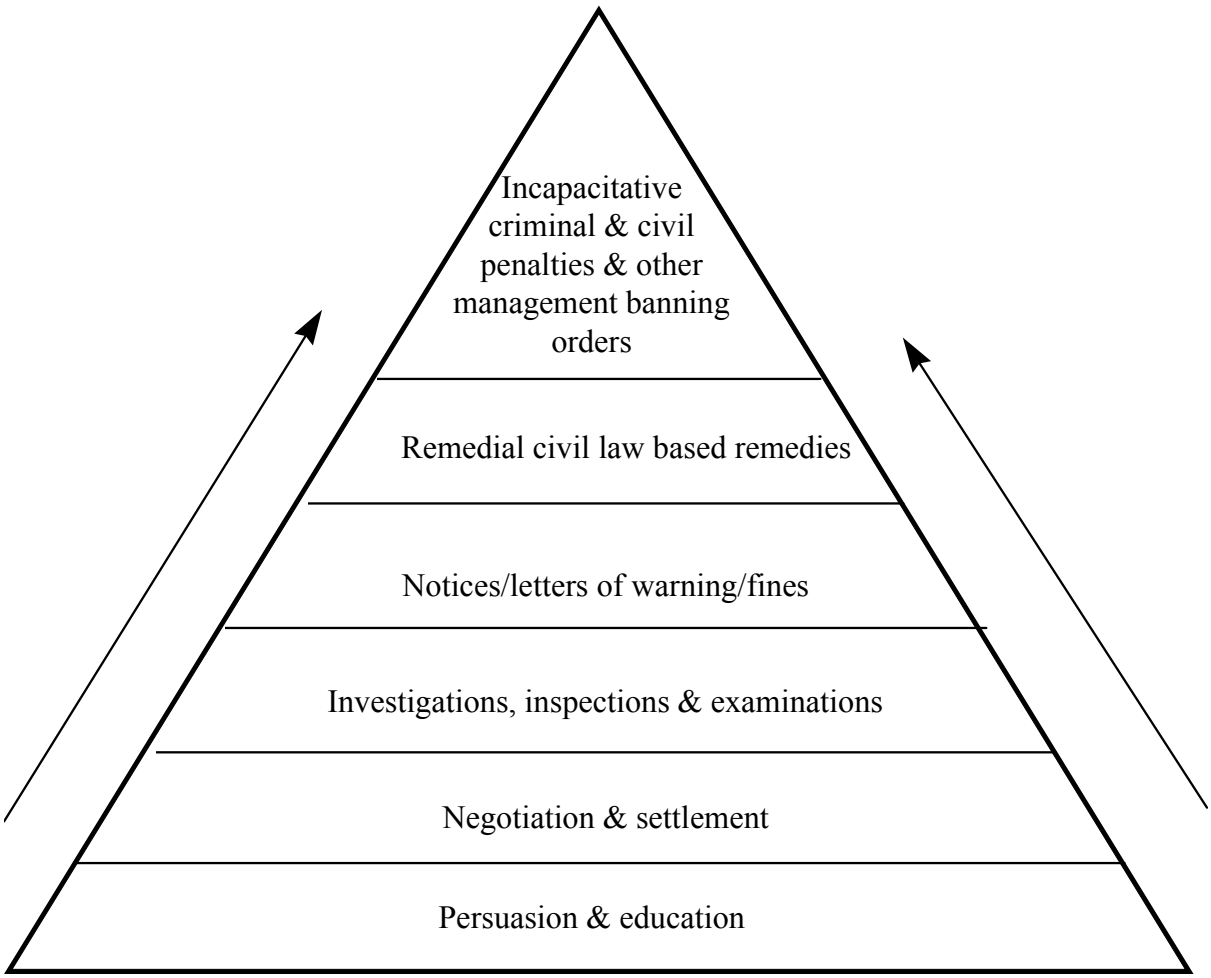
[50] This report is part of a wider study being undertaken by the Centre for Corporate Law and Securities Regulation in cooperation with ASIC on the effectiveness of civil penalties and other enforcement mechanisms. This phase of the study has an internal focus: theoretical underpinnings; ASIC's approach and ASIC's enforcement outcomes. The second phase will have an external and comparative focus, examining the effectiveness of civil penalties and other enforcement mechanisms as a regulatory response.

[51] See Part IIIC.

[52] Australian Securities and Investments Commission Act 1991 (Cth); Crimes Act 1914 (Cth) and State Crimes Acts.

Figure 2: Enforcement pyramid regarding directors' duties under the Corporations Law



1. Persuasion and education

The bottom level of an enforcement pyramid typically consists of a series of incentives or "carrots" which encourage compliance and avoid unnecessary antagonism between the regulator and persons regulated.[53] The Corporations Law enforcement pyramid reflects this trend. Measures directed towards achieving compliance through conciliatory cooperation include:

- Surveillance programmes and tools such as media releases used by ASIC as part of its national corporate plan to encourage awareness of statutory obligations, improve compliance levels, and detect/deter contraventions. They cover areas such as securities dealers and investment advisers; corporate financial reports; prospectus and takeovers documents; managed investments schemes; abuse of the corporate form; statutory records compliance; and auditors and liquidators activities.

[53] Gunningham and Johnstone, supra n 9, 117.

- ASIC education and advice programmes, such as the ASIC sponsored round-table discussions on corporate governance and the following "Information for Companies" available from the ASIC website[54]:

    - Running a company;
    - Company essentials;
    - The company director's survival kit;
    - Your obligations under the Corporations Law;
    - Penalty notices; and
    - Insolvency - warning to directors and officers.

2. Negotiation and settlement

ASIC has a wide discretion to choose how to deal with cases of suspected non-compliance and is empowered to negotiate and settle cases rather than launch court proceedings by s 11 (4) of the ASIC Act. Since 1 July 1998, ASIC has also had the power to accept an enforceable undertaking from a person in connection with a matter ASIC has power to investigate under the ASIC Act.[55] ASIC has stated its position on enforceable undertakings in ASIC Practice Note 69. Also, ASIC has reported on specific instances in which it has accepted enforceable undertakings by a person not to take part in the management of a company in ASIC Media Releases MR 98/236 and MR 98/340.

3. Investigations, inspections and examinations

Another level in the Corporations Law enforcement pyramid is a byproduct of ASIC's enforcement powers under its own enabling Act and the Corporations Law. The ASIC Act empowers ASIC to:

- conduct investigations as it thinks expedient for the due administration of the Corporations Law such as where it has a suspicion of a contravention of the Corporations Law or other laws relating to fraud or dishonesty (ASIC Act s 13) or following the receipt of a report from a receiver or liquidator (ASIC Act s 15);
- serve a notice on a person who it suspects or believes can assist with an investigation compelling them to give reasonable assistance or to appear before an ASIC staff member to answer questions on oath (ASIC Act s 19; Corporations Law Part 5.9 Division 1);
- inspect books required to be kept by companies under the Corporations Law (ASIC Act s 28).

These measures serve multiple purposes. They serve a protective function. They assist ASIC detect and prosecute contraventions of the Corporations Law.[56] Also, they are deterrence-oriented. The possibility of adverse consequences resulting from the investigation, hearing or inspection inevitably preoccupies the mind of the regulated persons or entities called on. In

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54 ASIC website address: http://www.asic.gov.au.
55 ASIC Act s 93AA.
56 See Part V.

addition to any legal action which is subsequently taken against them by ASIC for contravening the Corporations Law, a raft of offences arise for failing to comply with these investigation, inspection and hearing requirements (ASIC Act ss 63-67). The procedures also consume the regulated's time and financial resources. The possibility of reimbursement of expenses by ASIC following completion of the procedures is limited.[57]

The exact placement of this set of sanctions within the Corporations Law enforcement pyramid can vary. The circumstances in which ASIC is empowered to exercise these enforcement powers suggest that this layer of enforcement response can apply to serious contraventions of the Corporations Law.[58] They can be viewed as a higher level of sanctions than the notices/letters of warning/fines level. However, with regard to ASIC they are more likely to be features of lower-level enforcement activity.

4. Notices/letters of warning/fines

The next rung in the Corporations Law pyramid marks the shift from "carrots" to "sticks", albeit that they are small sticks intended in most cases as only a "tap on the shoulder" rather than to impose a punitive sanction.[59] Many different mechanisms can be utilized at this level including the issuing of "show cause" notices and penalty notices. The mechanisms are intended to be preventative in nature but allow action to be taken quickly without the need to go to court. Their deterrence value is specific, rather than general. Examples of applicable measures include:

- "show cause" notices: ASIC may give a "show cause" notice to a director of two or more companies that have gone into liquidation paying their unsecured creditors less than 50c in each dollar owed. The notice requires the director to show cause why the director should not be the subject of a management banning notice (Corporations Law s 600(2)); and
- penalty notices: ASIC may serve a notice on a person alleged to have contravened the Corporations Law requiring them to pay a prescribed penalty within a specified period (Corporations Law s1313);

5. Remedial civil law based remedies

A key feature of the Corporations Law enforcement pyramid is the presence of civil law based remedies. These remedies are the traditional domain of shareholders and, in limited circumstances, creditors, seeking redress for the consequences of certain corporate activities. The Corporations Law, assisted by the ASIC Act, harnesses the natural potency of civil remedies and turns them into enforcement tools available for use by ASIC. This potency derives from fact that, in some circumstances, they offer "real-time" or immediate responses for the recalcitrant minority of corporate law offenders who fail to change their behaviour under threat of less aggressive measures. Examples of these measures in the Corporations Law and related laws include:

- court orders freezing assets, preventing foreign travel and/or the transfer of assets (Corporations Law s 1323);

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57 See ASIC Act s 89. There is no common law right to recover expenses: *Re Equiticorp Finance Ltd.; Ex parte Brock (No 2)* (1992) 27 NSWLR 391.

58 See Part V.

59 Gunningham and Johnstone, supra n 9, 122.

- court orders appointing a trustee, receiver or receiver and manager over the assets of individuals or companies (Corporations Laws s 1324);
- court orders winding up a company and appointing a liquidator (Corporations Law ss 464, and 472);
- court orders for payment of compensation by a person who contravened a civil penalty provision and the contravention caused loss or damage to the company concerned (Corporations Law s 1317HA);
- interim and final injunctive relief (Corporations Law s 1324).

ASIC also has power to commence legal action on behalf of shareholders under s 50 of the ASIC Act or for oppression of shareholders under s 246AA of the Corporations Law. Section 50 provides that where, as a result of an examination or from a record of an examination, it appears to ASIC to be in the public interest for a person or company to begin and carry on proceedings for the recovery of damages or property, ASIC may conduct such a proceeding in the person's or company's name. Section 246AA allows ASIC to apply to the court for a remedy for oppressive conduct in a case where it has undertaken an investigation.

6. Management banning orders

Three sets of management banning sanctions appear at the apex of the Corporations Law enforcement pyramid. They arise under ss 230, 599 and 600 of the Corporations Law.[60] Under s 230 the court may prohibit from managing a company a director, secretary or executive officer who:

- was an officer of a company which repeatedly breached the Corporations Law and the person failed to take reasonable steps to prevent the company breaching the Corporations Law;
- has repeatedly breached the Corporations Law; or
- has contravened s 232(2) (failure to act honestly as a company officer) or s 232(4) (failure to exercise a reasonable degree of care and diligence as a company officer).

Under s 599 the court may prohibit from managing a company a person who was a director of, or concerned in the management of, two or more companies which have:

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[60] Section 229 of the Corporations Law provides for automatic banning from managing a company in certain circumstances. Unlike ss 230, 599 and 600, there is no requirement for the court or ASIC to impose the order. Rather, in the specified circumstances, there is an automatic prohibition on managing a company. The specified circumstances are:

- a person becoming an insolvent under administration;
- a person being convicted:
  - on indictment of an offence against an Australian law, or any other law, in connection with the promotion, formation or management of a company; or
  - of serious fraud; or
  - of any offence for a contravention of specified sections of the Corporations Law including s 232 (which deals with directors' duties); or
  - of an offence of which the person is guilty because of s 1317FA(1) (criminal proceedings for breach of a civil penalty provision).

Section 229 provides that a person who is convicted within the circumstances specified must not, within five years after the conviction or, if the person was sentenced to imprisonment, after release from prison, manage a company without the leave of the court. In the case of an insolvent under administration, the person must not manage a company without the leave of the court.

- been wound up for insolvency;
- been under administration;
- executed a deed of company arrangement;
- ceased to carry on business because of insolvency;
- had a levy of execution which has not been satisfied;
- had a receiver or manager appointed; or
- entered into a compromise or arrangement with creditors.

Under s 600 ASIC may prohibit from managing a company a person who has been a director of two or more companies that have gone into liquidation paying their unsecured creditors less than 50c in each dollar owed.[61]

A banning order is a quasi incapacitation order. If imposed, it prevents a person being involved in the management of a corporation but does not prevent the person from being involved in the corporation in another capacity. Section 599 allows a court to ban a person from management of a company for up to five years, which is the same as for the ASIC imposed banning orders under s 600. Section 230 allows for an indefinite management banning order.

7. Incapacitation - civil and criminal penalties

Also at the apex of the Corporations Law pyramid is incapacitation through the civil and criminal penalties found in Part 9.4B of the Corporations Law. They belong to the same level of the pyramid because they are mutually exclusive sanctions, the selection of one operates as a bar to the use of the other. In the context of enforcement against directors as natural persons this is contrary to the enforcement strategy promoted by strategic regulation theory which advocates that civil penalties and criminal penalties should be separate levels within the pyramid, with civil penalties occupying the middle to higher levels and criminal penalties occupying the highest level of the enforcement pyramid.[62]

The bar preventing both civil penalty and criminal proceedings is only one of a number of problems of significant complexity under Part 9.4B discussed in this Research Report.[63] Another concern is the similarities between the civil and criminal penalty regimes. Both offer pecuniary penalties with a maximum amount of $200,000. The distinction between them appears to be one of stigma, with the criminal pecuniary penalty being more injurious to reputation than the civil penalty equivalent. In addition, both regimes have incapacitation orders. The civil penalty regime includes a management banning order for an unspecified duration. The criminal regime contemplates incapacitation, in the form of a prison sentence of up to five years. It would be preferable if there were a wider variety of civil penalties available, so that the "deterrent" effect of the criminal penalty regime could be enhanced. Some of the problems mentioned in this report are to be addressed in the Corporate Law Economic Reform Program Bill 1998 introduced into Federal Parliament on 3 December 1998. The reforms are outlined in Appendix B to the report.

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61 For more detailed discussion of ss 229, 230, 599 and 600, see H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law*, looseleaf, para [7.191].

62 For companies, different considerations may apply. For example, a civil compensation order may be the ultimate sanction if it is large enough to result in the winding-up of the company.

63 See Bird, supra n 6, 413-420 for discussion of a number of these problems.

D. A third dimension to the pyramid?

The enforcement pyramid discussed above is very much a two dimensional model which assumes smooth practical interaction between the regulator and the regulated depicted by the various tiers of enforcement response. There is a large question mark over whether the reality which is the 'rough and tumble' of commerce and its regulation by the Corporations Law delivers such measured and desirable outcomes. The reality of enforcement suggests a far more complex pyramid than the one depicted above. To understand the fuller picture, it is necessary to examine the activities of the many players in the ongoing drama of regulatory compliance (not least the regulator, the regulated, the media and intervening professional actors such as accountants, lawyers, liquidators, the Director of Public Prosecutions (DPP), courts, specialist tribunals and the police).

It is the effect of the interaction (both systematic and random), of the intervening elements in the regulatory mix which is both a theoretical and practical goal of this and other ongoing research projects. The aim is to colour in some of the three dimensional background of the regulatory pyramid of strategic regulation theory as it exists in the context of corporate regulation in Australia. This report focuses predominantly on the insights to be gained from the regulator's engagement with the enforcement pyramid. Research into other intervening elements in the regulatory profile is the subject of ongoing research.[64] The canvas for this attempted three dimensional picture is one specific tier in the enforcement pyramid - civil penalties in relation to the enforcement of directors' duties with the objective of discovering what actors and processes constitute the interplay of its regulatory profile.[65]

V. ASIC

A. Introduction

As the research project focuses predominantly on ASIC's engagement with the enforcement pyramid in the Corporations Law, it is appropriate to define the context in which that engagement takes place by way of an overview of ASIC's objectives, investigatory powers and enforcement procedures.

B. Objectives and functions

ASIC is a Commonwealth statutory corporation created by the Australian Securities and Investments Commission Act 1989 (ASIC Act). ASIC describes itself as "an independent government body that enforces and administers the Corporations Law and consumer protection law for investments, life and general insurance, superannuation and banking (except lending) throughout Australia".[66] ASIC describes its purpose as being to "reduce fraud and unfair practices in financial markets and financial products so consumers use them confidently and companies and markets perform effectively."[67]

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[64] It is the intention of the research team to continue to develop this picture through subsequent empirical research involving other regulatory players.

[65] This theoretical stance is influenced by notions of regulatory tripartism, a theory of regulation which advocates a system of regulation involving three institutional forms; the government, the regulated entities and third parties representing public interest concerns and causes. See generally, Ayres and Braithwaite, supra n 8.

[66] Australian Securities and Investments Commission, *Annual Report 1997-98*, 2.

[67] Ibid.

Section 1(2) of the ASIC Act states that in performing its functions and exercising its powers, ASIC must strive to:

- maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy;
- promote the confident and informed participation of investors and consumers in the financial system;
- achieve uniformity throughout Australia in how ASIC and its delegates perform those functions and exercise those powers;
- administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements;
- receive, process and store, efficiently and quickly, the information given to ASIC under the laws that confer functions and powers on it;
- ensure that information is available as soon as practicable for access by the public; and
- take whatever action it can take, and is necessary, in order to enforce and give effect to the laws that confer functions and powers on it.

C. Investigatory powers

The ASIC Act provides for four grounds upon which ASIC may commence a formal investigation:

- a contravention of the Corporations Law (section 13 of the ASIC Act);
- a contravention of a law of the Commonwealth or of a State or Territory, being a contravention that:
  - concerns the management or affairs of a corporation or a managed investment scheme; or
  - involves fraud or dishonesty and relates to a corporation or managed investment scheme, securities or futures contracts (section 13 of the ASIC Act);
- the Minister directs ASIC to investigate a matter because, in the Minister's opinion, it is in the public interest for that matter to be investigated (section 14 of the ASIC Act);[68]
- ASIC receives a report of a receiver or liquidator lodged under section 422 or 533 of the Corporations Law (section 15 of the ASIC Act).[69]

As part of conducting a formal investigation, ASIC has the power to require the production of books and the giving of an explanation of their contents and may, if necessary, seize such books by search warrant. ASIC may also require the disclosure of information about securities or futures contracts.[70] Where ASIC or its investigators has reasonable grounds to suspect or believe that a person can give information relevant to a matter that it is investigating or is to investigate, ASIC may undertake a private examination of that person.[71] Where a person is to be subject to an

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[68] Section 14(2) describes the possible matters which the Minister may direct ASIC to investigate. These include alleged or suspected contraventions of the Corporations Law or other laws concerning the management or affairs of companies; dealing in securities; dealing in futures contracts; the affairs of a company; or the giving of advice, analyses or reports about securities or futures contracts.

[69] For more detail on the circumstances in which ASIC may commence investigations and its powers when conducting such investigations, see J Kluver, "ASIC Investigations" in *Australian Corporation Law: Principles and Practice*, Volume 3, looseleaf, Chapter 15.

[70] ASIC Act, Part 3, Division 3 and Part 3, Division 4.

[71] ASIC Act, Part 3, Division 2.

examination, that person must receive from ASIC a formal notice advising him or her of matters including the nature of the matter being investigated and certain rights such as the right to be legally represented and rights in respect of providing self-incriminating information. Any information which ASIC obtains by way of an examination may be used by ASIC in subsequent criminal or civil proceedings.

In 1997-98, ASIC assessed 3,798 complaints from the public alleging breaches of the law. Of these complaints:

- 39 per cent were referred for surveillance;
- 16 per cent were resolved with the complainant;
- 4 per cent resulted in cautions or undertakings;
- 3 per cent led to formal investigations;
- 38 per cent were not pursued.[72]

In the same year, ASIC assessed 3,711 reports from company liquidators, receivers, administrators and auditors. 2,842 of these reports alleged offences while the remaining did not allege any offence but informed ASIC of directors of companies that had returned less than 50 cents in the dollar to their creditors. Of the reports lodged with ASIC:

- 4 per cent were resolved;
- 9 per cent were pursued through surveillance;
- 1 per cent were investigated;
- in 86 per cent no useful action could be taken because the reports were submitted too late.[73]

In 1997-98, ASIC commenced 215 new investigations and completed 199 major litigation enforcement actions.[74]

As at 30 June 1998, ASIC employed 658 staff who worked in enforcement and regulatory activities (57 per cent of its total staff of 1,152).[75] Expenditure on enforcement and regulatory activity totalled $70 million in 1997-98 or 59 per cent of ASIC's total running costs in that year.[76]

D. Enforcement procedures

Insights into ASIC's enforcement procedures were gathered by the research team from answers to the interview questions. This section discusses the specifics of decision-making processes within the enforcement sections of ASIC based on the responses of those interviewed. The information contained in this section provides a useful contextual framework for understanding ASIC's enforcement procedures prior to more detailed examination of how those procedures impact upon the use of civil penalties.

We asked respondents to describe the procedures that they follow upon receipt of a liquidator's report. This process was selected for discussion because it is a major source of case referral to ASIC and should therefore be highly representative of its decision-making processes. Question

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72 Supra n 66, 33.
73 Ibid, 33.
74 Ibid, 60.
75 Ibid, 2.
76 Ibid, 23.

12(a) of the interview schedule asked who determines whether to conduct an investigation into matters contained in a liquidator's report.

All respondents stated that a report goes through the standardised assessment channels of evaluation. There are two types of liquidators' reports. Those that do not allege offences go to the ASIC triage system and are recorded on the database. Those reports and indeed any other complaints/referrals which allege offences are evaluated by the Complaints Management Program (CMP) in each region. Overall, the CMP writes off a significant percentage of complaints as they do not come within the Corporations Law or are very minor offences. Standardised ASIC organisational procedures are followed, with the CMP analysing each matter and producing a report. The report is then reviewed by a more senior committee, called a Technical Review and Assessment Committee (TRAC). It makes decisions on what information in the report needs to be clarified and a final resourcing decision, based on recommendations and other operational priorities. This committee is usually composed of about four senior personnel within each regional office. There are no fixed membership rules, but Regional General Counsel, Regional Director of Operations and Regional Director of Enforcement are usually involved. The TRAC makes an assessment based on similar criteria to the CMP, guided by accompanying reports, the TRAC's oversight of the global enforcement picture within that regional office and Case Selection Criteria.

Broadly speaking, the Case Selection Criteria involve three questions. The first is whether the complaint is likely to give rise to a cause of action within ASIC's jurisdiction with an appropriate remedy. The second involves the TRAC considering whether taking enforcement action in relation to the matter would have any regulatory effect, either because of the significance of the matter in its own right or because it is representative of a wider trend of non-compliance. The third question is whether there are any other general considerations which suggest that enforcement action should not be taken, for example, the age of the matter, the fact that significant witnesses may be located overseas and whether the complainant is as equally placed as ASIC to commence enforcement action. It is open to the TRAC, in a regional office, to give its CMP more specific targeting criteria, which tend to be of a prescriptive nature. The nature of the criteria will depend on the operational priorities of the Regional Office from time to time. One respondent believed that all ASIC enforcement personnel would agree that:

> "The major criterion is regulatory effect. The ASC does not merely have an investigation orientation, it is very committed to campaign-based enforcement, with both a simultaneous specific and general deterrence motivation."[77]

This issue of regulatory effect and the consolidating influence of project methodology is discussed more fully below. If the TRAC decides to resource a matter the next obvious issue is that posed by question 12(c), which asked: who conducts the investigation? One respondent offered this analogy:

> "Investigations are managed like building projects. A team is established which would: ..build a project management document; scope objectives, tasks, time-frames, risks and strategies....A month later, a decision review will decide if the investigation continues."

[77] Most of the interviews were conducted in mid-1998 just prior to 1 July 1998 when the Australian Securities Commission became the Australian Securities and Investments Commission. Hence the references in many of the interviews to the ASC.

The TRAC will allocate resources to a matter as it sees fit and so it varies as to who may be assigned to investigate a matter. One respondent said the process:

> "...depends on what the misconduct is, the size of the matter, what the liquidator is seeking us to do. The matter may go to the liquidator assistance programme, the small business programme, or the major investigation area...
> …The Operations Committee [TRAC] of senior personnel will assign a case officer to a matter and give broad directions as to investigative strategy. The case officer will compile preliminary reports which are submitted to [TRAC], which may, or may not, then alter the course of the investigation and remedy sought."

Another respondent confirmed this view and added that it is often:

> "...very much a matter of horses for courses…Usually someone from the enforcement program, sometimes also from the commercial program, almost invariably some lawyers [become involved]."

ASIC offices are divided up into operational groups, the composition of which varies from region to region. Personnel are taken from appropriate groups where possible, but staffing decisions may often be guided by available resources. In a smaller office such as Canberra, often those who prepare the reports on matters for the TRAC will then conduct any further investigation, which will proceed under project methodology lines as in other ASIC offices. It is inevitable that some operational differences exist between regional offices given the different complexities, characteristics and priorities of the markets that these offices have responsibility for.[78]

Regarding the various reports produced within ASIC, question 12(d) asked what are the key topics/themes included in the investigation report. In general, preliminary and ongoing reports during an investigation are held by the case officer, but are available to superiors in the hierarchy. The ASIC activity management system is available to anyone within ASIC and indicates the stage a matter has reached, but does not contain any confidential information. [79]

Continuing with the specific issues raised by the interview schedule, question 12(g) asked what happens if the matter is not referred to the Director of Public Prosecutions (DPP).[80] The response was standard among the respondents. If ASIC is going to litigate civilly, it will start communicating with counsel about how a brief should be prepared.

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[78] The issue of regional variation is discussed in Part VIID.

[79] In general, s 16 interim reports and s 17 final reports are not frequently prepared. There is some variation within the regions as to the scale of reports that are generated. Section 16 of the ASIC Act deals with interim reports on investigations and provides that where, in the course of an investigation, ASIC forms the opinion that:

- a serious contravention of a law of the Commonwealth or a State or Territory has been committed;
- to prepare an interim report about an investigation would enable or assist the protection, preservation or prompt recovery of property; or
- there is urgent need for the Corporations Law to be amended;

it shall prepare an interim report.

Section 17 of the ASIC Act deals with final reports on investigations and provides that at the end of an investigation under s 13 or s 15, ASIC may prepare a report about the investigation and must do so if the Minister so directs. The report must set out:

- ASIC's findings about the matters investigated;
- the evidence and other material on which the findings are based; and
- such other matters relating to, or arising out of the investigation as ASIC thinks fit or the Minister directs.

Two recent examples of s 17 reports are *Report of the Special Investigation into Spedley Securities Limited* (December 1998) and *Report of the Investigation into Burns Philp & Company Limited* (December 1998).

[80] Details of the ASIC:DPP working relationship are discussed in Part VIIIB.

Retaining a specific focus on civil penalties, question 12(h) asked who authorises the issue of civil penalty proceedings. ASIC makes the decision on issuing civil penalty proceedings and they are authorised by the TRAC in each region. Responsibility for issuing the court papers rests with the senior lawyer in the region, generally having the title of Counsel, who will be both a member of the TRAC and the project sponsor for the action.

Of course there would be several levels of input before the Counsel takes this action. Those working on a case make recommendations about how a matter should be pursued. It is then up to senior management to ratify that recommendation or suggest other strategies, through the same assessment committees that review all potential investigations, before making an executive decision. The view of the DPP may also be significant in deciding upon civil penalties. Consequently, there will be consultation with the DPP regarding any possible civil penalty action.

It is clear from questions analysed in this section so far, that there is a high, though not completely uniform degree of standardisation in the decision-making processes of the different ASIC regional offices. All respondents detailed how ASIC project methodology management techniques were applied to all cases, so that appropriate matters were investigated with appropriate levels of resources and appropriate modes of enforcement were pursued. It was apparent from the interviews that ASIC is making strenuous efforts to function, and to be seen to function, as a truly unitary national regulator. In the words of one respondent:

> "...we operate nationally, all the time, a lot of national hook ups, meetings, deployment of resources, national thinking from enforceable undertakings to civil penalties. There's a constant sharing of information, all designed, not because we want to have it done exactly the same way everywhere, but because we do want to have some national consistency and standards across all of our enforcers. Because if ASIC does something in Adelaide, it affects ASIC everywhere."

Having provided an overview of ASIC and its enforcement procedures, our focus now turns specifically to civil penalties.

VI. THE UTILITY OF CIVIL PENALTIES

A. Overview

Parts VI to X of the report discuss the views of senior ASIC enforcement personnel concerning the use and operation of civil penalties as enforcement tools. Part VI discusses ASIC's views of the use and effectiveness of the civil penalty regime. It is an overview which distills the issues that influence ASIC's use of civil penalties. Those issues are then reported in further detail in Parts VII to X. Part VII explores the issues arising from the enforcement philosophy, activities and culture within ASIC itself. Part VIII discusses the issues arising from the interplay between ASIC and other regulatory agencies. Part IX reviews the issues arising from the availability of alternative enforcement measures apart from civil penalties. Part X identifies the issues requiring law reform.

B. ASIC's perception of civil penalties

The overwhelming view of the respondents was that civil penalties are a positive initiative in the enforcement of the Corporations Law. This was invariably expressed in both specific and analogous terms. For example:
"…the civil penalty remedy is a particularly useful one...";
"...civil penalties can be a most effective regulatory mechanism...";
"...civil penalties provisions have got pretty good teeth...";
"...civil penalties are an additional useful enforcement arrow in the quiver..."; and
"...civil penalties usefully extend the enforcement toolkit..."

One respondent perceived civil penalties in these terms:

> "I think they have a legitimate place in the menu of potential outcomes for dealing with misconduct that has been brought to our attention. When they were first introduced, one commentator referred to them as a 'noxious hybrid', and I think there's something to be said for that description in a sense that to those who are subject to a civil penalty, elements of the process are obviously a civil process, but elements of the process also have a criminal element to it. So, in terms of the thinking that needs to go on at ASIC about what circumstances are appropriate for a civil penalty, it's difficult, and requires some sophistication [regarding] the circumstances of each case as to whether that misconduct really should be dealt with criminally, as opposed to civilly. In dealing with that issue, market expectations might not always be met as to which approach is more appropriate, because very often, if the misconduct is serious enough, then someone will say 'why didn't you prosecute?'"

This reply is an early signal of the complexities of the civil penalty regime (as perceived by those interviewed) and reflects the fact that the collective and enthusiastic support for civil penalties was qualified in every case. All the respondents agreed that in theory civil penalties did extend and diversify the regulatory capability of law enforcement, and as such were a welcome addition to the enforcement quiver/toolkit.

However, in the authors' view, it appears that the actual experience of civil penalties in practice has not matched their enforcement potential or the desire of the regulators themselves to implement them. The responses to interview questions revealed that the disparity between the intrinsic enforcement capability of civil penalties and the enthusiasm of the regulators to apply them on the one side, and the low incidence of civil penalties on the other, is due to a complex set of interrelated operational factors to be discussed shortly.

C. Use of civil penalties

ASIC media releases indicate that it has commenced only fourteen civil penalty applications relating to ten case situations since 1993:

1996: one in the Northern Territory (Brock re Tropical Image Homes Pty Ltd);
one in Queensland (Leishman re Medalion Homes); and
one in Western Australia (Cooke re Earth Family Trust & Peace Shield Ethical).

1997: two in Tasmania (Nandan re Tasmanian Spastics Association; Spencer re Harq Nominees Pty Ltd); and
two in Victoria (Wardell and Gdanski re Sands & McDougall Pty Ltd).

1998: two in Queensland (Donovan and Donovan re Good Life Company and Friends Pty Ltd);
one in Victoria (Peart re Maroona Trading Co Pty Ltd); and
four in Western Australia (Lester and Lester re Snowdeli Pty Ltd; Doyle and Satterthwaite re Chile Minerva NL).[81]

This figure of fourteen is surprisingly low and many of those interviewed were not aware of what the national total might be. Of particular interest to the authors was the fact that up to the date of the interviews the New South Wales office (being the largest and most active office, in enforcement terms, accounting for approximately 40 per cent of total activity) had not launched a single civil penalty action.[82]

The uncertainty about the incidence of civil penalties is a reflection of the ambiguity that surrounds them in general. The interviews reveal that this ambiguity may be felt not only by officers of ASIC, but also by members of other law enforcement agencies, the judiciary and not least, by those being regulated and the general public. The difficulties of raising consciousness levels about civil penalties were put into perspective by one respondent when answering question 2(b) about whether civil penalties perform a significant deterrent function. The reply was to the effect that it was hard enough making directors aware of their obligations to act honestly and fairly, let alone raising awareness of civil penalties.

Having briefly set the scene on how (in a very general sense), civil penalties are perceived by the respondents, their views on specific questions are now outlined. The specific questions asked the respondents to assess the effectiveness of civil penalties in terms of punishment and deterrence, two goals of strategic regulation theory.[83]

D. The effectiveness of civil penalties

Question 2(a) asked how effective a regulatory mechanism are civil penalties and it drew a range of responses.

> "I think civil penalty provisions as originally contemplated do have the capacity to be more efficient. There are several reasons for that. One is that the whole process was meant to be in the control of ASIC, so we brought the proceeding ourselves if we thought it was appropriate. Because of the way the system works, having made an application, that acts as an absolute bar to criminal prosecution, so necessarily I think one needs to consult with the DPP before you embark on a process which excludes a criminal outcome. So that has an impact on efficiency, because the DPP needs to be satisfied that the circumstances don't warrant criminal prosecution. Again, that means that you have to have good procedures and lines of communication with the DPP, so that you can make an efficient or quick decision about whether to bring a civil penalty application. That's being worked through and there are issues about how much does the DPP need to know before it makes that decision."

The strategic role of the DPP on the civil penalty regime is an important influence on perceptions of the regime's effectiveness.[84] All the respondents agreed that civil penalties could

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[81] See Appendix C for comparative verdicts and other specific details of the individual civil penalty actions.

[82] This is not due to any systemic opposition within the New South Wales office towards civil penalties. Quite the opposite is in fact the case and this paradox is discussed in more detail later in this report.

[83] See Part IV for discussion of strategic regulation theory.

[84] The role of the DPP is examined in more detail in Part VIIIB.

be more effective, but there were distinct differences of opinion on how much more effective they might be. One respondent was quite enthusiastic:

> "Certainly I think they are an effective part of the regulatory weaponry and I'm actually a great fan of civil penalty orders. I've seen them as very useful in the environment that I've been working in particularly, which is...small proprietary companies, as opposed to large corporates; where the fact of criminality is very difficult to establish and there are relatively small amounts involved, so launching a major criminal investigation isn't often warranted. It's often a case of either mismanagement, or ignorance, or something like that, rather than specific criminal intent. So, that's important, but it's also important to have criminal sanctions there as the ultimate penalty and I'm aware of the enforcement pyramids approach. Certainly I see civil penalties as sitting somewhere in the middle of the enforcement pyramid and they should be linked to criminal sanctions ultimately somehow."

This was the most positive endorsement of civil penalties and it is perhaps significant that the respondent came from one of the smaller regional offices which has used civil penalties. However, there is no uniform view on civil penalties across the smaller offices and representatives from other smaller offices did not support civil penalties quite as strongly. One theme that emerged was that the lack of use of civil penalties tends to undermine their effectiveness.

> "I think the regime at present isn't very effective, but it's certainly got the potential to be. I think it's not effective because it's had extremely limited use and I know here in [this regional office] we've not instituted to date any civil penalty."

One of the respondents from another office agreed:

> "From the regulator's point of view you'd have to say it's not particularly effective because it's not really used."

However, several of the other respondents found this question problematic precisely because the lack of use of civil penalties makes it hard to assess their utility, and the practical difficulties of launching civil penalty actions (discussed in more detail below), compound this problem. The reality of enforcement is that the profile of a person against whom it would be appropriate to commence civil penalty proceedings is narrow. Specifically, that profile is as follows:

- The conduct must be serious enough to at least warrant banning the proposed respondent to protect members of the public.
- The proposed respondent must not already be bankrupt. There is an automatic prohibition on a bankrupt managing a company (s 229) and a bankrupt may be presumed not to have any money to pay a pecuniary civil penalty.
- The conduct must be serious enough that something more than a banning order is called for. If only a banning order is called for, then provisions such as ss 230, 599 and 600 will be appropriate.
- The conduct must be not serious enough to warrant criminal action. If it is, then civil penalty proceedings will not be appropriate. In many cases, banning will follow a conviction for criminal proceedings (s 229).
- The offence must not be too old. In many cases, directors' duties offences are identified by liquidators in s 533 reports. However, it is often the case that by the time the liquidator files the s 533 report, several years have elapsed since the offence was committed. This may

> render the offence so "stale" that little regulatory effect will be achieved by commencing action in relation to it, or mean that other matters where the offence is more recent be given a higher resourcing priority, due to their increased regulatory effect.

In practical terms, this means that there are very few potential respondents against whom it would be appropriate to commence civil penalty proceedings.

The general view on the effectiveness of civil penalties can be seen from this response:

> "The effectiveness of civil penalties is limited, because the initial concerns of investigators are on practical matters such as ascribing responsibility and tracing assets in a matter, and civil penalties are not especially useful in such issues. Investigators are more likely to be thinking in terms of injunctive strategies rather than civil penalties. In addition, most matters that might suit a civil penalty response would have also a potential criminal law character so they would be passed on to the DPP for evaluation.

On this point, a number of themes emerged from the responses of those interviewed. First and foremost is the over-riding rubric of pragmatism under which all ASIC personnel must function. They and their organisation have finite resources, investigators utilise the most practical tools and other civil strategies[85] are of more proven enforcement value than civil penalties. The second issue is the potential criminal element of civil penalties and the fact that the requirements (actual or potential), of the DPP have ramifications for any decision made by ASIC personnel about civil penalties. Third, there is a sense of uncertainty within ASIC about how the judiciary will deal with civil penalty actions and this impacts upon decision-making processes.[86] Fourth, amongst ASIC personnel, there is some uncertainty about: "...what the directors' duties provisions actually mean…" and this has compounded the ambiguity about civil penalties.[87]

These issues are substantial and mutually inhibit the incidence of civil penalty actions. The ensuing low incidence reflexively consolidates the reservations that initially stimulate the process of inhibition. ASIC personnel recognise this and there is a real desire to "...run some cases and test the judicial waters…" Enforcement personnel consistently consider the civil penalty option. For example:

> "...we would consider the potential outcome of a remedy like a civil penalty in almost every investigation we pursue. I apply a process here when we resource an investigation of, whether or not it's appropriate for us to take it on and then we would look at the whole range of remedies available and see what's appropriate in the particular circumstances, keep reviewing that as we move down the path of gathering the evidence to see how the scope is looking, and see if it can be refined and is still appropriate."

The key phrase here is: "...appropriate in the particular circumstances..." ASIC follows the general principles of project management methodology. For ASIC, project management

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85 The topic of alternative civil strategies is discussed in more detail in Part IX.

86 This topic is discussed in more detail in Part VIIID.

87 An example of the perceived ambiguity about the directors' duties provisions given by a number of the interviewees is s 232(6) of the Corporations Law. This section provides that an officer or employee of a company (or a former officer or employee of a company) must not make improper use of his or her position to gain, directly or indirectly, an advantage for himself or herself or for any other person or to cause detriment to the company. There has been a series of cases, including several judgments of the High Court of Australia, regarding what it means to "gain an advantage" and to make "improper use of position". These judgments include *Chew v R* (1992) 173 CLR 626; *R v Byrnes* (1995) 130 ALR 529; *R v Cook* (1996) 107ALR 171; and *R v Towey* (1996) 21 ACSR 46. The judgments are discussed in H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law*, looseleaf, para 9.280.

methodology is a standardised methodology used on all enforcement matters, more or less regardless of the scale and subject matter of the enforcement matter. Its first characteristic is that it involves establishing lines of responsibility between the project sponsor (who is usually a member of the senior executive in the office and who has strategic oversight of the matter), the project manager (who is normally a senior operational staff member who has day to day control of the enforcement matter) and team members. Secondly, it involves the creation of a project plan for the enforcement matter. The project plan will divide the matter up into phases. Before work is commenced on any phase a detailed task list is prepared. Thirdly, at regular intervals, the project sponsor and project manager will review the progress of the project against the task list and, if appropriate, adjust the task list in response to the additional information which is received as the investigation progresses. Mandatory project plan templates and reporting templates have been prepared to facilitate benchmarking of best practice.

Civil penalties are one enforcement tool that is often looked at by the enforcement personnel of ASIC on an ongoing basis. However, despite this attention, civil penalties are rarely actually used because, given the profile of potential defendants set out above and other factors identified in this report, they seldom fit the circumstances of various matters. This is clear from their low incidence and later sections of this report examine in more detail why the circumstantial fit of civil penalties has been so poor to date.

Question 2(b) raised the issue of the deterrent value of civil penalties. Deterrence in both its specific and general forms is obviously a high priority for regulators. Most of the respondents agreed that civil penalties possess some deterrent value, but of a lower grade, which has a limited effect on the market and they were unsure how its deterrent influence could be gauged.

The most popular view amongst the respondents was that many people were aware of various penalties in the Corporations Law, but civil penalties were unlikely to be specifically prominent in the mind of the business community because there have not been that many brought and therefore they are probably not a powerful deterrent. This corresponds with traditional theorising on deterrence which argues that it is the threat of detection and the certainty of punishment which act as deterrents to potential offenders. Civil penalties could potentially rate significantly on these criteria, but do not because of their low levels of usage to date. One respondent was of the view that it is the other ASIC enforcement weapons which promote deterrence and that civil penalty provisions are more motivated by protection than deterrence goals.

Despite this uncertainty regarding inherent deterrent value, what is clear from the interviews and also from the low numbers of civil penalty actions is that the *Catch-22* of civil penalties' minimal public profile in turn reduces their perceived worth as a deterrent. This places further doubt in the mind of a regulator about using civil penalty provisions when there are more proven deterrent options readily available. This delegitimation impact on the civil penalty regime due to its lack of use is an important issue and is discussed in more detail in later sections. The comments of one respondent on civil penalties in relation to deterrence and efficiency issues are a reasonable reflection of the respondents:

> "...where you're dealing with the classic investigation involving urgent complainants, lost funds and apparent misbehaviour by companies and company officers, your first thought and what really engages you initially in the matter is not …'we can turn this into a civil penalty proceeding and that's going to be really effective…' Your first thought is to understand what in fact has really happened. If what has happened appears to be that the complainants allege that they have been duped, or misled, or there's been some sort of

> dishonesty, and they've lost their funds or there's been a breach of duty by the directors of the company, then your next thought is to recover the funds as quickly as possible. That is to locate the funds, where they are now and freeze them, so that there is a frozen fund out of which compensation can be paid or lost funds can be recovered. They're the sorts of questions that really dominate the mind of the investigator and lawyer working on the matter…A lot of the time those questions get settled and satisfied before you have to resort to something like the high powered legal engineering that is in fact the civil penalty regime."

Unsurprisingly, it is these very real, very pragmatic and very immediate priorities that direct which tools ASIC enforcement personnel use. There is understandable reluctance amongst ASIC enforcement professionals about the incidental time, complications and expense associated with civil penalties. However, the respondents were refreshingly candid about the potential drawbacks of such a stance.

E. Subsequent analysis

The foregoing discussion has identified a complex set of interrelated factors which help to explain the low incidence of civil penalty enforcement under the Corporations Law. They include:

- ASIC's resource constraints, including financial, geographical and personnel contraints;
- ASIC's relationship with other regulatory agencies, including the DPP and the courts;
- the availability of alternative enforcement mechanisms apart from civil penalties; and
- legal issues, including the unclear nature of parts of the Corporations Law.

To facilitate further analysis, the research team divided these factors into four groups, based on the institutional setting in which the factors arise. The groups are:

- internal factors affecting ASIC enforcement practices (Part VII);
- external factors affecting ASIC enforcement practices (Part VIII);
- alternative mechanisms to civil penalties (Part IX); and
- legal issues (Part X).

VII. INTERNAL FACTORS AFFECTING ASIC ENFORCEMENT PRACTICES

A. Overview

The object of this Part is to report on the intra-organisational issues and constraints identified by the respondents as impacting on ASIC enforcement practices. The interview questions had a continuing focus on the subject of civil penalties, but the nature of the enforcement regime under Part 9.4B and the subject area itself, made it inevitable that broader enforcement issues would be covered during the course of the interviews. In particular, the internal issues nominated by the respondents as significant were:

- the enforcement philosophy underlying ASIC enforcement decisions;
- ASIC's financial resource constraints;

- the scope for regional differences in enforcement decision-making;
- the skills and experience of ASIC enforcement personnel; and
- the existence of a shared enforcement culture among personnel.

B. ASIC enforcement philosophy

The issues of ASIC's underlying enforcement philosophy first arose in connection with question 4, which asked respondents to describe how they might deal with matters that come within the ambit of Part 9.4B. There was a high degree of uniformity in responses, with little regional variation between ASIC offices. All respondents agreed that the option of a civil penalty remedy would be considered in many cases when the initial decisions are made about how a matter should be organised. However, as has been stated earlier the practical application of civil penalties has been small. This point was re-iterated in responses to questions 5(a),(b) and (c) which asked about the utility and deterrent values of Part 9.4B, and whether the new civil penalty system is an improvement on the previous regime. Approval of the new regime was qualified.

The respondents' views were influenced by the prevailing regulatory philosophies within ASIC. Their answers revealed that ASIC is taking an increasingly holistic approach to enforcement, as reflected in the use of project management methodology, CMPs and TRACs.[88] A blend of two regulatory philosophies explain this approach: a philosophy of "campaign based" enforcement, underpinned by strategic regulation theory. This is not surprising, given that a pyramid of enforcement measures, which is part of strategic regulation theory, is latent in the Corporations Law.[89]

The implicit influence of strategic regulation theory is evident in this respondent's reference to the wide range of strategies that can be employed to improve conduct. The importance of strategic, deterrent-based approaches to enforcement was implicit in many responses. For example:

> "I think that criminal prosecutions remain a very significant part of community expectations relating to deterrence. There's raging schools of thought as to whether that's true or not and whether its worth the resources required to bring criminal prosecutions, but I think criminal prosecutions can play a key part in deterrence. Secondly, its all the other strategies that you've bundled up in one form or another to do what I call 'establish a presence in the market'. One way of achieving deterrence is that those participants in the market feel our presence, they know that consequences will follow from unusual trading or being involved in transactions that aren't in the interests of the company. That can happen in all sorts of ways
> …As I say civil penalties, charges, getting liquidators appointed, getting assets frozen, banning directors, all those different things help it all come together…"

Campaign-based enforcement is used by regulators in many industries to identify or nominate specific areas or targets for regulatory attention. It is, for example, a common operational

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[88] The role of project management methodology, CMPs and TRACs was explained in Part V.

[89] The pyramid of enforcement applying to directors' duties in the Corporations Law was outlined in Part IV. One respondent referred to the work of Harvard University academic Malcolm Sparrow (*Imposing Duties: Government's Changing Approach to Compliance* (1994)) as giving rise to some approaches that, among others, ASIC is considering. The essence of that approach is that a particular important problem is identified, and a whole range of strategies and enforcement tools are brought to bear to solve the underlying causes of the problem. These tools can include education, new policy statements, amnesties, surveillance visits and enforcement action.

strategy in conventional policing. A narrowing of areas or targets is necessary because of the resource constraints facing all regulators, including ASIC. As one respondent explained:

> "…it's what I call tuning in the right direction. Somehow there's no point in just doing whatever comes along, there's got to be some sophistication regarding where you're putting your resources, so that means having a sophisticated complaints assessment approach, being able to analyse the complaints you're getting across the country, being able to spot issues whether they're of local or national significance and dealing with those issues in a way that's credible so that people feel as if you're making a difference and that they're actually going to change behaviour…"

ASIC believes that campaign-based enforcement has inherent deterrence value. One respondent described this effect in the following terms:

> "I think it sends appropriate messages as well, so I think there's a greater deterrence factor if those participating in the market feel that the regulator is looking at the right issues, the ones that really matter. If that's the case and we can deploy our resources in that direction, then that misconduct should be reduced because we're focusing our resources in the right area and running our campaign style approach to enforcement, which I think is right in the limited resources environment we're in."

ASIC provided this example of its use of campaign-based enforcement and strategic regulation theory. Assume that the intelligence information available to ASIC reveals that there is widespread non-compliance in the building industry with the obligation to keep financial records contained in s 286 of the Corporations Law. A director of a company who fails to take all reasonable steps to comply with or secure compliance with the obligation in s 286 contravenes s 344, which is a civil penalty provision. ASIC decides that because of the impact of insolvent trading in the building industry on creditors, it should devise a campaign to improve levels of compliance. The sort of integrated compliance strategy that would be devised is as follows:

- General educative and persuasive activities would be initiated. For example, explanatory material could be made available on ASIC's website to advise companies in the building industry of what sorts of financial records ASIC considers to be the minimum required and how to go about keeping those records. ASIC may also issue media releases that it is going to enforce the failure to keep adequate financial records in the building industry.
- Based on intelligence and weighted risk assessment criteria, a number of companies would be targeted for a surveillance visit. At the surveillance visit the financial records of the companies would be reviewed. It may be that in relation to some of the companies inspected, the deficiencies are such that an investigation is immediately commenced.
- In many cases, the outcome of the surveillance is likely to be a letter either advising the companies that ASIC has no concerns or raising a number of minor concerns, and suggesting that the companies seek professional accounting advice. The letter might also draw to the directors' attention provisions such as s 588G (which imposes a duty on directors not to have their company trade while it is insolvent).
- In more serious cases, ASIC may require the company to prepare and provide to it financial reports (pursuant to s 294(1)).
- A number of outcomes could be achieved by negotiation in appropriate cases. These include the directors of a company placing it under voluntary administration or the directors agreeing to make changes to their accounting procedures. Depending on the significance of what is agreed, an enforceable undertaking may be appropriate.

- The next step up in relation to enforcement is remedial civil orders, namely orders for damages against the directors contravening the Corporations Law. It is most unlikely that ASIC would take action of this kind against a "live" company. Actions of this kind are most likely to be undertaken by the liquidator of the company.
- In some cases, arising out of the surveillance visit and subsequent investigation, ASIC may form the view that it is appropriate to use its administrative powers to ban persons from being directors of a company. This will require ASIC case officers to form the view that banning was necessary to protect the public, in particular, creditors and shareholders of companies of the kind that the person in question is likely to manage.
- Where the conduct is more serious, or the proposed defendant is viewed as recalcitrant, ASIC may commence actions pursuant to s 230 or s 599 to obtain a Court order disqualifying the person from taking part in the management of a company. Alternatively, it may seek an order of this kind in civil penalty proceedings for breach of s 344. These orders are all protective in nature. Another form of protective order would be action to enforce s 229, for example, by obtaining an injunction to restrain a bankrupt from taking part in the management of a company or commencing summary proceedings against a bankrupt who had taken part in the management of a company.
- In cases where, in addition or substitution to a banning order, the conduct was of sufficient severity to warrant the imposition of a pecuniary civil penalty, then civil penalty proceedings could be commenced under s 1317EA.
- Where the conduct of the proposed respondent was tantamount to fraud, then criminal proceedings under s 1370FA could be commenced.

Each tool in the enforcement pyramid may be used by ASIC in order to induce a widespread increase in compliance with the financial record keeping provisions of the Corporations Law in the building industry generally. By using all the enforcement tools in combination, each mutually reinforces the other and increases the deterrent effect. For example, those wishing to comply with the law would be assisted to comply with the law through the educative functions. Those who can be described as "opportunistic" - who will comply with the law if they have to - will be assisted to comply by the information provided by ASIC and persuaded to comply by the threat of a surveillance visit (or actual visit) or more serious action being taken. The fact that there is widespread surveillance will increase the deterrent effect of the protective and penal enforcement responses as it will create the perception that there is a high risk of being caught. The use of a targeted media and communications strategy will also extend the deterrent effect of the protective and penal action actually carried out, as it will again increase the perception that the threat of protective or penal action is real. Those persistent offenders, who are either unwilling or unable to comply, are removed from the relevant sector of the business community. This creates the perception that ASIC will not let people evade the consequences of not complying with the standards contained in the Corporations Law.

C. Financial constraints

Reference has already been made to the over-riding rubric of pragmatism under which ASIC engages in enforcement activity.[90] This is hardly novel as a limited resource environment is the starting premise for most models of regulation, including strategic regulation theory. The respondents were asked questions designed to elicit comments as to the role played by resources

[90] See Part VID.

in both individual decisions whether to pursue civil penalties and institutional decisions as to how ASIC should carry out its enforcement responsibilities.

On a day-to-day level, it appears that the issue of resources, or more pertinently, lack of them, does not directly impede any ASIC decision to pursue a civil penalty.[91] However, indirectly this resource impediment probably does exist, especially taken in conjunction with perceptions about judicial attitudes and the potential for criminal action in a civil penalty-type situation, which causes the DPP to become involved in the decision-making process. Both issues are discussed in detail in Part VIII of the report, but one respondent summed them up in this way:

> "In considering whether or not to commence a civil penalty proceeding, you've got to balance the legitimate expectations of the DPP in dealing with the matter. Their views need to be sounded out....There has got to be a legal doubt over the efficacy of a lower court such as a Magistrates Court in a committal proceeding or the County Court in criminal trials, making or certifying that there has been a civil penalty contravention and having that certificate by itself recognised by the Federal Court or the Supreme Court without any re-argument over the issues. That poses a significant legal doubt which sounds commercially for the ASC in having to litigate the same matter twice, or at least go through the process of having to litigate twice, which we have to take into account when considering what options we have."

There is a constant interaction of resource concerns with current enforcement priorities, as individual enforcement personnel and TRACs make recommendations on appropriate operational strategies including whether to commence a civil penalty action.

Questions 3(b) and 11(a) were directed at the overall effect of ASIC resource decisions on the enforcement function of the Corporations Law and the performance of that function by ASIC. Question 3(b) asked the respondents whether lack of resources also impeded the Corporations Law successfully performing a deterrent function. Question 11(a) asked whether lack of resources was a significant impediment to ASIC successfully carrying out its enforcement responsibilities. All the respondents agreed that resources are always an issue and more resources would see more matters pursued. However, as one respondent succinctly noted, a doubling of available resources is unlikely to double deterrence. The respondent from one smaller office said that overall staff numbers have dropped off in that regional office by 50 per cent, but the number of enforcement staff has actually increased and the office is more active in enforcement than it has ever been. These changes reflect:

- the continuing consolidation of ASIC's activities, as more of its processing and administrative procedures are centralised; and
- the strategic staffing opportunities offered by developments in information technology which free up resources.

All the respondents agreed that:

- resources are less of a problem than one might think because ASIC is now more efficient in its use of resources in recent years as it has become more targetted in its general activities and in its application of project methodology case management; and

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[91] The respondents did not expressly acknowledge any such restraint on their decision-making relating to civil penalties.

- resources obviously help decide management strategy but ASIC is always prepared to spend significant amounts on investigations (despite resource constraints), if a matter demands a particular sort of response.

One respondent made the point that fewer resources have made case officers more disciplined as to what matters to take on and what results to seek to achieve.

Limitless budgetary support for ASIC is neither feasible nor desirable so resource problems of some sort are always likely. Yet it appears that current organisational arrangements based on project methodology approaches are delivering good cost-benefit returns overall, even if civil penalty actions are not yet an effective contributor to what the respondents believe is a generally positive ratio of funding: enforcement performance by ASIC. However, in the authors' view it must be the case that no matter how efficiently existing resources are used, "appropriate" matters are likely to slip through the enforcement net simply because of insufficient resources.

D. Regional variations

Variations in enforcement practices and priorities are more likely when enforcement decisions are made by regional offices of a national regulator, rather than centrally. The extent of variation within ASIC is reduced by its holistic approach to enforcement. However, it is unlikely to be uniformly applied at all times and across all regions. TRACs must merge their overview of the regional office with the immediate operational priorities of an individual matter as well as national enforcement priorities. It is at the TRAC decision-making stage that any regional variations in the circumstantial fit of the civil penalty enforcement mechanism may begin to emerge. The interviews suggest that the regional differences within ASIC are the product of the different enforcement priorities of the regions. However, the interviews did not reveal any specific regional bias towards, or against, civil penalties, despite some regional offices not having taken any civil penalty actions at all.

It is inevitable that the current enforcement priorities of regional offices within ASIC will vary. This is due in no small measure to the fact that there are substantial differences between the different types of markets that different regional offices supervise. For example, Canberra, Darwin and Hobart are obviously smaller, less sophisticated and less diverse financial centres than Sydney and Melbourne. Respondents from those regions confirmed that matters which might not be taken up in larger centres such as Melbourne or Sydney might be pursued in some of the smaller offices.

Similarly, on the issue of international co-operation or matters having an international character, respondents agreed that there were clear differences between the larger and smaller offices. One respondent stated that international matters were on the increase (especially regarding market matters), and that approximately 20 per cent of all ASIC matters in New South Wales have some sort of offshore connection.[92] Other respondents agreed that the international element is increasing in line with the increasing internationalisation of financial transactions. This is especially true in areas like warehousing of shares and some respondents had experienced success in freezing funds overseas in some matters. Traditionally, several of the smaller offices

[92] Increasingly, the Office of International Relations of ASIC is focusing upon issues of enforcement. In 1998 a senior lawyer was appointed to the Office of International Relations with particular responsibility for coordinating international enforcement activities. Also, the Commission recently appointed New South Wales Regional Office's Counsel (then one of ASIC's most experienced officers in enforcement) to head up the Office of International Relations.

have not had such international issues to deal with, but in the last couple of years some matters that have been investigated by smaller offices have had international elements. However, most felt that specific international regulatory cooperation is still the exception rather than the rule.

Regional variation was also acknowledged by respondents in situations where there might be a specific industry, or a specific offence, that is perceived as problematic in any given region at any given time. Such specific problems would receive local priority and this inevitably means variation of case-mix between different ASIC regional centres, resulting in enforcement resources being directed towards different enforcement strategies.

E. Variations in skill and experience base of personnel

Changes in the skills and experience base of personnel can produce shifts in the regulator's activities. ASIC evolved from the various state-based Corporate Affairs Commissions and the National Companies and Securities Commission, which had substantial numbers of investigators whose backgrounds were in the criminal law. The interviews revealed that the proportion of enforcement personnel within ASIC with civil law experience prior to joining ASIC is increasing, as is the level of civil law expertise of all ASIC personnel.

The respondents were not sure about the effect these changes have had on the number of civil penalty proceedings. No-one felt that ASIC enforcement personnel were strongly opposed to civil penalties, but several thought that the higher levels of civil law expertise now within ASIC did influence decision-making processes. For example, the view of one respondent, when discussing the increasing incidence of management banning orders, was that:

> "..there has been an increase in the last five years and there are probably a couple of reasons. When the ASC first started in 1991, most of the investigators that came into the organisation were largely ex-police, had a criminal law background and everything was focused towards prosecutorial action. I think of late we've moved to a more professional investigative base, so that investigators are more conscious of the range of remedies that we have and are more willing to consider the possibility of bringing banning-type actions than they would have been in the past. They're also seen now as significant sanctions, particularly as some of them have been handed down for a significant length of time, and they have a significant impact on the individuals, so it seems a worthwhile outcome."

Other respondents agreed with this comment on the changing staff profile of ASIC enforcement divisions across the regions:

> "...I think there is a very distinct historical element. People are more comfortable with the criminal law, or the concepts of criminal law, and there are not that many people highly experienced in civil litigation. It does require a different approach and a bit of a different philosophy. The tools are the same, the investigation, the evidence gathering, the preparation of evidence for trial, but it's that question of the outcome that you're seeking and how you go about getting there. I think that generally speaking, the organisation is very receptive and the people in it are very receptive, to try to do some new things, and this is part of what we've been working on."

Another respondent concurred and emphasised that breaches of the State Criminal Codes are often easier to prove than breaches of the Corporations Law. More familiarity with Criminal Codes and general criminal law by ASIC investigators and the DPP is a factor. A respondent

from a larger office believed that the operational and specific legal experience of some ASIC personnel can militate against civil penalties being pursued:

> "...there is a willingness at the management level and at the senior level to use whatever provision we can to get the desired result out of any matter. But the culture of the staff that do the work has an influence. I'm not saying that there's problems in the area, but some of the older investigative type people would prefer to go down the criminal route than the civil penalty route."

In summary, there is a concerted organisational progression within ASIC towards increased familiarity with civil law procedure and this may well help to raise the numbers of civil penalty actions launched.

F. Enforcement culture

The respondents' comments on the civil penalty regime were frequently peppered with references to the need to get "the right outcome". The most common view of civil penalties within ASIC was summarised by one respondent in the following terms:

> "...notwithstanding it's been around since 1993, it's sort of newish and a bit unknown. The tried and true methods, if they're found to be effective, one tends to follow those, because you want to get the right outcome."

This individual and collective desire to "get the right outcome" is symptomatic of an organisation which is careful about its enforcement choices (which may have militated against civil penalties), but not timid about meeting its enforcement responsibilities. One respondent summarised the enforcement culture of ASIC in these terms:

> "I feel it's a strong enforcement culture in a regulatory environment. I think enforcement is a tool, it's there to deliver regulation or regulatory outcomes, but all those things you read in section 1 of the ASC Law, those expectations of enforcement, play a vital role in giving credibility in delivering those outcomes. I think there's a strong commitment internally to enforcement, a proportionate amount of our resources goes into enforcement. In terms of the culture, I think it's a responsible culture, we're not gung ho. Our lawyers and investigators exercise their information gathering powers with objectivity and responsibility. We do not have a reputation for being bloody minded or inappropriate in the way we go about doing that, which I think is important. We're very professional, that's an important part of our enforcement culture. I think we're courageous, we do take on some hard cases, even though they might take longer than a lot of people would like, including me… there aren't too many agencies in the world that have our range of functions. We have the capacity to do complex wide ranging criminal investigations and deliver banning orders under section 600 of the Corporations Law. In relation to the Australian Federal Police, the DPP, the Sydney Futures Exchange, it's quite a wide range of sophisticated work...With these new consumer protection functions, which is another layer of complexity and sophistication required, the one organisation is on the one hand, going to put people in jail, but on the other hand, ensure people make proper disclosure. So, it's an interesting bundle."

It is important to contextualise these wide-ranging responsibilities with the issue of low totals of ASIC civil penalty actions to date. One respondent suggested that a comparison with the Australian Competition and Consumer Commission (ACCC) experience with civil penalties might be fruitful because the ACCC:

> "...took a couple of years to crank things up...and get runs on the board..but once..they were in their stride.. the rates of [ACCC] civil penalty actions has increased exponentially."

It will be interesting to observe if the ASIC experience in the future mirrors that of the ACCC. Assuming that civil penalty totals do rise over the next few years, it will also be important to note whether current regional variations concerning civil penalty actions within ASIC regional offices are sustained. The current totals are too low (fourteen civil penalty actions across all offices), to impute substantial statistical significance. However, relative to their size, Western Australia (five actions) and Tasmania (two actions), seem to be the regional offices more inclined to proceed on the civil penalty pathway. The respondent from Western Australia indicated that his office would commence other civil penalty actions. In the context of current civil penalty statistics, this represents a veritable flurry of activity and suggests that there may well be some force in the opinion that if an office has previously run a civil penalty action, then it will be more likely to pursue that strategy in the future.

G. Summary

The foregoing discussion highlights how the organisational philosophy, culture, decentralised operations and changing skills base of a national regulator are instrumental in its enforcement decisions, including whether to pursue civil penalty actions. The experience in Western Australia suggests that if a regional office has actually run a number of civil penalty actions, then it is more likely, despite the internal constraints enumerated here, to keep using them. The report now analyses the external constraints on the use of civil penalties.

VIII. EXTERNAL FACTORS AFFECTING ASIC ENFORCEMENT PRACTICES

A. Overview

The operational context of the civil penalty regime in the Corporations Law cannot be solely understood in terms of the internal factors relevant to ASIC, such as its enforcement culture and the skills and experience of its enforcement personnel. ASIC is only one of the three agencies or law enforcement groups which interact with the civil penalty regime. The other two are the Commonwealth Director of Public Prosecutions (DPP) and the judiciary. This Part reports on ASIC's working relationships with the DPP and the judiciary, and the effect these relationships have on the use of civil penalties. As will be seen, the broad view of the respondents is that review of ASIC enforcement decisions by the DPP and the judiciary is necessary and appropriate. However, the complexities of the relationships between ASIC, the DPP and the judiciary compound the internal constraints discussed in Part VII.

B. The DPP

1. Overview

An important aspect of the dynamic of the civil penalty regime in Australia has been the working relationships between ASIC and the various Directors of Public Prosecutions (DPPs), in

particular, the Commonwealth DPP. The fundamental importance of the ASIC: DPP relationship to the general regulatory agenda of ASIC was repeatedly emphasised by all the respondents. However, because of the specifics of the legal architecture of the civil penalty regime, the priorities of the DPP play a larger role in ASIC processes regarding civil penalties than they do in many other ASIC enforcement strategies. Many of the respondents directed attention to how the role of the DPP impacted on ASIC's decision-making process relating to civil penalty orders.[93] The interviews revealed that there were cultural and philosophical differences between ASIC and the DPP that influence decision-making processes.

2. Background to relationship

In order to understand the influence of the DPP on the use of civil penalties by ASIC, some historical background is necessary. The ASIC: DPP relationship is crucial to the enforcement of corporate law in Australia. Since September 1992, the framework for cooperative arrangements between the agencies has been based upon Ministerial Orders laid down by the then Attorney-General, Mr Michael Duffy. The Attorney-General was prompted to issue such orders because in certain respects "...co-operation and collaboration between the ASC and the DPP has...fallen short of the Government's expectations."[94] The Ministerial Orders formalised a new co-operative framework between ASIC and the DPP by establishing a National Steering Committee On Corporate Wrongdoing, comprising the Secretary to the Attorney-General's Department (the Convenor of the Committee), the Chairman of ASIC and the Chairman of the DPP. The Committee is resourced by the Attorney-General's Department, meets at least quarterly, and as required in other circumstances. Its major purpose is to oversee the ASIC: DPP relationship, resolve disputes and report to the Attorney-General. The Committee has sponsored the development of a Memorandum of Understanding (MOU) and other written guidelines between ASIC and the DPP. The latter have established systems and procedures to direct the ASIC: DPP working relationship. An important issue for these procedures and a key focus of the 1992 Ministerial Orders was consultation in respect of civil proceedings:

> "Except where the exigencies of the particular case prevent prior consultation, the ASC shall, before taking civil enforcement action in any matter in respect of which it considers that serious corporate wrongdoing of a criminal nature may have occurred, consult with the DPP regarding the appropriateness of taking such civil proceedings in the light of the possibility that criminal enforcement action may also be available." [95]

One respondent informed us that when civil penalties were first introduced, there was a degree of regional variation in the way the DPP State Offices and ASIC Regional Offices managed civil penalty matters. This was brought about by a number of factors including:

- uncertainty as to the role of the DPP given the fact that commencing civil penalty proceedings is a bar to subsequent criminal proceedings; and
- uncertainty as to how the provisions creating criminal liability for contraventions of civil penalty proceedings operate in practice.

Those uncertainties inevitably caused delays. However, in 1997 the DPP and ASIC settled the following two significant matters:

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[93] As part of the continuing and broader research project the research team will be canvassing the views of the DPP on issues arising from this research report.

[94] Ministerial Orders, *ASC Digest*, 1992, Update 183.

[95] Ibid.

- ASIC agreed that it would refer all civil penalty matters to the DPP prior to commencement of proceedings; and
- the DPP agreed to accept a reasonably limited brief in order to determine whether or not it was in the public interest for a potential civil penalty action to proceed by way of criminal action.

The documents which detail most of the working arrangements between ASIC and the DPP are confidential.[96] The research team did not discuss the content of these working arrangements with the respondents, but their views on the operational effects of the ASIC: DPP guidelines emerged in responses to questions 12 and 13 of the interview schedule. This is unsurprising given the subject of civil penalties, because their capacity for both criminal and punitive civil action inevitably highlights the practical effects of such procedural directives.

While it is obviously impossible to evaluate documents that have not been viewed by the research team, it is incontrovertible that the various priorities that ASIC and the DPP have are not always congruent regarding civil penalties, and it is understandable that at times ASIC personnel can find this frustrating.

3. Systemic differences

There is a systemic tension in the roles of the DPP and ASIC with respect to civil penalties, which was described in this way:

> "I think there are differences, but I think they're built in differences. The way a prosecutor thinks is very different from the way a regulator thinks. A prosecutor is by definition someone who's very measured, very objective and is conservative, they're trained that way because of the consequences of what they do, they put people in jail."

The role of the DPP is to manage Commonwealth criminal prosecutions in line with the Prosecution Policy of the Commonwealth. The role of ASIC is to function as a market and business regulator, concerned with changing behaviour using a number of tools, one of which is criminal prosecutions. The DPP's role as an independent prosecution decision-maker inevitably and properly means that additional time and consideration will be taken on issues than if the whole process had been conducted by one agency. The DPP (quite understandably), always wants to satisfy itself that there is no criminal element in a matter.

The issue of delay as the DPP evaluates a matter in terms of its own agency priorities was repeated by most of those interviewed. However, it is important to emphasise that despite the difficulties described, the respondents were generally positive about the ASIC: DPP working relationships in their regions, with one saying:

> "Yes, there are tensions from time to time as one could imagine, but we actually work very well with the DPP. They actually work very closely with us from the early stages, even prior to the formal hand-over process, so we tend to hand over the matter in a state the DPP is happy with, because the DPP is actually involved...Most matters we have put up to the DPP have been prosecuted."

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[96] This is certainly the case regarding civil penalties. The research team did not view these guidelines, but was provided with an Information Sheet: *ASIC Working Relationship With DPP*, by the National Director, Enforcement of ASIC.

This positive opinion on the ASIC: DPP relationship was repeated across most regions. For example:

> "I think we've built up an excellent relationship with the DPP… we've got a very good working relationship with them…we work hard at it. They respond to their referrals in varying ways, again, depending on the quality of the staff; and any organisation is dependent on the quality of its staff. That's just something we have to try and manage...I speak to the DPP on a daily basis to try and have a manageable relationship...
>
> There's always an ongoing process about how we're going. We formally meet with the DPP about every six weeks and we formally go through every matter that we have between us. We discuss how the matter's going, what the likely result of it is, the time before some result and how we're dealing with the requests that we've had between us. So, that's the formal way. It happens on a daily basis as well."

Another respondent gave this endorsement of the ASIC: DPP relationship in his region:

> "...an extremely good one. We're certainly able to sit down and talk things out fairly rationally. There have been from time to time rough spots in particular investigations, but it certainly never interfered with the broader relationship."

4. Regional variations

By and large the ASIC: DPP working relationship was viewed by respondents as one of positive collaboration across the regions, although there was some variation. There was also variation in the duration and intensity of the ASIC: DPP collaboration on an inter-region comparison, and also on an intra-region basis across time. Under present arrangements, ASIC is required to work with the Commonwealth DPP rather than State DPPs. There are arrangements between the Commonwealth and State DPPs under which the Commonwealth DPP can approach the State DPP about laying State-based charges in a matter. In most cases the State DPPs have granted the Commonwealth DPP such access. The DPP does seem to be more regionally-oriented than ASIC and this impacts upon working practice in general, and on civil penalty applications in particular:

> "They don't act as nationally as we do, so I think their regional offices are more independent than ours are to us. So, I think it's very important that there be good working relationships because there are regional differences. So, the regional liaison is very important."

The role of the DPP may limit use of the civil penalty procedure. In the words of one respondent when discussing civil penalties in general:

> "I think the theory of civil penalties is excellent. I think the drafting of it is extremely complicated, but the theory is good. But in practice, in this office, from my recollection, I don't think we've ever used the provisions, and I think there's probably two main reasons for that. First, the relationship that we have had with the DPP, and I don't know whether you're aware of...it's the guidelines of the DPP that we have to give them first bite of the cherry so to speak. We've found on a few cases where we maybe thought a civil penalty was the way to go, but by the time we go through our normal processes of investigating, evidence collection, brief preparation and consultation with the DPP, the opportunity for a civil penalty seems to have been lost because of that length of time....The second part of why we haven't done too many [civil penalty actions] is maybe a little bit of a case by

> case basis. The matters that we've got, there's been nothing to get back and we would really have been obtaining empty orders."

This theme of the legitimate involvement of the DPP having the potential for slowing moves towards civil penalties was repeated in most regions.

Almost all the respondents described the relationship in their region between ASIC and the DPP as a collaborative one, with varying degrees of interaction. ASIC and the DPP are making continuing efforts to improve their interaction. For example, through analytical workshops:

> "I, in particular, am very keen in using workshops to do case studies. So you pick two or three matters that have been completed and some time's gone by and do post mortems, figure out what worked and what didn't. So, I'm trying to promote that a lot more, because that really tests the maturity of the relationship and the capacity to be able to sit down with your colleagues and say: this and that worked; you really should have got back to us sooner on that issue; you should have got counsel involved in that matter etc, and they get stuck into us. It's having that feedback in both directions and trying to create a forum and an atmosphere where that happens."

ASIC and the DPP are also trying to harmonise specific administrative elements of their interactive working practice:

> "We're developing at the moment a system, they're calling it the Litigation Support System (LSS) which I think will be Commonwealth best practice by the time it's finished. It is a wholly integrated document, registration of handling and management system as well as being an analytical system, so all of the documents coming into our possession during the course of an investigation will…be imaged and investigators will be required to work on the issues. All the analytical tools, the search tools are all on the system. We've worked very closely with the DPP to develop it and they think it's terrific. It's already being used in several matters in Queensland, Victoria and Western Australia, in fact everywhere, every office has had a pilot."

This is an example of the commitment of both ASIC and the DPP to increasing their interactive efficiency and demonstrates their institutional commitment to a productive co-operative relationship. As an overall comment on these issues, the interviews reveal that although there is some variation in how ASIC and the DPP work together across the regions, the basic relationship is generally positive.

5. Mechanics of ASIC:DPP relationship

Turning from a global view of the ASIC: DPP relationship to the mechanics of their operational interaction, questions 12(f) and 13(b) asked how matters were referred by ASIC to the DPP and how the DPP responded to such referrals. Generally, the referral process is not a single event and there is usually a process of consultation built on regional working practice. The DPP is kept informed of what matters are under way and may, or may not, be referred to them. It varies between matters, but usually at the initial preliminary investigations stages, there would be no involvement with the DPP. The DPP may become involved very shortly thereafter, and so sometimes may be fairly closely involved in the earlier stages of a matter. There may be input into the report and referral process by: an ASIC specialist in the area covered by the matter, an Investigations Manager, or the TRAC. Another respondent stated that there may be some variation in managerial arrangements across the regions, but the project plan is usually written up

within six weeks of resourcing a matter. It is at this early stage on whether or not to pursue an investigation that the DPP is usually first informed of a matter, because by then it is normally clear if there may be a criminal element involved:

> "...soon after that we'll ask the DPP to appoint a liaison officer and then we'll gradually get them involved on a needs basis/tactical direction basis....The information they get really depends on what they need.."

One respondent described the use of an Investigation Project Proposal that:

> "..sets out the detail of the investigation, what its focus is, resource usage issues etc. It's designed to be some sort of matrix, to keep things on track and measure how our investigation's going. At the end of that…the investigator puts together the brief and we have a standard form for that, together with the report which sets out the facts, the recommended charges and whatever observations the investigator thinks are appropriate to be made. That brief is reviewed by the Director of Enforcement and if he's satisfied that it is appropriate, then that brief is sent over to the DPP."

The ASIC: DPP referral process is overseen by the Director of Enforcement in each regional office and the section of the DPP that deals with corporate law matters. There are also ASIC:DPP committees which monitor the working relationships and engage in strategic information sharing on a more formal level. More informally, ASIC personnel keep their DPP counterparts informed if there are briefs likely to come their way. So, it can be seen that the referral process is an interactive one which can vary depending on the requirements of specific investigations. Nevertheless, like any relationship, some difficulties arise from time to time:

> "There are differences. The guidelines are there, but the differences I think are largely understandable or attributable to things like the mix of skills of the…case officer[s]. If you're dealing with a very experienced DPP person who's worked with you quite a lot in other matters, you can imagine how short the conversation is about what a witness statement ought to look like, because you've done it twenty times before. It's very different if you haven't dealt with this person before or it's your first one. If the relationship is good but just inexperienced, either on our side or on theirs, that has a direct impact on the frequency and the quality of the communications. Another difference might be the involvement of external counsel. In some states, the DPP do their own trial work, in other states they don't, they brief out, and that reflects the local culture. So, in Western Australia for example, where you don't have a divided profession, the senior people in the office there do their own trials. That doesn't happen in Melbourne. So that has an impact on the quality and frequency of communications, and who needs to be in the meetings. Another key feature of the issue is staff changes, our people leave, go to other offices, move on, same thing with the DPP, so that has an impact. All those things can conspire to mean that a lot of matters get driven by those dynamics."

These common, pragmatic realities of working life anywhere, are present in the regional offices of both ASIC and the DPP.

Question 13(c) asked what happens if the DPP does decide to press criminal sanctions. The next step is that the DPP refers the matter back to ASIC. ASIC then goes through the procedural issue of taking out the summons or warrant.

Question 13(d) raised the issue of what happens if the DPP determines not to press criminal sanctions in a matter. All respondents agreed that there are rarely disagreements between ASIC

and the DPP over pressing criminal sanctions and if there are, then they are usually resolved by round table discussions between ASIC and DPP personnel. Once the decision not to press criminal sanctions has been made, then ASIC has to decide whether or not to devote even more resources to pursue the matter civilly. There are a number of options including:

- if there is a civil penalty provision breach, then ASIC may launch civil proceedings;
- the matter might be closed down and interested parties informed; or
- ASIC might take administrative action, such as seeking a management banning order.

C. Other agencies

The DPP is extremely important in the operational praxis of ASIC, but there are other agencies and law enforcement interest groups which influence ASIC decision-making processes. Question 12(l) asked what other decision-making procedures ASIC would follow and several respondents discussed ASIC's working relationship with the Australian Stock Exchange and the Sydney Futures Exchange. One respondent observed that the constantly changing character of the financial sector means that ASIC has to be very adaptive in its relationships with such organisations.

D. The judiciary

1. Overview

The judiciary is the other important player in ASIC's regulatory praxis because its opinions and rulings directly impact upon decision-making by ASIC personnel. In addition to the judiciary, there is also the Administrative Appeals Tribunal (AAT), which reviews ASIC administrative decisions. This section reports on the role which judicial and administrative review has had in shaping ASIC enforcement decisions.

2. Judicial review

Question 9 asked the respondents to discuss the most significant court judgments affecting the enforcement role of ASIC since 1993. The cases nominated most frequently were: *Johns v ASC, Dietrich v R, Gould v Brown, R v Byrnes, Oates v Williams, Boys v ASC, ASC v Deloitte Touche Tohmatsu* and *Mesenberg v Cord Industrial Recruiters*.[97] Appendix D provides a summary of these judgments. Also mentioned in a general way were judgments relating to: the effectiveness of ASIC notices, especially to compel information; judicial interpretations with regard to insider trading; directors' duties; the prospectus provisions of the Corporations Law; and the investigative powers of ASIC.

How these judgments have affected ASIC enforcement operations were described in a number of ways. The *Johns* case "..concentrated the ASIC mind on issues of natural justice…challenged ASIC thinking about a couple of provisions, especially section 25 of the ASIC Act; clarified the ambit of ASIC powers to release information; and significantly affected how ASIC organises its release of confidential information procedures."

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[97] *Johns v ASC* (1993) 178 CLR 408; *Dietrich v R* (1992) 177 CLR 292; *Gould v Brown* (1998) 151 ALR 395; *R v Byrnes* (1995) 183 CLR 501; *Oates v Williams* (1998) 28 ACSR 394; *Boys v ASC* (1997) 24 ACSR 1; *ASC v Deloitte Touche Tohmatsu* (1996) 138 ALR 655; *Mesenberg v Cord Industrial Recruiters Pty Ltd* (1996) 19 ACSR 483.

One respondent raised the concern that the *Oates* decision opens up avenues for collateral attack on the investigation process. The consultation required by the *Oates* decision is in addition to ASIC's practice of offering all potential criminal defendants a record of interview prior to charges being laid.

Some of the respondents felt that recent cases on directors' duties has meant that although there has been some clarification of what the duties of directors are, some courts (especially criminal), have written extra elements into them and made some elements more confusing.[98]

The *Dietrich* case has troubled several of the respondents who agreed that it had prompted applications which led to: delay; consumption of increased enforcement resources; uncertainties about using ASIC compulsory powers in relation to such applications; and could affect decisions to stay proceedings. Several respondents felt that these problems may get worse with changes to legal aid funding. This is a concern because *Dietrich* applications often require a month's work by two or three ASIC staff on asset checking, interviews and other issues, and so involve significant resources. Other judgments can have significant effects in a less direct manner. For example, one respondent's view on the *Boys* case which:

> "...dealt with the ASC's employment of consultants in an investigation and their role; and whether there was a conflict of interest in releasing information to them for private purposes. That case I think has the potential to have an impact considering the resource environment that we operate within at the moment and how we resource investigations in the future."[99]

The respondents believe that, in general, the courts have been fairly understanding of ASIC's position and ASIC has done reasonably well in review situations. Most judicial comment has been favourable. There was a collective sense among the respondents that judges are becoming more sophisticated in their approach to the Corporations Law, which was expressed by one respondent in these terms:

> "I think that the attitude of the judiciary generally to Corporations Law offences has undergone a transformation over the last two to three years...there's been a series of decisions where the courts have taken very seriously breaches of the Corporations Law."

Respondents' perceptions about this improvement in judicial approach were not so positive with regard to civil penalties. All the respondents would like the courts to express a clearer view on how they regard civil penalties and they felt that some judges place almost a criminal standard of proof with regard to civil penalty provisions, even though the statutory test is the balance of probabilities. Unsurprisingly, the practical result of this is some concern about how the courts might apply a civil standard of proof in a civil penalty action which results in the imposition of a penalty. According to one respondent there is a feeling within ASIC that:

> "...the courts are going to have a higher standard of proof [than] a pure civil standard if you're imposing a penalty."

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[98] See, for example, the cases mentioned in note 87.

[99] This is an interesting point because we are living in an era when most nation states are continually searching for ways to reduce government spending. Privatisation and widespread out-sourcing of traditional public agency functions are now considered conventional. This is certainly true within the justice system where there is a growing emphasis on managerialist approaches to the delivery of justice. ASIC, in common with most other public agencies, is extremely cost-conscious and is likely to make increasing use of external professional support in the future.

3. Administrative review

ASIC personnel are continually mindful of administrative review, and that awareness probably contributes to improved decision-making. One respondent had an extremely healthy attitude towards administrative review which was the focus of question 10(a):

> "I think that we do need to be tested and challenged on the decisions that we're making…I know it has the ability to tie us up enormously at times, but I think that the only way we're going to clarify a lot of the areas of the law is to be tested and actually challenged so that we have some law on the issues..."

Question 10(b) continued this theme by inquiring about the effects of appeals to the Administrative Appeals Tribunal (AAT), the Federal Court and the Ombudsman.[100] All the respondents agreed that administrative challenges may delay a case, but they rarely change whether or not ASIC pursues a case. Several respondents observed that some defendants had used administrative review as a delaying tactic. Also, it is not uncommon that people will utilise AAT review of ASIC decisions as an alternative commercial strategy, especially in take-over situations.

Question 10(c) asked respondents if they had any personal experience of judicial and administrative review, and how they would evaluate that experience. In general, respondents had very little difficulty with any review, but would like to see a more coherent way of dealing with the review process.

The general feeling of all respondents towards both judicial and administrative review was that the principles and processes of such reviews are necessary in order to maintain public and parliamentary confidence in ASIC; even though there are occasions when such review is employed as a tactical device to delay ASIC proceedings.

4. Impact on ASIC decision-making

Legal and resource issues for ASIC interact constantly, and influence simultaneously on a number of levels the enforcement decision-making processes of ASIC. The importance of this within the enforcement praxis of ASIC was illustrated by responses to questions 13 and 14.

Question 13(e) asked if there was forum shopping by ASIC personnel between Federal and State courts. There was widespread agreement amongst the respondents that ASIC almost invariably acts in the Federal Court, in order to gain uniformity across states and create precedents which have national consistency. The Supreme Court in each region is also used on occasions though. However a number of respondents observed that the Federal Court is inevitably speedier than the Supreme Court and is generally more attuned to Corporations Law matters. The latter issue was neatly summarised by one respondent:

> "...one of the advantages of using the Federal Court is the fact that there's a small number of judges that are available to us and we can be confident they have experience in the sort

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[100] Under the ASIC Act and the Corporations Law, ASIC has the power to make decisions on a wide range of matters including registration, licensing, investigating and exempting from provisions of the Corporations Law. A review on the merits of a decision by ASIC can be made by the AAT. Where a complaint about a decision made by ASIC goes to the process used by ASIC rather than the merits of the decision, an application may be made for judicial review by the Federal Court under the Administrative Decisions (Judicial Review) Act 1977.

> of matters that we bring before them, because there's only a small number of them handling those matters. As opposed to the Supreme Court, where there's a much larger number of judges around, some of whom may have experience in this area, some who don't. So, in a sense, the Federal Court is becoming a specialist tribunal in dealing with Corporations Law matters.."

The substantial influence of judicial perceptions or preferences on ASIC decision-making processes was further highlighted in responses to question 14. It asked respondents how they would describe the impact of State Criminal Codes on enforcement decisions in general, and in particular, decisions regarding civil penalties.

It is the role of the DPP to decide what charges are laid. Most respondents spoke of the importance of the role of state criminal law, and the fact that in some cases that law more appropriately captures the criminality of the acts in question than the Corporations Law.

Three other points emerged from the interviews about state criminal law. The first is that most aspects of that law have been well litigated, and thus may be preferred to a Corporations Law offence which may, in the circumstances, be viewed as a test case. Second, some state criminal law offences may allow a case to be presented to a jury in a simpler manner than an available Corporations Law offence. Third, the maximum penalties for state law criminal offences tend to be higher than the Corporations Law and it may be necessary to lay charges under state criminal law for an appropriate penalty to be imposed. For example, provisions for theft in Western Australia allow for up to 10 years imprisonment and that is considered to be a more powerful deterrent than many sanctions available under the Corporations Law. One respondent stressed that:

> "...much more substantial penalties are awarded by the courts for breaches of Criminal Codes than for breaches of the Corporations Law. If you had the same conduct for a breach of section 232 [of the Corporations Law] as you would say for misappropriation or theft, the State charge would get a much higher penalty than a breach of section 232. The courts just seem to view it differently."

Other respondents shared this general view, and added:

> "...that sometimes it is easier to prove State Crimes Act offences, the elements are a lot simpler than proving say a section 232 breach, depending on what the conduct was...

One respondent believes there is an increasing reliance on the State Criminal Codes in comparison to five years ago:

> "I'd suggest that 50 per cent of the matters and 50 per cent of the charges that we lay are laid under the State Crimes Acts...
>
> ...we've seen the complications with section 232 [of the Corporations Law] and the intent issues. The DPP in this State anyway, tends to think that some of the provisions of the Crimes Act are going to be easier to prove with the identical set of facts."

E. Summary

The foregoing discussion reveals how judicial attitudes towards civil penalties are taken into account in making enforcement decisions. These issues are compounded by the fact that the

legitimate expectations of the DPP inevitably mean that ASIC can be less certain about the budgetary and other issues raised in Part VII if a matter falls within the ambit of the DPP. These factors can have a very concrete effect in shaping the decision-making mind set of ASIC personnel deciding on potential civil penalty strategies. It is inevitable that the interpretations and priorities of other agencies and interest groups involved in enforcing the law in conjunction with ASIC, such as the DPP or the judiciary, may sometimes be different to ASIC goals or strategies on certain issues. What is clear from these interviews is the preparedness of ASIC personnel to work around such differences and retain a principled commitment to their statutory responsibilities under the Corporations Law.

IX. ALTERNATIVE REMEDIES TO CIVIL PENALTIES

A. Overview

This Part reports on the impact which the availability of alternative civil sanctions has had on the incidence of civil penalty prosecutions. It is an issue on which there is both regional convergence and regional divergence within ASIC. The convergence lies in the fact that strategies such as injunctions and management banning orders are universally more popular than civil penalties. The divergence is that there is some regional variation in the emphasis that is placed on different civil enforcement strategies. This Part examines ASIC's use of injunctive measures and management banning orders.

B. Use of injunctions

Question 8 of the interview schedule asked if there had been a significant increase in applications for injunctions by ASIC since 1993. Section 1324 of the Corporations Law allows ASIC to apply to the court for an injunction where a person is engaged or is proposing to engage in conduct that contravenes or would contravene the Corporations Law. The popularity of injunctive remedies amongst many ASIC enforcement personnel is clear from their responses. In the words of one respondent:

> "I think the sanctions that allow us to [go] to the Federal Court and freeze peoples' assets, stop them moving in and out of the country…are quite a strong deterrent and we've been using that in quite a high percentage of the matters that we're doing now. Out of eighty matters that we have on our books at the moment, ten of them are probably along those lines, which is an extremely high percentage as opposed to four or five years ago."

These arguments are pervasive amongst ASIC personnel across all regional offices precisely because they are so persuasive. Injunctions are a swift response which can deliver immediate investigative and enforcement benefits, and this need for speed has become a higher ASIC priority in recent years. Several respondents agreed that the rise in injunctions is fuelled by:

- this speed factor;
- a greater involvement of lawyers within the operational area; and
- a multi-disciplinary approach to investigations.[101]

[101] The effects of the changing profile of law enforcement personnel at ASIC was examined in Part VIIE.

Injunctions facilitate a more proactive style of enforcement which can be used against companies which still hold assets. Several respondents felt that ASIC has been using injunctions more innovatively in recent years. Their numbers have risen, especially in relation to breaches of the prospectus provisions of the Corporations Law. Injunctions are often coupled with another regulatory action, in particular, preservation orders and applications for receiverships. However, the respondents revealed a distinct regional variation in the numbers of injunctions, with a marked contrast between the smaller and larger offices. Smaller offices have tended to seek fewer injunctions, if any at all, reflecting fewer opportunities than larger offices to seek relief of this kind.

An important issue concerning injunctions is that the general public can relate to them in a way that is very different from civil penalties. This is because people can see the direct effects within a short time frame of judicial orders freezing assets, obtaining possession of passports and shutting down rogue companies. The understandable desire by ASIC to not only fulfil its enforcement obligations, but also be widely seen as fulfilling its enforcement obligations, makes it even harder for more complex, time-consuming and more esoteric strategies such as civil penalties to be positioned front and centre in the enforcement consciousness of ASIC. Civil penalty strategies cannot be portrayed as similarly swift, decisive and obvious in their effect as injunctions, and the inhibiting influences on their usage are once again obvious.

A final point about injunctions was raised by question 12(k) which asked respondents when ASIC would proceed to issue civil proceedings in relation to s 50 cases[102] and s 246AA[103] cases. Section 264AA cases were not considered by respondents to be a useful enforcement tool. By contrast, s 50 cases were seen to be useful for substantial and significant cases. Section 50 was also seen as forming an important part of the general deterrence that ASIC undertakes through enforcement of the Corporations Law.

Use of sections 50 and 246AA is not common in any regional office. By comparison, s 1324 is much the more important provision in all the regions.

C. Use of management banning orders

The generally positive view of the respondents towards injunctions is largely repeated with regard to management banning orders. There are similar, but not identical trends relating to ASIC usage of such orders and this was the subject addressed by question 7 of the interview schedule. It asked respondents if there had been a significant increase in management banning orders since 1993 and how they would explain any increase that may have occurred.

The responses showed that there are more distinct levels of regional variation regarding banning orders in comparison to injunctions. This is true for both the use of management banning orders under s 600 (under which ASIC may order persons not to manage corporations[104]), and ss 230 and

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[102] Section 50 of the ASIC Act provides that where, as a result of an examination or from a record of an examination, it appears to ASIC to be in the public interest for a person or company to begin and carry on proceedings for the recovery of damages or property, ASIC may conduct such a proceeding in the person's or company's name.

[103] Section 260 of the Corporations Law became s 246AA on 1 July 1998 as a result of amendments made by the Company Law Review Act 1998. The section allows ASIC to apply to the court for a remedy for oppressive conduct in a case where it has undertaken an investigation.

[104] Under s 600 ASIC may prohibit from managing a company a person who has been a director of two or more companies which have been unable to pay their secured creditors more than 50 cents in the dollar.

599 (under which a court may order a person not to manage a corporation[105]). There is not merely a large office: small office dichotomy, but also reflects sharp contrasts between individual large offices and individual smaller offices. Consequently, it is worth considering the comments of different respondents from different states in turn. First, in one small office numbers of s 230 actions have risen slightly since 1993. There are five or six before the court now, where previously there was only one, and that a couple of years ago. The rise is due to wanting to take advantage of banning orders if a matter isn't criminal in nature. In contrast, numbers of s 600 actions have:

> "…really dropped off. I think that's because in the past, before the ASC's time and even in the early years of the ASC, there was almost an automatic section 600 process invoked, whereas now our view is that it's one of the range of remedies that we could use in an appropriate circumstance. So there's more judgment applied."

The view of another respondent from a different small office, which had only a small number of s 230 and s 600 actions, was that:

> "The reason we don't do a lot of 600s is amongst other things, we've had quite a number of convictions and they're automatically banned upon those convictions, so conduct that is likely to attract our attention and warrant an application under section 600 is really unlikely to arise in circumstances where we haven't already done an investigation and dealt with something else."

A trend emerging in some offices is a move away from a "volume" based approach, relying heavily on s 600, towards an approach focusing on individuals against whom the public needs particular protection. The practice of using a volume based approach seemed strongest in the two largest offices.

An issue mentioned by some respondents is the different benefits of ss 230 and 600:

> "Historically, section 600 orders have been more popular than section 230, but they are administrative actions and so gain little publicity; sanctions under section 230 generate more publicity and this is important to the ASC's strategic goals.

Publicity is a powerful enforcement tool and acknowledged by ASIC pesonnel as an important part of achieving regulatory impact. It is mentioned continually as a key component of ASIC's holistic strategy. The relative failure of civil penalties to attract media attention is one explanatory factor for their low enforcement profile.

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[105] Under s 230 the court may prohibit from managing a company a director, secretary or executive officer who:

- was an officer of a company which repeatedly breached the Corporations Law and the person failed to take reasonable steps to prevent the company breaching the Corporations Law;
- has repeatedly breached the Corporations Law; or
- has contravened s 232(2) (failure to act honestly as a company officer) or s 232(4) (failure to exercise a reasonable degree of care and diligence as a company officer).

Under s 599 the court may prohibit from managing a company a person who was a director of, or concerned in the management of, two or more companies which have:

- been wound up for insolvency;
- been under administration;
- executed a deed of company arrangement;
- ceased to carry on business because of insolvency;
- had a levy of execution which has not been satisfied;
- had a receiver or manager appointed; or
- entered into a compromise or arrangement with creditors.

Another issue is the circumstances which lead to use of banning orders. A respondent from one of the largest offices observed:

> "There's been a bit of an increase in section 230 proceedings and again that is for the most part tackling the lodgment of document problem...We did a survey through the system and found that there were a small number of people who continually formed companies and never lodged anything. The view was taken that it was potentially an abuse of the corporate form and the ASC should be doing something about it, and a number of section 230 actions were taken by the ASC in the Federal Court to ban those people from management."

When trying to summarise on the subject of management banning orders it is difficult to offer conclusive analysis on the levels of s 230 and s 600 actions over time, without having access to the specific totals of such activity across all regions over a period of some years. What is clear is that there is regional variation, that there are contrasting views on what is happening in different regions, and that sometimes there may be divergence of opinion within the same office on some of these issues.

D. Impact on choice of civil penalties

What significance the use of management banning orders has for civil penalties warrants analysis. It seems unlikely that there is any distinct policy position on a national, or regional level, for management banning orders to be preferred over civil penalties or other strategies. Rather, the popularity of s 230 and s 600 (and as we have seen this is by no means uniform for both sections and across all regions), is probably due to their pragmatic enforcement characteristics. They can achieve good effect in a relatively straightforward way compared to a general directors' duties action. In this sense, they are similar to injunctions and are favoured by ASIC enforcement personnel in such situations as dealing with phoenix companies[106] because "...they take offenders out of the action…" Civil penalties (to date), are not perceived by ASIC personnel as possessing an equivalent capacity to deliver comparable swift, straightforward and certain enforcement outcomes.

The issue of deterrence is related to the use of different enforcement tools. Question 2(e) asked respondents what sanctions in the Corporations Law, other than civil penalties, provide a significant deterrent function. In answering this question, one respondent made the valid point that the deterrent capability of civil penalties, criminal sanctions, or indeed the Corporations Law in general, must all be considered as only parts of an overall regulatory strategy.

Bearing this contextual operational reality in mind, the replies of the other respondents reflect the views that have emerged so far in this report about the relative utility of civil penalties. One respondent was very clear on the subject of comparative deterrent value and ranked them in this way:

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[106] A phoenix company has been described as "a company of limited liability that fails and is unable to pay its debts to creditors…At the same time, or soon afterwards, the same business rises from the ashes of the former company with the same directors or management, under the guise of a new limited liability company, but disclaiming any responsibility for the debts of its predecessor, sometimes with a similar name and operating from the same premises": Law Reform Committee of the Parliament of Victoria, *Curbing the Phoenix Company*, Third Report, 1995, para 1.1.

> "The most effective deterrents that the ASC has available (in descending order), are: prosecutions; injunctions; publicity; disqualifications; receiverships; and declarations."

Another felt that imprisonment, damages, disgorgement, licensing action, banning orders and stop orders on prospectuses can all be significant deterrents. Another respondent nominated: injunctions, damages actions, disqualifications (eg s 600), widespread publicity of ASIC action and criminal charges as having deterrent impact. Another stressed the deterrent value of the directors' duties provisions generally, but especially in a take-over situation, where an ASIC investigation can halt a take-over. One reply emphasised civil actions in general, especially regarding illegal capital raising if there is wide publicity. There was much support for the deterrent value of those provisions that allow freezing and seizing of assets, orders for restitution and those which impose personal liability. One respondent took this view:

> "I think there's a whole range of remedies that go part of the way there, but not fully there, and there's probably a whole middle gamut missing…There's probably a whole group of cases where you're doing something civil anyway, where it'd be nice just to [add] a penalty to ground out a regulatory response."

E. Summary

It can be seen from the discussion in Parts VI to IX that there was broad agreement amongst respondents that resource issues, the DPP influence, judicial attitudes, more pragmatic alternatives such as injunctions and management banning orders, and the low number of civil penalty actions, all inhibit recourse to civil penalty procedures. For example, a banning order pursuant to ss 230, 599 or 600 has an equal deterrent effect to a civil penalty banning order, but for various reasons, may be easier to obtain. This in part explains the low incidence of civil penalty banning orders.

X. LEGAL FACTORS

A. Overview

The final topic is the deficiencies in the drafting of the Corporations Law and their impact on ASIC's use of civil penalties. The deficiencies reported on here are those identified by the respondents only.[107] The discussion gives rise to the issue of law reform, which was not a nominated topic of the interview schedule. Problems with the statutory provisions, and potential reforms to them and the regulatory praxis of ASIC, were suggested by all respondents at various times, and in response to various questions, during the course of the interviews. The purpose of this Part is to draw together these views on the current operation and reform of the civil penalty provisions.

B. Deficiencies in the Corporations Law

The criticisms of the current drafting of the Corporations Law by the respondents centred around two impediments: a lack of clarity or ambiguity as to the meaning of the provisions, and a lack of flexibility in the range of enforcement sanctions. The starting point was question 3, which asked respondents to identify any factors that were significant impediments to the Corporations

[107] For a broader discussion, see Bird, supra 6, 413-420.

Law successfully performing a deterrent function. This gave rise to a discussion of the drafting of the current statutory provisions.

1. Lack of clarity

There was general agreement among the respondents that there were problems of clarity within the Corporations Law which posed dilemmas for ASIC enforcement personnel. As one respondent explained:

> It means that it's difficult for us in running actions because there's...so many sections in there that are open to a number of interpretations and we don't know how the court will approach it. For us to go, the evidence in respect of some of those technical matters will require a very detailed investigation that will take a long time, cost a lot of money and you have to determine whether it is worth the time and money in light of the fact that we might be running a prosecution under a section that hasn't previously been interpreted and the interpretation may well go against us. That's perhaps the main difficulty using the Corporations Law."

All the respondents agreed that the directors' duties provisions (s 232) were one of the areas which had significant difficulties of interpretation. The interpretation problems are caused largely by the lack of statutory guidance as to the linkage between contravention of a civil penalty provision and the resulting liability for contravention. That liability may be a civil remedy, a civil penalty or a criminal sanction. There is no guidance as to the relationship between the different liability forms, except for s 1317FA, which requires an additional mental component to be proved before a criminal sanction can be imposed. What is unclear is whether that mental component is in addition to, or in substitution for, any mental component required to prove a contravention of the civil penalty provision itself. For example, s 232(2) requires directors to act honestly. A contravention of s 232(2) would therefore require evidence of a lack of honesty by a director. Section 1317FA requires evidence of a contravention by a director coupled with intentional dishonesty, before the contravention becomes a criminal offence. Similar considerations arise when attempting to differentiate between a contravention giving rise to civil remedies and one giving rise to a civil penalty. The Corporations Law is silent as to whether the mental component required to prove a contravention in order to obtain a civil remedy is different or the same as that required for the imposition of a civil penalty. The lack of guidance as to the linkage between civil penalties and criminal penalties, caused one respondent to observe:

> "I do not believe that at any criminal trial, you can then, at the conclusion of that trial, mount a new application, requiring the jury, assuming it's before a jury, to turn its mind to different standards of proof, different mental elements and in essence, undertake a retrial. Although the possibility is there in the Corporations Law, I don't believe it can be done. I believe the practical and theoretical barriers are too great...I believe there are too many conceptual difficulties with [the civil penalty/criminal penalty linkage] in terms of how you actually put it to the court."

The regulatory problems thrown up by the civil penalty/criminal penalty linkage were confirmed by all the other respondents and there was criticism of s 1317FA usually in terms of difficult situations where:

> "...the uncertainty of what the directors' duties provisions actually mean has sort of flowed into our uncertainty about running a civil penalty case as well…We have had some problems in working out what section 1317FA does say and mean."

Several spoke of the difficulties of trying to establish proof to a criminal standard in terms of s 1317FA. This was expressed in specific terms such as:

> "...the difficulty of understanding the interaction of the provisions of section 232 with section 1317FA..."

Question 11(b) asked respondents if legislative ambiguity was an impediment to ASIC carrying out its enforcement responsibilities. The respondents were generally quite sanguine on this issue, believing that ambiguity in the law is a problem, but they all accepted that "...ambiguity is a fact of life for regulators." Legislative ambiguity is a problem for many professional groups, not only regulators, and unsurprisingly becomes a phenomenon that is absorbed into regulatory praxis:

> "...I think there's a lot of ambiguity in the legislation. It's something that we don't think about every day now because we have confined our actions in the enforcement area, especially in the Corporations Law, not so much the ASC Law, to certain sections. That's all we seem to concentrate on. We rarely go outside those areas."

The earlier discussion on the collective concern about the civil penalty regime is important in the context of this comment. It is important because the cocktail of pressures and priorities (whether external or internal, collective or individual, regional or national), which impacts upon the law enforcement personnel of ASIC imposes, of necessity, a fiercely pragmatic regulatory mind-set. The undeniable reality is that at this point in time at least, the civil penalty regime is not perceived as possessing sufficient pragmatic utility to be a regularly attractive or appropriate regulatory option.

2. Duplication of sanctions

Analysis of the enforcement provisions of the Corporations Law as a pyramid of sanctions reveals a degree of duplication of sanctions. Management banning orders are the most obvious example. They can be imposed by ASIC under s 600, or by the court under ss 230, 599 and 1317EA. The maximum period for an ASIC imposed management banning order is 5 years. The same limit applies to court imposed banning orders under s 599, but the other provisions have no time-limits. Another example is the pecuniary penalty of $200,000, which may be imposed as either a civil penalty order or a criminal sanction, with greater stigma attaching obviously to the criminal penalty.

Questions 3(c) and 11(c) asked whether duplication of sanctions detracted from the deterrent effect of the Corporations Law, or impeded ASIC in its enforcement responsibilities. None of the respondents felt there are significant problems of duplication of sanctions in terms of undertaking an action, but several would like to see increased consistency in sanctions handed down by courts. One respondent felt that any problems of duplication of sanctions would fall away if there was a sufficiently flexible Corporations Law regime.

3. Reforms to Part 9.4B

Question 6 asked whether Part 9.4B should be amended and, if so, how. At the time of the interviews, the Federal Government had not introduced into Parliament the Corporate Law Economic Reform Program Bill 1998, which includes a rewritten Part 9.4B, although an Exposure Draft of the Bill had been released for public comment. A summary of the civil penalty reforms in the Bill is contained in Appendix B.

Almost all respondents wanted the civil penalty regime extended into other provisions of the Corporations Law, such as takeovers, capital raising provisions, and market and securities offences especially concerning market practice, such as s 997 and s 998.[108] There was also a very strong feeling amongst all the remaining respondents that civil penalties should be applied more widely provided existing difficulties with their operation could be solved. One respondent suggested that civil penalties should be expanded to more substantive offences under the Corporations Law, such as: frauds by officers (s 596); falsification of books (s 1307); and providing false or misleading statements (s 1308) and information (s 1309). Perhaps the most radical response on these issues was:

> "If I had my way, I'd probably have a civil penalty for every contravention, coupled with a general fraud provision, and probably just a handful of specific provisions of criminal penalties, probably around the insider trading area...
>
> The theoretical model that I'd like to be operating under as a regulator is where the court has the power to really do anything. It's sort of got that power already under sections like section 737 and section 1114 where the court can make any order it deems fit. I think that you intuitively get a feel for what's an appropriate regulatory outcome in a particular case and it'd be nice if the court had sufficient flexibility to be able to give it to you."

Respondents had further concerns about:

- double jeopardy elements of the civil penalties regime and how courts would react; and
- the provisions of s 1317FA being too broad, and directed towards a criminal remedy rather than a civil penalty response.

The problem of double jeopardy being an inherent element of the civil penalty regime was a very real concern for another of the respondents:

> "...if you have an investigation into some corporate misconduct, the public interest isn't really served by choosing to lay a criminal charge and that charge for whatever reason not succeeding. In those circumstances it's pretty unlikely we're going to bring a civil penalty action, it's not appropriate, it's oppressive. You're at risk as a law enforcement agency of being oppressive in those circumstances, there's an element of double jeopardy I think, so from the law enforcement agency's point of view, or at least from my point of view, you choose the path you want to go down early on. Obviously circumstances change, so you always have the discretion, but as a general principle, I don't think it's appropriate to take fairly substantial action against someone and if you fail, then take other different substantial action against them, possibly 4-5 years after their misconduct. Having to crank up a different kind of action, resources, more delay, so in that scenario then the jury acquits. What are you supposed to do then? Bring another application and 2 years can go by before the judicial system deals with it, and in the mean time there are other matters to deal with. So I don't want to fetter having the power and discretion, but those other considerations would weigh heavily I think."

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[108] Section 997 prohibits stock market manipulation while section 998 prohibits false trading of securities and market rigging transactions.

This unease about potential double jeopardy has been another question mark over the enforcement utility of civil penalties and contributes to their low incidence in ASIC enforcement response totals.[109]
The level of disquiet about s 1317FA was even higher than for the problem of double jeopardy. For example, one respondent would like to see Part.9.4B extended over most contravention provisions but stressed that the threshold of s 1317FA and its inherent uncertainty need to be resolved. Section 1317FA has been rewritten as part of the reforms proposed by the Corporate Law Economic Reform Program Bill 1998, with the intention of reducing some of this uncertainty.

One of the barriers to the effective use of civil penalties has been the requirement of the current provision which excludes subsequent criminal proceedings if a civil penalty order is obtained without utilising s 1317FA. The Corporate Law Economic Reform Program Bill 1998 proposes to remove the bar, but issues of double jeopardy, discussed previously, will remain.

Other respondents commented favourably on the impact of the proposed reforms:

> "I think that they're largely sensible…One of the issues that's been dealt with in the civil penalty regime [proposed reforms] is that the application for a civil penalty by ASIC will not act as a bar to criminal proceedings…It makes it easier I think for ASIC to make its own decision at an early stage as to whether or not to make an application, and then if circumstances require it, to subsequently bring a criminal prosecution."

All of the above comments reveal the continuing pre-occupation with regulatory effect, which is obviously an appropriate stance for a professional regulator. The desire for pragmatic regulatory effect is also evident in the view of respondents that civil penalties be extended fairly widely, because they can be an extremely useful regulatory strategy. They should be made more market-oriented, focusing on activities such as: insider trading, capital raising and market manipulation. However, any extension should be coupled with clearer guidelines about how civil penalties should be used.

4. Linkages with other sanctions

Questions 2(c) and 2(d) produced an interesting range of opinions in response to asking whether civil penalties should be more systematically linked to other sanctions, and whether such a process would increase the deterrent capability of civil penalties. A group of three respondents was unsure how civil penalties could be more systematically linked, because they felt that they already were in the sense that disqualification, compensation to the victim and pecuniary penalty are parts of the process. One respondent emphasised that compensation and getting unlawfully obtained money back to victims, are usually a higher priority for ASIC than any pecuniary penalty. This group of respondents felt that civil penalties are already systematically linked to other sanctions and that their deterrent capability would not rise until there had been a substantial rise in civil penalty enforcement actions.

The recurring message is thus thrust 'centre-stage' once more, civil penalties will not achieve their enforcement potential until they are used more often, and they will not be used more often, until they have been used more often.

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[109] Double jeopardy remains an issue under the revised Part 9.4B proposed by the Corporate Law Economic Reform Program Bill 1998.

The other respondents do believe that the Corporations Law and regulatory sanctions need to be more inter-linked and packaged, and that civil penalties could contribute to a more systematic approach. They favour running civil penalties in conjunction with other proceedings, whether in the civil or criminal arena. This combined approach can give a matter an increased sense of urgency which affects lawyers and investigators on the case, and judges who hear relevant applications. Also, civil penalties could be linked more closely to measures that would affect peoples' liabilities and improve asset tracing. The majority of the respondents contended that these types of strategies, if widely applied, would certainly improve deterrence.

6. Specific reforms

Respondents nominated a number of specific reforms. These included:

- reforms to the Evidence Acts in the various states to facilitate ASIC cases in court. For example, a reduced emphasis on pleadings and discovery rules, especially when ASIC has used its powers of compulsion to gather evidence under oath;
- the use of formalised and enforceable undertakings within the Corporations Law. ASIC was given the power to accept such undertakings from 1 July 1998.[110] Enforceable undertakings save case preparation and case hearing time. It was suggested they would be be extremely useful in the areas of: commercial programmes (especially small business programmes), and capital raising schemes. The practical regulatory potential of enforceable undertakings is evident in this response:

  > "I think that enforceable undertakings would be to me the jewel in the crown. It would save so much time in litigation."

- the removal of the current five year statutory limitation period for taking action in relation to offences classified as serious. Alternatively, the five year time limit for a case should begin from when the contravention was identified, or was brought to the attention of ASIC;
- the problems of proving intention under sections such as s 997 (which deals with stock market manipulation) should be addressed; one respondent thought civil penalties might help in this area; and
- the introduction of a general fraud provision.

C. Other regulatory impediments

Apart from the impediments under the Corporations Law itself, respondents cited the impact of time issues, difficulties associated with criminal law proceedings and the legalistic and complex corporate environment within which ASIC must operate, as factors influencing ASIC enforcement decisions.

Time issues were the most frequently heard complaint, both in relation to gathering required documentation, as well as necessary investigation and court time. Time constraints have helped civil law strategies (such as injunctions and management banning orders) to become perceived by many as an often swifter route than the criminal law option. ASIC has clearly stated goals of desirable timelines regarding investigation, including that of completing 85 per cent of major

[110] This power did not exist at the time of most of the interviews. See ASIC Act s 93AA, introduced on 1 July 1998.

corporate investigations within twelve months.[111] The increased strategic priority being given to the time element is likely to boost the selection of civil law remedies by ASIC personnel.[112] Nevertheless, even increased use of various civil law remedies will not remove the problem of delay, and other respondents stressed the managerial and other operational frustrations that result from this. For example:

> "...a problem for the ASC [which] is very hard to explain to our people, is that the time it takes to finish a matter is probably only a third within our control. We've got our responsibilities, then there's the DPP, and then there's the court time; and just putting it all into thirds, two thirds are totally beyond our control as to the length of time it takes to complete a matter before the criminal courts."

Another respondent was very critical of the regulatory utility of the criminal justice process because of the length of time a matter can take to get to trial.

The inherent problems of delay associated with both the criminal and civil process are of course increased by strategic use of delays in the process by some of those whom ASIC investigates. One respondent detailed how this is an integral aspect of the regulatory scene, commenting that a high degree of importance is placed by the legal system on procedural fairness The ability of people being investigated to delay an investigation by collateral challenge was also seen as an issue.

In general, use of due process is an acceptable element of the regulatory paradigm, and this respondent, like the others, sees it as a necessary part of regulation in an open and democratic society. However, what cannot be denied are the recurring complaints about lack of speed. One of the major contributing elements to the lack of speed in the enforcement of some aspects of the Corporations Law is the inherent complexity of many financial transactions. This is certainly the view of one respondent:

> "I suppose the main thing is the very complex nature of the transactions that we are investigating in themselves presents a difficulty in that they're difficult for us to unravel. Also, any step of a complex transaction, there could be any number of explanations as to why it was structured in that particular way. What that means is that it's a long slow process to construct a proper investigation. That's perhaps the major impediment to our enforcement responsibility...The time it takes…to get a brief into court is also a problem, but the complexity of the matters partly explains that."

However, perhaps the greatest indictment of the current corporate regulatory infrastructure is the result of the interaction between these negative elements of time and complexity. The negative effect of this interaction was described by one respondent in this way:

> "The complexities, costs and other difficulties facing private parties who try to pursue remedies under the Corporations Law are enormous. So enormous, that in reality ordinary people simply cannot do so, and this reduces the deterrent effect of the Corporations Law itself."[113]

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[111] Australian Securities and Investments Commission, *Annual Report 1997-98*, 23.

[112] The earlier discussion of this issue in Part IX showed how this process is well under way within ASIC.

[113] This issue of the relative disenfranchisement of much of the population from the whole legal process, not merely corporate law, is a major issue in late-modern legal and political discourse and cannot be covered within the confines of this report. What is true, and what needs to be emphasised here, is that the levels of disenfranchisement of the majority of citizens are accentuated in the corporate law sphere. The reality for most people is that it is a *no-go domain* for them and they are entirely dependent on public regulators such as ASIC. This stark truth underlines the increasing need to ensure that regulators such as

XI. CONCLUSIONS

The Australian Federal Parliament seems to have a high degree of faith in the use of civil penalties in company law. They were introduced in 1993 with the hope that there would be more effective enforcement of directors' duties. On 1 July 1998, Parliament extended the application of civil penalties under the Corporations Law to a number of additional statutory provisions. However, the reality is very different from the government's perception. Since 1993 there have been few civil penalty actions commenced by ASIC.

The research revealed that the civil penalty regime is perceived by ASIC as serving only a limited deterrent function. Parts VI to X of the report identified the factors nominated by those interviewed as responsible for this state of affairs. To recap, they include ASIC's:

- resource constraints, including financial and personnel constraints;
- relationships with other regulatory agencies, such as the DPP and the judiciary;
- recourse to alternative sanctions; and
- concerns about the limited utility of civil penalties and the unclear nature of the civil penalty regime in the Corporations Law and its regulatory praxis.

Several of these factors warrant particular attention. First, there are a number of alternative remedies which, from the investigator's point of view, appear to be more viable. In particular, there are injunctions which provide a "real time" remedy. In addition, the public can see the direct effects within a short time of injunctions that have the effect of freezing assets and shutting down rogue companies. The understandable desire by ASIC to not only fulfil its enforcement obligations but also to be widely seen as fulfilling its enforcement obligations, makes it difficult for more complex and time-consuming strategies such as civil penalties to be positioned at the forefront of ASIC enforcement strategies. Civil penalties are not as swift, decisive and obvious in their effect as injunctions.

Another viable remedy is s 600 of the Corporations Law which allows ASIC to impose a management banning order upon a person in certain circumstances. Section 600 is an effective remedy according to many of those interviewed. It does not require ASIC to bring court proceedings although the person banned may challenge the ASIC banning order in court. There are significant differences among the regional offices of ASIC in the use of s 600. However, as the respondents made clear, management banning orders can effectively "take offenders out of the action". Although the civil penalty regime does allow for the obtaining of management banning orders, these must be imposed by the court and necessarily involve complex litigation.

A second factor (related to the first) were the reservations expressed by a number of those interviewed about delays associated with use of the courts in the area of enforcement and, in addition, some of the difficulties of interpretation that have resulted from certain judgments.[114] These uncertainties in the interpretation of basic statutory provisions regulating directors' duties

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ASIC do have sufficiently flexible regulatory instruments (including an effective civil penalty regime), and the necessary resources to meet their public interest responsibilities.

[114] For example, the interpretation of s 232(6) of the Corporations Law: see note 87.

(which are civil penalty provisions) reinforce the trend to use alternative enforcement mechanisms such as management banning orders.

Third, there was some indication that many of those in the enforcement section of ASIC come from a criminal law background and therefore have a tendency to prefer criminal actions rather than civil penalties. This has changed over time with the recruitment of a considerable number of lawyers with civil litigation experience.

Fourth, those interviewed indicated that the requirement to liaise with the Director of Public Prosecutions over significant enforcement matters impacts on the use of civil penalties. The consequences resulting from the requirement to liaise with the DPP was a recurring theme in the interviews. These consequences include: (i) the requirement means that the DPP effectively has a veto over the use of civil penalties; (ii) the need for the DPP to satisfy itself that there is no criminal element in a matter may result in delay that can impact on the opportunity for a civil penalty action; and (iii) ASIC and the DPP have different enforcement objectives. The role of the DPP is to prosecute criminal breaches of the law while ASIC has broader objectives which include using civil remedies. These different objectives can limit the likelihood of civil penalties being pursued.

A fifth factor limiting the use of civil penalties is the unclear drafting of the civil penalty provisions; particularly regarding the elements that have to be proved to satisfy the court that a breach of a civil penalty provision has occurred.

Sixth, some respondents observed that where the same conduct of the offender may breach both the Corporations Law and a State Criminal Code, there is an incentive to frame legal action as a breach of the State Criminal Code because it may be easier to prove a breach of the Code given some of the uncertainty that surrounds the civil penalty provisions of the Corporations Law. In addition, some respondents expressed the view that courts tend to hand down more severe penalties for breaches of State Criminal Codes than for breaches of the Corporations Law. Again, this is an incentive to frame the legal action as a breach of the State Criminal Code.

Seventh, civil penalties were seen by respondents as having only limited utility. For example, where a director who has breached a civil penalty provision is bankrupt, a civil penalty action offers little to ASIC unless it believes that the offender's actions are so serious as to warrant criminal prosecution. This is because the two civil penalty sanctions are a pecuniary penalty and/or a management banning order. Imposing a pecuniary penalty upon an offender who is already bankrupt may serve little purpose and a bankrupt is automatically prohibited from managing a corporation so that resort to a civil penalty action is not needed to achieve this objective. This highlighted the need expressed by many respondents for ASIC to have at its disposal a broad range of enforcement tools.

Finally, a number of those interviewed were of the opinion that under-utilisation of civil penalties has had the effect of undercutting the deterrent function of this enforcement tool. The low public profile of civil penalties reduces their perceived worth as a deterrent and this places further doubt in the minds of enforcement personnel about using civil penalties when there are more proven enforcement options available.

Civil penalties are based upon strategic regulation theory whereby integrated sanctions escalate in response to more serious contraventions. Civil penalties should inhabit the upper level of

regulation with criminal law at the apex of the enforcement pyramid and methods of persuasion and education at the lower level. An initial analysis suggests that civil penalties should be reasonably widely used in relation to enforcement of directors' duties. However, as the research set out in this report indicates, there are some significant reasons why this has not occurred.

APPENDIX A

INTERVIEW SCHEDULE

1. Describe your position and role within the ASC.

Current enforcement regimes

2 (a) How effective are civil penalties as a regulatory mechanism?

(b) Do civil penalties perform a significant deterrent function?

(c) Should civil penalties be more systematically linked with other sanctions such as disqualification and criminal penalties?

(d) If civil penalties were more systematically linked with other sanctions, would deterrence be significantly improved?

(e) In your view what other sanctions in Corporations Law provide a significant deterrent function?

3. To what extent are the factors listed below significant impediments to the Corporations Law successfully performing a deterrent function?

(a) lack of clarity in the drafting of the Corporations Law;

(b) lack of resources;

(c) duplication of sanctions; and

(d) other significant impediments of which you are aware.

4. Describe how you deal with matters that might come within the ambit of Part 9.4B.

5. (a) As currently constituted, is Part 9.4B useful to regulators?

(b) Does Part 9.4B serve a meaningful deterrent function?

(c) Is the new civil penalty system an improvement on the previous regime?

6. In your view, should Part 9.4B be amended; and, if so, how?

7. In your view has there been a significant increase in management banning orders since 1993; and, if so, how would you explain any increase that may have occurred?

8. Do you think that there has been a significant increase in applications for injunctions by the ASC under s 1324 since 1993; and, if so, how would you explain any increase that may have occurred?

9. (a) What do you consider to be the most significant court judgments affecting the ASC's enforcement role since 1993?

   (b) What have been the effects of those judgments on ASC enforcement operations?

10. (a) What is your general view regarding judicial and administrative review of ASC enforcement actions?

   (b) In particular, how would you describe the effects of appeals to the Administrative Appeals Tribunal, the Federal Court and the Ombudsman?

   (c) Have you had any personal experience of such review and how would you evaluate that experience?

11. To what extent are the factors listed below significant impediments to the ASC successfully carrying out its enforcement responsibilities?

   (a) lack of resources;

   (b) legislative ambiguity;

   (c) duplication of sanctions; and

   (d) other significant impediments of which you are aware.

Decision-making process

12. Describe the procedures that you follow upon receipt of a liquidator's report by first answering the questions below, and then providing further details which you feel are informative.

   (a) Who determines whether to conduct an investigation into matters contained in a liquidator's report?

   (b) What are the criteria or indicia used to determine whether to conduct an investigation?

   (c) Who conducts the investigation?

   (d) What are the key topics/themes included in the investigation report?

   (e) Who within the ASC receives a copy of the investigation report?

   (f) Who determines whether the matter should be referred to the DPP (State or Commonwealth)?

(g) If the matter is not referred to the DPP, what happens next?

(h) Who authorises the issue of civil/civil penalty proceedings?

(i) When would the ASC proceed to issue civil penalty proceedings for a breach of civil penalty provisions?

(j) When would the ASC proceed to issue management banning order proceedings for breach of a civil penalty provision?

(k) When would the ASC proceed to issue civil proceedings in relation to s 50 cases and s 260 cases?

(l) What other decision-making procedures would the ASC follow?

13. (a) What are the types of contravention matters referred to the DPP?

(b) How does the DPP respond to these referrals?

(c) If the DPP determines to press criminal sanctions, what happens next?

(d) If the DPP determines not to press criminal sanctions, what happens next?

(e) Is there forum shopping between Federal and State courts?

14. How would you describe the impact of State Criminal Codes on enforcement decisions in general, and in particular, decisions regarding civil penalties?

APPENDIX B

THE NEW CIVIL PENALTY RULES UNDER CLERP

The Corporate Law Economic Reform Program Bill 1998 (Cth) (CLERP) will rewrite the civil penalty rules in Part 9.4B of the Corporations Law. The Bill was introduced into Federal Parliament on 3 December 1998. The purpose of this Appendix is to outline the major changes in the operation of the civil penalty regime under CLERP. In summary, the new Part 9.4B will operate as follows:

1. Part 9.4B will deal exclusively with civil penalties. The current Part 9.4B provides for both a civil penalty and a criminal penalty regime. The criminal regime has been removed from the new Part 9.4B. The regime of criminal sanctions will now be governed by the substantive provisions of the Corporations Law and s 1311, the general penalty provision.

2. Section 1317E prescribes the provisions of the Corporations Law which are civil penalties. With one exception, they are the same provisions which are civil penalties under the current section 1317DA. The exception is the statutory duty of care and diligence, which will no longer be a civil penalty provision. Remedial consequences will be the only form of liability for a person who contravenes this duty.

3. The range of civil penalties which can be imposed by a court will not change. However, the new Part 9.4B will only deal with the imposition of pecuniary penalties. The imposition of management banning orders will be governed by s 206C of Part 26.D of the Corporations Law, entitled "Disqualification from Managing Corporations". Part 2D.6 will govern all methods by which a "person can be disqualified from management", including contravention of a civil penalty provision. The substitution of the expression "disqualification" in place of "management banning order" in the current provisions brings the provisions into line with the terminology used in other jurisdictions, notably the United Kingdom.

4. New s 1317G provides that a court can order a pecuniary penalty of up to $200,000 in circumstances where there has been a contravention of a civil penalty provision which materially prejudices the interests of the corporation; its ability to pay creditors or is considered by the court to be sufficiently serious to warrant such a penalty. The first and second of these considerations, the interests of the corporation and the ability to pay creditors, are new considerations. The third is present in s 1317EA(5) of current Part 9.4B.

5. New s 206C states that the court may disqualify a person from managing a corporation if it is satisfied that a contravention of a civil penalty provision has taken place and that disqualification is justified. In determining whether the disqualification is justified, the court is to have regard to the person's conduct in relation to the management, business and property of the corporation and other matters the court considers appropriate. These considerations extend the requirements under the current section 1317EA(4), which

prevent the court from making an order if it is satisfied that despite the contravention, the person is fit and proper to manage a corporation.

6. New s 1317H provides that a court may order a person to pay compensation to a corporation for damage resulting from the contravention of a civil penalty provision. Significantly, those damages may include profits made by the person as a result of the contravention. This is an extension of the current s 1317HA which permits the court to make orders for compensation but not profits.

7. The civil rules of evidence and procedure continue to apply to civil penalty proceedings (s 1317L). The time-limits applying to civil penalty prosecutions (s 1317EC), being six years after contravention, also remain the same. The defence of having acted honestly and reasonably in all of the circumstances will continue to be available to the accused in civil penalty prosecutions (s 1317S).

8. Directors' statutory duties have also been amended and relocated to Chapter 2D of the Corporations Law, entitled "Officers and employees". The duties have been recast slightly, with the intention of simplifying them but not changing their substantive effect. The new statutory provisions distinguish between "civil" obligations and criminal offences. The expression "civil" contemplates both remedial and penal proceedings of a civil nature. The reformulated provisions are:

   (a) duty of care and diligence (s 180(1) - civil obligation only);
   (b) duty of good faith (s 181 (1) - civil obligation only);
   (c) duty not to misuse the position of director (s 182(1) - civil obligation only);
   (d) duty not to improperly use information obtained by reason of the person's office (s 183(1) - civil obligation only);
   (e) contravention of ss 181-183, committed with a prescribed mental state is an offence: s 184. The required mental component varies according to the statutory duty contravened.

9. The criminal penalty regime, currently in Part 9.4B, will continue to apply to the substantive provisions of the Corporations Law which provide expressly that contravention of that provision is an offence. The new s 184, outlined above, is an example of such a provision. As with the current regime, the criminal sanctions are prescribed in Schedule 3 (s 1311(3)).

10. It will be possible to bring criminal proceedings against a person who has previously been the subject of civil penalty proceedings (s 1317P). This is a reversal of the rules in the current Part 9.4B (s 1317FB), which operates as a bar on criminal prosecutions where civil penalty prosecutions have already been undertaken. However, evidence used in any civil penalty proceedings is not admissible in criminal proceedings where the conduct which is the subject of the criminal proceedings is substantially the same as the conduct which gave rise to the civil penalty proceedings (s 1317Q).

APPENDIX C

CIVIL PENALTIES

COMPARATIVE VERDICTS

(Table prepared by ASIC)

Respondent	Date of Orders	Pecuniary Penalty	Banning Period	Sections Contravened	Brief Description	Sources
Alan David Doyle	Matter ongoing				ASIC litigation commenced on 2 September 1998. ASIC alleges breaches of CL s232 in relation to a decision to return the proceeds of a placement of shares in Chile Minera NL.	ASIC MR 98/263
Derek William Satterthwaite	Matter ongoing				Same action as Doyle	ASIC MR 98/263
Arthur David Peart	Matter ongoing				Breaches of CL s232(4) alleged in relation to Maroona Trading Co Pty Ltd. Commenced on 19 November 1996.	VG 3569 of 1996
Keith Lester	6/11/98	$1,000	6 yrs	s588G	Lesters' failed to prevent Snowdeli Pty Ltd (In Liq) from incurring debts totalling $702,181 at a time when there were reasonable grounds to suspect that the company was insolvent. Unsecured creditors of $897,421 left on liquidation.	ASC MR 98/170; ASIC MR 98/335
Robin Lester	6/11/98	$1,000	6 yrs	s588G	Same details as for Keith Lester	ASC MR 98/170; ASIC MR 98/335
John Phillip Donovan	20/8/98	$40,000	10 yrs	s232	Donovan, a director of the Good Life Company and Friends Pty Ltd, breached CL s232 by allowing Good Life to sell growerships and quotas to growers of Kefir (a fermented milk product) when there was, to his knowledge, no market for the product. On appointment of an administrator it was found that there were large contingent liabilities to growers which could not be met because of a lack of market for the company's stockpile of the Kefir product. Proforma balance sheet estimated net assets of Good Life at negative $7,031,994.43.	ASIC MR 98/249 (1998) 28 ACSR 583

Julia Gwendolin Donovan	20/8/98	$4,000	3 yrs	s232	Same action as John Donovan. Julia Donovan breached her duties by allowing John Donovan to engage in the conduct which he did.	ASIC MR 98/249 (1998) 28 ACSR 583
Michael Geoffrey Spencer	24/07/97	$5,000	-	s232(6) s79(a)	Spencer was involved in the contravention of s232(6) in that he devised and implemented a scheme whereby a director of Harq Nominees Pty Ltd caused the company to assign its register of clients to the AMP Society in order to satisfy a personal debt of $235,000 owed by the director of the company to the Society. The Court held Spencer did not act dishonestly but was negligent, careless and confused in giving advice to the director and the company and in taking action on behalf of the director and the company in relation to the assignment of the register.	(1997) 25 ACSR 143; ASC MR 97/173
Satya Nandan	10/4/97	$20,000	3 years	s232(6)	Nandan, the general manager of the Tasmanian Spastics Association, borrowed $25,201 from the Association without consent of the Board of Directors. The Court held the contraventions involved a deliberate, systematic and unauthorised misuse for personal or private purposes, of the funds and facilities of the Association, on a regular and ongoing basis.	(1997) 23 ACSR 743 ASC MR 97/079
Robert John Wardell	21/03/97	$5,000	4.5 years	s588(G)	Following the ASC's action against Wardell in the Federal Court for an alleged failure to prevent Sands & McDougall Wholesale Pty Ltd from incurring debts between October 1993 and June 1994 during which time the company continued to trade whilst it was allegedly insolvent, the ASC accepted undertakings from Wardell to the Federal Court. Net asset deficiency of $5 million.	ASC MR 97/066
John Eddie Gdanski	21/03/97	$4,000	2 yrs	s588(G) s79(c)	Same action as against Wardell, ASC alleging that Gdanski was knowingly concerned in and party to the breaches of the CL by Wardell.	ASC MR 97/066
Allen Cooke	29/11/96	-	5 yrs	ss292 and 293 and 318	Cooke contravened s318 by failing to maintain proper balance sheets and profit and loss accounts for a number of companies.	ASC MR 96/270

Roger Keith Brock	18/11/96	-	10 yrs	s588(G)	While Brock was a director of Tropical Image Homes, the company continued trading long after it would have been apparent to any responsible director that the company was unable to pay its debts. Incurred debts of $629,332.87 after he was aware there were reasonable grounds to suspect the company was insolvent.	ASC MR 96/258
Gordon Leishman	18/10/96	-	5 yrs	s588(G)	Leishman, a director of Medalion Homes Ltd, failed to prevent the company from incurring debts at a time when there were reasonable grounds to suspect that the company was insolvent. The company and other related companies were involved in large scale real estate transactions in and around Brisbane involving approximately $44m in residential real estate.	ASC MR 96/237

APPENDIX D

SUMMARY OF JUDGMENTS REFERRED TO BY THE RESPONDENTS[1]

Dietrich v The Queen (1992) 177 CLR 292

Dietrich had been charged under the Customs Act 1901 (Cth) with offences relating to the importation of heroin. Dietrich was unsuccessful in five separate applications for legal representation, and was unrepresented at trial in the Victorian County Court. An application by Dietrich to adjourn the hearing was refused, and he was duly convicted. An application for leave to appeal to the Court of Criminal Appeal was dismissed. Dietrich then applied for special leave to appeal to the High Court.

The majority of the High Court (Chief Justice Mason, Justices Deane, Toohey, Gaudron and McHugh) allowed the appeal, set aside the conviction and ordered a new trial. The leading judgment of Chief Justice Mason and Justice McHugh noted that trial judges cannot appoint counsel in order that a trial may proceed. However, a trial should ordinarily be postponed where the accused is unable to obtain legal representation for reasons other than due to their own fault, until such time as legal representation is available. Where an application to delay the trial is refused in such circumstances, the resulting trial is not a fair one due to the lack of representation of the accused. Hence, any conviction of the accused must be quashed by an appellate court, on the grounds of a miscarriage of justice, in that the accused has been convicted without a fair trial.

Johns v Australian Securities Commission (1993) 178 CLR 408

In 1990, a Royal Commission was set up to inquire into the failure of the Tricontinental group of companies. At the same time, the National Companies and Securities Commission commenced an investigation into Tricontinental, pursuant to a ministerial direction by the Victorian Attorney-General, under section 291(1) of the former *Companies (Victoria) Code*. Later, the newly formed ASC delegated its powers and functions under Pt 3 of the *ASC Act* to a delegate. The Managing Director of Tricontinental, Ian Johns, was duly given a notice to appear before the delegate for investigation into the activities of the group. Transcripts of the examination were made available to the Royal Commission, which then made them available to the media, whereupon information contained in the transcripts was published. Johns then commenced proceedings, seeking, inter alia, an order to review the ASC decision. Justice Heerey in the Federal Court dismissed the application, and the Full Court dismissed the subsequent appeal. Johns was granted leave to appeal to the High Court.

In separate judgments, Justices Brennan, Dawson, Gaudron and McHugh held that, before authorising the Royal Commission to use the transcripts in public hearings, the delegate should have given Johns an opportunity to oppose the authorisation. Therefore, the decision to release the transcripts on that basis was invalid. Justice Brennan considered that the disclosure of information to the Royal Commission was within the power conferred by sections 25(3) and

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[1] Summaries prepared by David Noakes.

127(4)(b) of the *ASC Act*, as the Royal Commission would be assisted by the information in Johns' transcripts. Justice Brennan found that the use of the transcripts by the Royal Commission in public hearings was valid, given the approval by the delegate. The decision by the ASC or a delegate whether or not to grant a condition of confidentiality upon disclosure of information was made under the powers conferred by the Act, therefore it was open to judicial review under the *Administrative Decisions (Judicial Review) Act*. Section 127(1) required information given to the ASC in confidence or in connection with the performance of its functions or powers to be protected from unauthorised use or disclosure. Section 127(4)(b) authorised disclosure to State agencies, however Justice Brennan considered that the ASC could still impose confidentiality restrictions upon this disclosure. Justice Brennan found that the delegate had taken all relevant matters into consideration, and that the decision to disclose without imposing confidentiality restrictions was not manifestly unreasonable. However, this was not a situation where the rules of natural justice ought to have been disregarded due to some countervailing reason, such as the potential frustration of an investigation by a State law enforcement agency. Therefore, Justice Brennan held that the ASC ought to have given Johns an opportunity to argue against the decision, and that the decision was therefore invalidly made. The Court disagreed on the appropriate remedy, however Justices Brennan, Dawson and Toohey considered that since the information was already in the public domain, further dissemination would not be restrained.

R v Byrnes (1995) 183 CLR 501

The respondents were directors of two public companies. The respondents had been convicted in the District Court of South Australia of offences against section 229(4) of the *Companies (South Australia) Code* - making improper use of position (s 229(4) is now s 232(6) of the *Corporations Law*). The respondents had improperly arranged for a company to guarantee bank loans made to a second company. On appeal to the Court of Criminal Appeal, the convictions were set aside on the ground that there was an absence of criminal intent. The Crown was granted special leave to appeal to the High Court.

The leading judgment of Justices Brennan, Deane, Toohey and Gaudron held that the test of impropriety did not depend on the alleged offender's consciousness of impropriety. Rather, it was an objective test. Impropriety consists of "a breach of the standards of conduct that would be expected of a person in the position of the alleged offender by reasonable persons with the knowledge of the duties, powers and authority of position and the circumstances of the case" (at 515). By exercising their powers knowing that they lacked the proper authority, for the purpose of gaining an advantage for one of the companies, and by failing to disclose their interests, the respondents had breached section 229(4). The appeal by the Crown was allowed and the matter remitted to the Court of Criminal Appeal to reconsider the facts in the light of the High Court's finding.

The respondents have appealed to the High Court on other matters.

Australian Securities Commission v Deloitte Touche Tohmatsu (1996) 138 ALR 655

The ASC had commenced proceedings on behalf of the failed Adsteam group of companies, against the former directors and the former auditors of the group. The proceedings were commenced under section 50 of the *ASC Act*, which permits the ASC in certain circumstances, to carry on proceedings in the name of a company. The auditor, Deloitte Touche Tohmatsu,

challenged the proceedings under the *Administrative Decisions (Judicial Review) Act* 1977 (Cth). Justice Lindgren in the Federal Court found that under section 50, the ASC was bound, and had failed, to take into account that it was a matter for the directors of a wronged company to determine whether proceedings should be commenced in the name of the company. The ASC appealed to the Full Court.

The Full Court considered that, upon its true interpretation and proper application, section 50 was remedial in character and conferred upon the ASC a wide discretion. The decision whether or not to bring proceedings under the section required a judgment by the ASC as to where the public interest lay. Whilst this decision was open to judicial review, by its very nature it was something that was not easily susceptible to such a review. In this case, judicial review would be granted if the ASC had failed to address the correct legal questions or if the ASC's process of reasoning had been manifestly unreasonable. The Full Court held that the ASC had taken into account all relevant matters that were appropriate in determining whether or not to invoke section 50. The Full Court examined the decision by Justice Lindgren to set aside the ASC decision for failing to take into account the fact that Adsteam was still in business, and that the board opposed the commencement of proceedings against the auditors. The Full Court decided that the facts proved that Adsteam was actually trading under extraordinary circumstances, and that the board had confined its opposition to a proposal that former directors be sued. In any event, the Full Court rejected the importation of the rule in *Foss v Harbottle* (1843) 67 ER 189 into section 50, considering that there was nothing express in the language of the section to indicate that its operation was limited to situations where the board concurred in the institution of proceedings. The appeal was allowed.

Mesenberg v Cord Industrial Recruiters Pty Ltd (1996) 19 ACSR 483

The sole two directors (and equal shareholders) in a company had a falling out. Mesenberg, one of the directors, purported to dismiss the other director (the second defendant) from the board, and to terminate the employment of the second defendant's husband (the third defendant). Mesenberg then commenced proceedings against the company (the first defendant), the second defendant, the third defendant, and a new company set up by the second and third defendants (the fourth defendant). Mesenberg sought damages and an injunction to prevent the defendants from operating the new company in competition. The matter came before Justice Young in the New South Wales Supreme Court in interlocutory proceedings.

On the question of standing, Justice Young decided that the fifth exception to *Foss v Harbottle* (1843) 67 ER 189 (the 'interests of justice') had no application, as the granting of the orders sought would deprive the second defendant of her ability to earn income. Furthermore, it was held that only the ASC had the power to seek an injunction for breach of section 232 of the *Corporations Law*, as the section is a civil penalty provision. The plaintiff's request for an order under section 260 (the oppression remedy) to buy out the second defendant was refused, as there was no oppression shown. The judge considered that in this case of a 'quasi-partnership' that was deadlocked, the directors owed duties to each other as much as to the company. Hence, the plaintiff was entitled to standing under the third exception to *Foss v Harbottle* (the 'enforcement of a personal right of the shareholder'). After examining the evidence the judge considered that the second defendant had made a deliberate attempt to divert the first defendant's business into her own and her husband's hands. However, as the judge concluded that the plaintiff did not have entirely clean hands, having paid himself substantial 'management fees', the judge stood the matter over to allow the parties to reach agreement on an equitable solution, whereupon the

judge would grant the remedies sought. At the subsequent hearing, the court ordered that the second defendant was liable to account to the plaintiff for any profits made in breach of her fiduciary obligation to act in the best interests of the company. The judge also granted leave to the second defendant to file a cross-claim for winding up the company and other orders.

Boys v ASC (1997) 24 ACSR 1

The applicants had been the auditors of a company that was in receivership. The applicants were the subject of separate proceedings that alleged they had, inter alia, been negligent in their audits. When the receiver had first considered making a claim against the auditors, it had sought authorisation from the ASC pursuant to section 597 of the *Corporations Law* to examine the auditors. At the time, the ASC was also considering its own action under section 13 of the *ASC Act*, and decided to enlist the assistance of the receiver. A consultancy agreement was reached with the ASC, whereby the ASC would control and direct the investigation, and the receiver would provide assistance in return for a copy of the transcripts of the examination of the auditors. The transcripts were duly released and it was on the basis of these that the action against the auditors commenced. The auditors applied to restrain the receiver and the ASC from using the transcripts in the proceedings, and to restrain the receiver from acting against them in the proceedings.

In the Federal Court, Justice Carr held that the ASC had lawfully exercised its powers under the *ASC Act* in the release of the transcripts and other information. Justice Carr found that the ASC would have proceeded with an investigation had the consultancy agreement not been entered into by the ASC. Nevertheless, the consultancy agreements constituted a substantial purpose in the ASC's decision as to the manner in which it would conduct the investigation. However, the applicants failed to establish that the ASC did not have a bona fide belief that there was reason for the investigation as required under section 13(3). The applicants also failed to establish that the receiver had an actual or potential conflict of interest resulting from the consultancy work performed for the ASC. Justice Carr rejected the applicants' submission that the appointment of the receiver as consultant to the ASC contravened section 127(1) of the *ASC Act*, as the receiver and the ASC had agreed that any release of the information would have to be in accordance with the law. Furthermore, as the receiver had agreed to provide its services free of charge, the ASC did not incur any 'expenses', of which failure by the ASC to pay would contravene section 90 of the *ASC Act*. Justice Carr also rejected the applicants' contention that they were denied procedural fairness by the ASC in relation to the establishing and the carrying on of the investigation. The ASC was obliged to extend procedural fairness to the applicants, as any disclosures which they may have been compelled to give might have substantially increased the chances of their being found negligent in a later trial. Thus, the exercise of the considerable powers of investigation under Pt 3 of the *ASC Act* so directly and materially adversely (or otherwise) affected or could have affected the applicants' interests that they were entitled to procedural fairness. Justice Carr considered there to be sufficient proof that procedural fairness was extended. The application was dismissed.

An appeal from the judgment of Justice Carr was dismissed by the Full Federal Court: *Boys v ASC* (1998) 26 ACSR 464. An appeal for special leave to the High Court was unsuccessful.

Gould v Brown (1998) 151 ALR 395

In 1992, the Federal Court ordered that a company be wound up pursuant to the *Corporations Law*. Subsequently, the liquidator applied for orders for the issue of summonses to direct certain persons to attend for examination about the affairs of the company. The Court made the orders and summonses were issued pursuant to those orders. The appellants sought declarations from the Federal Court that it had no jurisdiction to make the winding-up orders or to order and conduct the proposed examinations. The appellants sought an order setting aside the summonses issued pursuant to the examination orders. Chief Justice Black in the Federal Court reserved certain questions to the Full Court for determination. The applicants appealed to the High Court.

The leading judgment of Chief Justice Brennan and Justice Toohey dismissed the appeal, holding that jurisdiction over the *Corporations Law* had been properly vested in the Federal Court. As jurisdiction to make a winding-up order was virtually the same as the power to make a sequestration order under the bankruptcy law, winding-up was therefore equally a judicial process and jurisdiction to make a winding up order could be vested in the Federal Court. In relation to the examination, the court's function in conducting examinations was not the determination of the rights and liabilities of adversaries and was incidental to its function in making the winding-up order. However, the incidental character of the function together with the traditional supervision exercised by the court in performing it, were held to be sufficient to stamp the court's role in supervising and conducting examinations with a judicial character. Therefore, the examination power conferred on the Federal Court by sections 596A and 596B of the *Corporations Law* was within the conception of 'judicial power' in Chapter III of the Constitution, so that the examination orders made in this case were valid. The appeal was dismissed.

Several other cases raising related constitutional issues are currently before the High Court.

Oates v Williams (1998) 28 ACSR 394

The appellant sought judicial review of a decision by the Federal Minister for Justice to consent to the institution of criminal proceedings against the appellant. The appellant was a former director of two companies that were now insolvent. In 1995, the ASC charged the appellant with, inter alia, contraventions of the *Companies (Western Australia) Code*. Prior to charging the appellant, the ASC sought the consent of the Minister to institute proceedings. The consent was required under section 1316 of the *Corporations Law*, as more than five years had elapsed after the date of the last transaction to which the charges related. The appellant sought judicial review of the Minister's decision to consent. Justice Moore in the Federal Court held that there was no evidence from which it could be inferred that the Minister had failed to take into account any relevant matter, and that the Minister was not obliged to accord procedural fairness to the appellant. The appellant appealed to the Full Court of the Federal Court.

The Full Court held that the Minister was required to allow the appellant an opportunity to make representations. The effect of section 1316 in this case was that charges could not be laid against the appellant unless the Minister gave his consent. Under section 1316, the Minister must decide whether it is reasonable to allow the prosecution to proceed out of time. This will involve the consideration of: the reason the prosecution was not commenced within the five year period; whether the grant of consent will unfairly prejudice the accused; the seriousness of the offence with which the accused is charged; whether the public interest would be served by the prosecution of the offence, and any harm that has been caused by the commission of the offence. Section 1316 does not require the Minister to be satisfied that there is a prima facie case against

the accused, as that is the responsibility of the person authorised to institute the prosecution. Whilst section 1316 does not require the Minister to consider whether the institution of a prosecution is frivolous, if the Minister becomes aware of circumstances that show that a prosecution is frivolous, consent should not be granted. The Court held that the Minister was required to accord the appellant a right to be heard before granting consent. In this case, the appellant had a defence to a criminal prosecution that was conferred by statute. That immunity from prosecution was conditional, in that it would be lost if the Minister granted consent to a prosecution out of time. The Minister could not take away this immunity without giving the appellant an opportunity to be heard, unless the legislation manifested a clear intention that such a duty did not exist. There was no such intention in the legislation. Furthermore, the merits of the decision under section 1316 will not be considered during the course of a criminal trial, thereby requiring that the accused be given the opportunity to be heard on the merits of the decision at the time it is made. The Court allowed the appeal, set aside the orders of Justice Moore, and declared that the consent given by the Minister was void.

Special leave to appeal to the High Court has been granted.