CIVIL PENALTIES AND THE ENFORCEMENT OF DIRECTORS' DUTIES#

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ABSTRACT

The Australian federal Parliament introduced civil penalties into company law in 1993 with the expectation that there would be more effective enforcement of directors' duties. However, in the six years since civil penalties were introduced, the Australian Securities and Investments Commission (ASIC) has commenced only 14 civil penalty actions. The research undertaken by the authors reveals that civil penalties are perceived by ASIC as serving only a limited deterrent function. The factors responsible for this include ASIC's: (1) resource constraints, including financial constraints; (2) relationships with other regulatory agencies, such as the Director of Public Prosecutions (DPP) and the judiciary; (3) ability to choose from a range of sanctions; and (4) concerns about the limited utility of civil penalties given the unclear nature of the civil penalty regime and its regulatory praxis.

The research for the study was funded by grants from the Criminology Research Council and the Australian Research Council. The views expressed are not necessarily those of the Councils. Although the study was carried out in cooperation with ASIC this article is an independent analysis by the research team of the issues discussed. The views of ASIC staff set out in this article 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.

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I. INTRODUCTION

The regulation of directors' duties in Australia is primarily governed by the *Corporations Law*,[1] which is administered and enforced by ASIC.[2] The regime of sanctions relevant to directors' duties was fundamentally reformed in 1993, with the introduction of new measures centred on civil penalty mechanisms which drastically reduced criminal law oversight of directors' duties.[3] Previously, contraventions of the statutory duties of directors constituted criminal offences, punishable by criminal sanctions. Now only the most serious contraventions merit criminal sanctions and the vast majority of contraventions attract civil penalties instead.[4]

The civil penalty regime had been 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.[5]

Civil penalties have now been in place for six years, so it is timely to evaluate the relative success of the regime and engage those responsible for its administration in the process of analysis.[6] The central purpose of this article is to report the findings of a research project which undertook these tasks.

The structure of the article is as follows. Part II identifies the research question and methodology. Part III outlines the history and operation of civil penalties under the *Corporations Law* and Part IV outlines the theoretical influences underpinning the research project. This is followed in Part V by an

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1 The *Corporations Law* is the principal statute regulating Australian corporations.

2 On 1 July 1998 the Australian Securities Commission became 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 S Wallis (Chair), *Financial System Inquiry Final Report*, March 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 (Cth).

3 The civil penalty regime was integrated into the *Corporations Law* by the *Corporate Law Reform Act* 1992 (Cth), effective from 1 February 1993.

4 The new regime implemented the recommendations in the Senate Standing Committee on Legal and Constitutional Affairs, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*, 1989 (referred to hereafter as the Cooney Report since the Committee chair was Senator Barney Cooney). The report had criticised the former regime, finding 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.

5 Cooney Report, *ibid* at 190-1. 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.

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

overview of ASIC's enforcement practices and perceptions of civil penalties. Parts VI to IX identify and evaluate the key factors which were found to influence the use of civil penalties by ASIC and Part X concludes with a summary of the main findings.

II. RESEARCH QUESTION AND METHODOLOGY

A. Research Question

Our research examined how ASIC uses civil penalties as an enforcement tool against company directors. The principal aim was to identify and evaluate critically the factors which impact on 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.[7] 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[8] and environmental regulation.[9] Strategic regulation theory is outlined in Part IV of the article.

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 14), from ASIC's Head Office and each of the Regional Offices. Positions held by the respondents included: 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 sample was selected through a process of consultation between ASIC's National Director, Enforcement (NDE) and the research team. Due to the sensitive nature of many of the issues that would be the subject of discussion and

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7 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*, Oxford University Press (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*, Oxford University Press (1994).

8 See, for example, F Haines, *Corporate Regulation: Beyond 'Punish or Persuade'*, Clarendon Press (1997); N Gunningham and R Johnstone, *Regulating Workplace Safety: Systems and Sanctions*, Oxford University Press (1999).

9 G Richardson, A Ogus and P Burrows, *Policing Pollution: A Study of Regulation and Enforcement* Clarendon Press (1982); K Hawkins, *Environment and Enforcement*, Clarendon Press (1984).

the confidentiality obligations imposed on ASIC by s 127 of the *Australian Securities and Investments Commission Act* 1989 (Cth), 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.

While these procedures obviously do not conform to the criteria of random selection, in this case such an approach would not have been suitable. The focus of the research project was the civil penalty regime and its role in ASIC enforcement. Given the small number of actions brought since the commencement of the regime, it was important to involve personnel who had had practical enforcement experience with civil penalties and/or had been involved in decision-making processes about whether civil penalties should be sought in particular cases. 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.[10] Copies of this schedule were sent to the NDE and the respondents several weeks before the interviews took place. This gave the respondents sufficient time to reflect on the specific issues raised by the various questions and relate them to their experience within ASIC. 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 90 to 180 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 perceives and uses the civil penalty regime. These factors are:

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

10 See Appendix A for the interview schedule.

The effects of these factors are discussed in Parts VI to IX.

III. HISTORY AND OPERATION OF CIVIL PENALTIES UNDER THE CORPORATIONS LAW

A. Operation of the Civil Penalty Regime

(i) Civil Penalty Provisions

Civil penalties are given force by sections 1317DA to 1317JC in Part 9.4B of the *Corporations Law*. Under s 1317DA the provisions for which civil penalties would apply in the case of breach 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;[11] and
- s 588G - duty of a company director not to allow the company to trade while insolvent.

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

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

The focus of this article is on the civil penalty provisions applying to directors' duties which were already in place as at 1 July 1998 (principally, ss 232(2), (4), (5), (6) and 588G).

11 Section 318(1) became, with some modifications, s 344(1) on 1 July 1998.

(ii) Summary of the Consequences of Breach of a Civil Penalty Provision

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

Where a civil penalty provision is breached, the potential consequences include:

1. 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 such an application, 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 of 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 has contravened the civil penalty provision, and against any other person involved in the contravention (s 79);
8. contravention of a civil penalty provision may constitute a criminal offence if the contravener has acted or omitted to act knowingly, intentionally or recklessly and, in addition:
   (i) the contravener was dishonest and intended to gain an advantage for themselves or any other person; or
   (ii) the contravener intended to deceive or defraud someone (s 1317FA);
9. the maximum penalty for a criminal contravention is $200 000 or five years imprisonment or both, and a person found guilty is prohibited from managing a corporation for five 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 and for any loss suffered by the corporation as a result of the act or omission constituting the contravention (s 1317HD);
11. the court may grant relief from liability for contravention of a civil

penalty provision (s 1317JA).

(iii) Civil Penalty Contraventions

Civil penalty provisions serve both remedial and penal goals.[12] Part 9.4B preserves a company's general law remedial rights against a director who breaches his or her duties to the company.[13] Also it allows a statutory remedy of compensation to a company against a director who contravenes a civil penalty provision.[14] 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.

(iv) 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[15] and/or an order banning a person from managing a corporation for an unspecified period.[16] Criminal penalties comprise a fine of up to $200 000 or five years imprisonment or both.[17] 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.[18]

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.[19] The 'bar' on subsequent criminal proceedings was introduced to address double jeopardy concerns.[20] Civil penalty proceedings involve a lower evidentiary burden than criminal prosecutions because they are

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12 Remedial proceedings meaning those instituted to recover loss or damage arising from non-compliance with the *Corporations Law*.

13 *Corporations Law*, s 1317HE.

14 See generally *Corporations Law*, ss 1317HA-HE.

15 *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 (Cth), s 91.

16 *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.

17 *Corporations Law*, ss 1317FA(1) and 1311(2)-(3). See also *Corporations Law*, Third Schedule, Penalties.

18 *Corporations Law*, s 1317FA(1).

19 *Corporations Law*, s 1317FB. The reverse is not the case. See *Corporations Law*, ss 1317GC-GD.

20 To address the concern that a defendant is not exposed to both civil and criminal penalties for the same contravention.

conducted using civil rules of evidence and procedure.[21]

(v) Prosecutions under Part 9.4B

Civil penalty proceedings under Part 9.4B can be brought by ASIC or an authorised ministerial delegate.[22] However, criminal prosecutions are brought by the DPP, pursuant to a memorandum of understanding between ASIC and the DPP. A general defence of honesty and fairness is available to defendants in civil penalty proceedings, but not criminal proceedings.[23] The current drafting of Part 9.4B creates a number of evidentiary problems for both civil and criminal proceedings which are discussed later in this article.[24]

B. Historical Background

(i) The Previous Regime of Sanctions

Part 9.4B commenced operation on 1 February 1993. A comparison to the *Corporations Law* preceding Part 9.4B's introduction highlights the impact of the reforms. Prior to the insertion of 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.[25] Civil remedies enabled recovery for loss or damage resulting from contravention.[26] 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.[27]

(ii) Reform Impetus

Part 9.4B resulted from three reform proposals of the Cooney Committee, in its report titled *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*.[28] They were:

- that criminal liability under company law should not apply in the absence of criminality;[29]
- that 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;[30] and
- that civil penalties be provided for breaches by directors where no criminality was involved and, in appropriate circumstances, that people

21 *Corporations Law*, s 1317ED(1).
22 *Corporations Law*, s 1317EB.
23 *Corporations Law*, s 1317JA.
24 See also H Bird, note 5 *supra* at 413-20.
25 *Companies Code*, s 570; *Corporations Law*, s 1311.
26 *Companies Code*, ss 229(6), (7) and (10); *Corporations Law*, ss 232(7), (8) and (11).
27 K Mann, "Punitive Civil Sanctions: The Middle Ground Between Criminal and Civil Law" (1992) 101 *Yale Law Journal* 1795 at 1798.
28 Note 4 *supra*.
29 *Ibid* at 190.
30 *Ibid* at 191.

suffering loss as a result of a breach be able to claim damages in proceedings brought to recover the loss.[31]

The Cooney Committee's proposals sought to construct a pyramid of enforcement measures supporting the regulation of corporate officers by the *Corporations Law*.[32] This concept reflects the influence of strategic regulation theory, which provides a means of ordering the sanctions which can be imposed under the *Corporations Law*, from the least to the most severe. The first and second proposals suggested confining criminal sanctions to contraventions that were "genuinely criminal in nature".[33] The intention was to reduce the scope of, but not remove, criminal sanctions, which at the time of the proposals, applied to all contraventions deemed to be offences by the *Corporations Law*. The Cooney Report firmly discouraged the complete removal of criminal sanctions.[34]

The Committee's third recommendation had two parts: the introduction of civil penalties for misconduct falling short of a criminal offence; and the expansion of civil remedies to include new compensation rights in civil penalty proceedings.[35] Civil penalties would be both monetary and non-monetary in nature. Their purpose was to sanction misconduct falling short of a criminal offence.[36] The provision of civil remedies in civil penalty proceedings preserved the availability of civil remedies in all contravention cases. Taken together, the proposals recommended a hierarchy of enforcement measures: civil remedies followed by civil penalties and, lastly, criminal sanctions.[37] This hierarchy enabled a strategic approach to regulatory enforcement, as explained in Part IV.

IV. THEORETICAL INFLUENCES ON THE STUDY

A. Strategic Regulation Theory

Strategic regulation theory provides a broad 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. The economic premise behind this view is that persuasive measures are less costly than enforcement measures. For persuasion to be effective, however, the threat of punishment must lie behind the regulator's conciliatory actions or gestures. This threat should consist of a set of integrated sanctions, which the regulator can enforce when a contravention occurs. The sanctions should escalate in severity in proportion to the nature of the contravention.

This concept is usually graphically represented by the pyramid model, with

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31 *Ibid* at 190. A further recommendation concerning 'on-the-spot' fines was also made: *ibid* at 192.
32 *Ibid*.
33 *Ibid* at 190.
34 *Ibid* at 188.
35 *Ibid* at 191.
36 *Ibid* at 80.
37 *Ibid* at 190-1. C Dellit and B Fisse, note 7 *supra* at 583-92.

incapacitation at the apex.[38] Incapacitation can be achieved through both civil and criminal measures. For the natural person, criminal sanctions which incapacitate that person (that is, a jail term), 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 the regulated population, including those who commit minor acts of non-compliance. The upper levels are necessary for dealing with others such as the incompetent, the irrational and especially those rational calculating citizens who believe that it is not in their self interest to comply unless the costs outweigh the benefits.[39] 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 can be gauged from its proximity to the apex of the pyramid.[40] 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.

The goal of the pyramid enforcement model 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 accept the reality of non-compliance and be prepared to move 'up' the enforcement pyramid. The rationale of strategic regulation theory and the pyramid model is that the 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 be done effectively at the bottom levels 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".[41]

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

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

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38 Professor Braithwaite formulated and developed the enforcement pyramid in a number of his publications: see, for example, J Braithwaite, *To Punish or Persuade: Enforcement of Coal Mine Safety*, State University of New York Press (1985); I Ayres and J Braithwaite, note 7 *supra*.

39 I Ayres and J Braithwaite, note 7 *supra*. 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 J Scholtz, note 7 *supra*.

40 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 at 196.

41 J Braithwaite, "Responsive Business Regulatory Institutions" in C Coady and C Sampford (eds), *Business, Ethics and the Law*, Federation Press (1993) 88.

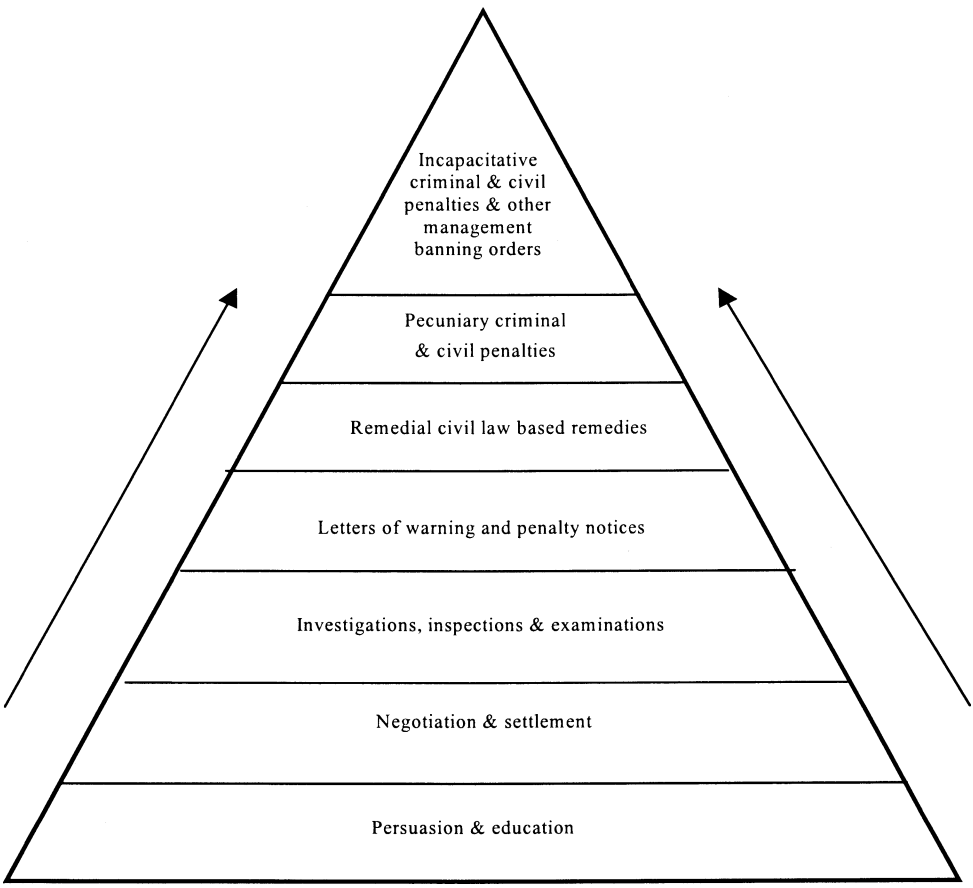
B. The Enforcement Pyramid in the *Corporations Law*

The research project tested, inter alia, whether the use of civil penalties by ASIC is consistent with its desired regulatory functions. Figure 1 depicts the pyramid of enforcement mechanisms available to ASIC to secure compliance by directors with their statutory duties under the *Corporations Law*. In analysing the levels of the pyramid, a number of observations should be kept in mind:

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 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 *Australian Securities and Investments Commission Act* and related crimes legislation.[42]

42 *Australian Securities and Investments Commission Act* 1989 (Cth) (*ASIC Act*); *Crimes Act* 1914 (Cth) and state Crimes Acts.

FIGURE 1: ENFORCEMENT PYRAMID REGARDING DIRECTORS' DUTIES UNDER THE *CORPORATIONS LAW*[43]



(i) Persuasion and Education

The lower levels of an enforcement pyramid typically consist of a series of incentives or 'carrots' which encourage compliance and avoid unnecessary antagonism between the regulator and the regulated.[44] The *Corporations Law* enforcement pyramid reflects this trend. The persuasion and education level might include surveillance programs, education and advice programs, and other 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 and deter contraventions.[45]

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43 This representation of the enforcement pyramid is adapted from the work of I Ayres and J Braithwaite, note 7 *supra*; C Dellit and B Fisse, note 7 *supra*; B Fisse and J Braithwaite, *Corporations, Crime and Accountability*, Cambridge University Press (1993) p 142.

44 N Gunningham and R Johnstone, note 8 *supra*, p 117.

45 ASIC website address: <http://www.asic.gov.au>.

(ii) 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 the power to investigate under the *ASIC Act*.[46] 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.[47]

(iii) Investigations, Inspections and Examinations

This level in the *Corporations Law* enforcement pyramid is a result of ASIC's enforcement powers under both 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 several purposes. They have a protective function in that they assist ASIC in detecting and prosecuting contraventions of the *Corporations Law*. They also have a deterrent function. There is a distinct possibility of adverse consequences resulting from an investigation, hearing or inspection for the regulated persons or entities. In addition to any legal action which is subsequently taken against them by ASIC for contravening the *Corporations Law*, they may also be liable for failing to comply with investigation, inspection and hearing requirements (*ASIC Act*, ss 63-7). These procedures consume the regulated person's or entity's time and financial resources, and the possibility of reimbursement of expenses by ASIC following completion of the procedures is limited.[48]

The exact placement of this set of sanctions within the *Corporations Law* enforcement pyramid is uncertain. The circumstances in which ASIC is empowered to exercise investigation, inspection and examination powers include

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46 *ASIC Act*, s 93AA.

47 See, for example, MR 98/236 and MR 98/340.

48 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.

serious contraventions of the *Corporations Law*. Thus, these sanctions can be viewed as occupying a higher level than the letters of warning and penalty notices. However, because of ASIC enforcement procedures, discussed in Part V, they are more likely to be features of lower-level enforcement measures.

(iv) Letters of Warning and Penalty Notices

Letters of warning and penalty notices are the next rung in the *Corporations Law* pyramid. They mark the shift from a 'carrots' to 'sticks' enforcement policy, albeit that they are small sticks intended in most cases as only a "tap on the shoulder" rather than a punitive sanction.[49] Many different mechanisms can be utilised at this level including the issuing of 'show cause' notices and penalty notices. Such mechanisms are intended to be preventative in nature. Their deterrent value is specific, rather than general. However, they allow action to be taken quickly without requiring recourse to the courts. 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 50 cents 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*, s 1313).

(v) 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. Their potency derives from the fact that, in some circumstances, they offer 'real-time' or immediate action against the recalcitrant minority of corporate law offenders who fail to change their behaviour under threat of less aggressive measures. Examples of civil law remedies in the *Corporations Law* include:

- court orders freezing assets, preventing foreign travel and/or the transfer of assets (*Corporations Law*, s 1323);
- court orders appointing a trustee, receiver, or receiver and manager over the assets of individuals or companies (*Corporations Law*, s 1324);
- court orders winding up a company and appointing a liquidator (*Corporations Law*, ss 464 and 472); and

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49 N Gunningham and R Johnstone, note 8 *supra*, p 122.

- court orders for payment of compensation by a person who contravened a civil penalty provision causing loss or damage to the company concerned (*Corporations Law*, s 1317HA);
- interim and final injunctive relief (*Corporations Law*, s 1324).

(vi) Pecuniary Criminal and Civil Penalties

The penultimate layer of the pyramid consists of the pecuniary civil and criminal penalties found in Part 9.4B. Fines of up to $200 000 may be imposed as either a civil or a criminal penalty. The two types of penalty are part of 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 constitute 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.[50]

Another difficulty concerning the placement of pecuniary penalties (civil or criminal) within the pyramid involves the size of the penalty imposed. While a fine of up to $200 000 is available, often a much lower sum is imposed by the court. The penalties imposed to date (see Appendix B) have ranged from $1 000 to $40 000. If a small pecuniary penalty is imposed, it is arguable whether the penalty can rightfully be depicted as belonging among the upper levels of the enforcement pyramid.

(vii) Management Banning Orders

At the apex of the *Corporations Law* enforcement pyramid, there are three possible types of management banning sanctions. They arise under ss 230, 599 and 600 of the *Corporations Law*.[51] Under s 230, a court may prohibit from managing a company a director, secretary or executive officer who:

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50 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.

51 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 (dealing 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.

- 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, a 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 a receiver and 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 50 cents in each dollar owed.[52]

A banning order is a quasi incapacitation order. If imposed, it prevents a person being involved in the management of a company but does not prevent the person from being involved in the company 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.

(viii) Incapacitative 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 both belong to the one level of the pyramid for the same reason that pecuniary criminal and civil penalties do, namely, because the selection of one operates as a bar to the use of the other.

The bar preventing both civil penalty and criminal proceedings is only one of a number of problems of significant complexity under Part 9.4B. Another concern is the similarities between the civil and criminal penalty regimes. Both offer pecuniary penalties up to 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

52 For more detailed discussion of ss 229, 230, 599 and 600, see HAJ Ford, RP Austin and IM Ramsay, *Ford's Principles of Corporations Law*, Butterworths looseleaf (1999) at [7.191].

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.

C. A Third Dimension to the Pyramid?

The enforcement pyramid is very much a two dimensional model which assumes smooth, predictable interaction between the regulator and the regulated as 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 in the marketplace suggests a far more complex pyramid than the one depicted above. It is therefore necessary to examine the activities of the many players in the field of regulatory compliance (the regulator, the regulateds, the media and intervening professional actors such as accountants, lawyers, liquidators, the DPP, courts, specialist tribunals and the police).

Assessing the effect of the interaction between these players (both systematic and random), 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 article focuses predominantly on the regulator's engagement with the enforcement pyramid. Other intervening elements in the regulatory profile are the subject of ongoing research.[53] 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.[54]

V. ASIC'S ENFORCEMENT PRACTICES AND PERCEPTION OF CIVIL PENALTIES

As the focus of this article is on ASIC's use of civil penalties, it is appropriate to establish the context in which that occurs by way of an overview of ASIC's objectives, investigatory powers and enforcement procedures. This leads to a preliminary analysis of ASIC's perception of civil penalties.

A. ASIC's Objectives and Functions

ASIC is a Commonwealth statutory corporation created by the *Australian*

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

54 This approach is influenced by the theory of regulatory tripartism, 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, I Ayres and J Braithwaite, note 7 *supra*.

Securities and Investments Commission Act 1989 (Cth). 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".[55] 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".[56]

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 that is necessary in order to enforce and give effect to the laws that confer functions and powers on it.

B. Investigatory Powers

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

1. a contravention of the *Corporations Law* (s 13 of the *ASIC Act*);
2. 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, managed investment scheme, securities or futures contracts (s 13);
3. if 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

55 Australian Securities and Investments Commission, *Annual Report*, 1997-98 at 2.
56 *Ibid.*

investigated (s 14);[57]

4. if ASIC receives a report of a receiver or liquidator lodged under s 422 or s 533 of the *Corporations Law* (s 15).[58]

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.[59] As discussed above, where ASIC or its investigators have 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.[60] Where a person is to be subject to an 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; and
- 38 per cent were not pursued.[61]

In the same year, ASIC assessed 3711 reports from company liquidators, receivers, administrators and auditors. 2842 of these reports alleged offences while the remainder 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; and
- in 86 per cent no useful action could be taken because the reports were

57 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.

58 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, Butterworths looseleaf, Ch 15.

59 *ASIC Act*, Part 3, Division 3 and Part 3, Division 4.

60 *ASIC Act*, Part 3, Division 2.

61 Note 55 *supra* at 33.

submitted too late.[62]

In 1997-98, ASIC commenced 215 new investigations and completed 199 major litigation enforcement actions.[63]

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).[64] 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.[65]

C. Enforcement Procedures

ASIC follows standardised procedures in its enforcement decision-making processes. Referrals such as liquidators' reports go through the standardised assessment channels of evaluation. 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). On the basis of recommendations and other operational priorities, TRAC makes a decisions as to what information in the report needs to be clarified and also a final resourcing decision. 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 supervision 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 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 to consider 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. One respondent believed that all ASIC enforcement personnel would agree that:

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62 *Ibid* at 33.
63 *Ibid* at 60.
64 *Ibid* at 2.
65 *Ibid* at 23.

> 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.[66]

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.

D. 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...".

However, ASIC media releases indicate that it has commenced only 14 civil penalty applications relating to 10 case situations since 1993.[67] This figure of 14 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 of ASIC, 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.

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 reveal 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 discussed shortly.

This relative uncertainty about the incidence of civil penalties is a reflection of the ambiguity that surrounds them in general. Question 2(a) of the interview schedule asked how effective civil penalties are as a regulatory mechanism and the general view of their effectiveness can be seen from this response:

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66 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 are to the ASC.

67 See Appendix B for comparative verdicts and other specific details of the individual civil penalty actions.

> 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. There is also some doubt amongst ASC personnel about the efficacy of lower courts, [Magistrates Court in a committal proceeding, County Court in a criminal trial], ruling on civil penalty contraventions and those decisions not being re-argued at length in a Federal or Supreme Court - this raises commercial/resource issues for the ASC.

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[68] 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. Thirdly, 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.[69] Fourthly, amongst ASIC personnel, there is some uncertainty about "what the directors' duties provisions actually mean" and this has compounded the ambiguity about civil penalties.[70]

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. 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 used rarely because, given the factors identified in this article, they seldom fit the circumstances of various matters.

In relation to the issue of circumstantial fit, several respondents observed that civil penalties offer little if the person alleged to have breached a civil penalty provision is bankrupt. This is because the two civil penalty sanctions are a pecuniary penalty and/or a management banning order. Imposing a pecuniary penalty upon a person who is already bankrupt and who may be assumed unable to pay the penalty serves no purpose. In addition, a person who is bankrupt is automatically prohibited from managing a company under s 229 of the *Corporations Law* so that resort to a civil penalty action is not needed to achieve

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68 The topic of alternative civil strategies is discussed in more detail in Part VIII.

69 This topic is discussed in more detail in Part VII.

70 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) 107 ALR 171; and *R v Towey* (1996) 21 ACSR 46. The judgments are discussed in HAJ Ford, RP Austin, IM Ramsay, note 52 *supra* at [9.280].

this objective.

Question 2(b) raised the issue of the deterrent value of civil penalties. 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. Potentially civil penalties could rate significantly on these criteria, but do not because of their low levels of usage to date.

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. The comments of one respondent on civil penalties in relation to deterrence and efficiency issues are a reasonable reflection of the respondents as a group:

> 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.

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

VI. INTERNAL FACTORS AFFECTING 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.

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.[71] 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*.[72]

The implicit influence of strategic regulation theory is evident in the respondents' references 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. ASIC believes that campaign

71 The role of CMPs and TRACs was explained in Part V.

72 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*, Westport (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.

based enforcement has inherent deterrent 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.

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 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.[73] However, indirectly this resource impediment probably does exist, in view of perceptions about judicial attitudes and the potential for criminal action in a civil penalty-type situation. There is 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.

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 targeted in its general activities and in its application of project methodology case management; and
- 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.

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

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

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. The current totals are too low (14 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.

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.

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. 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.

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 agreed with this comment on the changing staff profile of ASIC enforcement divisions across the regions and its influence on civil penalties:

> 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.

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.

Other respondents observed that 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.

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. We now focus on the external constraints on the use of civil penalties.

VII. EXTERNAL FACTORS AFFECTING ASIC ENFORCEMENT PRACTICES

The operational context of the civil penalty regime in the *Corporations Law* cannot be understood solely 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 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 above.

An important aspect of the dynamic of the civil penalty regime in Australia has been the working relationships between ASIC and the various DPPs, in particular, the Commonwealth DPP. The fundamental importance of the ASIC and DPP relationship to the general regulatory agenda of ASIC is well known and was 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. The interviews revealed that there were cultural and philosophical differences between ASIC and the DPP that influence decision-making processes.

Since September 1992, the framework for cooperative arrangements between ASIC and the DPP has been based on Ministerial Orders laid down by the then Attorney-General, Mr Michael Duffy.[74] 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.[75]

The documents which detail most of the working arrangements between ASIC and the DPP are confidential.[76] 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 and 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. It is impossible to evaluate documents that have not been viewed by the research team, but 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. 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 would have been taken if the whole process had been conducted by one agency. The DPP (quite

74 Ministerial Orders, *ASC Digest*, 1992, Update 183.

75 *Ibid.*

76 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.

understandably), always wants to satisfy itself that there is no criminal element in a matter. This theme of the legitimate involvement of the DPP slowing moves towards civil penalties was repeated by respondents from most regions. What this means is that the role of the DPP may limit the use of civil penalties. In the words of one respondent:

> 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.

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. The judiciary is another important influence 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.

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. Respondents' perceptions 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".

ASIC personnel are continually mindful of administrative review, and that awareness probably contributes to improved decision-making. 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.

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.

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. Secondly, 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. Thirdly, 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*][77] 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 one 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.

The discussion in this Part reveals how judicial attitudes towards civil penalties are taken into account by ASIC in making enforcement decisions. 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. These issues are compounded by the fact that the legitimate expectations of the DPP inevitably mean that ASIC can be less certain about the

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77 Section 232 of the *Corporations Law* contains the basic duties of directors such as the duties to (1) act honestly, (2) exercise reasonable care and diligence, and (3) not make improper use of information or position.

budgetary and other issues raised in Part VI 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.

VIII. ALTERNATIVE REMEDIES TO CIVIL PENALTIES

This Part reports on the impact which the availability of alternative civil sanctions, in particular, injunctions and management banning orders, has had on the incidence of civil penalty actions

Alternative civil sanctions such as injunctive remedies are popular amongst many ASIC enforcement personnel. 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 80 matters that we have on our books at the moment, 10 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. Alternative civil remedies such as 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.

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 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.

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. The responses showed that there are more distinct levels of regional variation regarding banning orders in comparison to injunctions. This is true for both their use of management banning orders under s 600 (under which ASIC may order persons not to manage corporations) and ss 230 and 599 (under which a court may order a person not to manage corporations).[78] There is not merely a large office/small office dichotomy, but the response reflects sharp contrasts between individual large offices and individual smaller offices.

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 personnel 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.

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.

The popularity of ss 230 and 600 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

78 Sections 230, 599 and 600 were outlined in Part III.

in such situations as dealing with phoenix companies[79] 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.

It can be seen from the discussion in Parts VI to VIII that there was broad agreement amongst respondents that resource issues, the influence of the DPP, 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. Each of these factors helps to explain the limited use of the civil penalty regime. Legal factors also play a role as explained in Part IX.

IX. LEGAL FACTORS

The final topic is the deficiencies in the drafting of the *Corporations Law* and other regulatory impediments, and their impact on ASIC's use of civil penalties. The deficiencies reported here are those identified by the respondents only.[80] The criticisms of the current drafting of the *Corporations Law* by the respondents centred around two impediments: a lack of clarity as to the meaning of the provisions and a lack of flexibility in the range of enforcement sanctions.

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 was subject to multiple interpretations. 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

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79 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 Third Report, *Curbing the Phoenix Company*, 1995 at [1.1].

80 For a broader discussion, see H Bird, note 5 *supra* at 413-20.

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 to, or the same as, that required for the imposition of a civil penalty.

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.

Ambiguity in the law is a recognised problem and the respondents 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.

Almost all the 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 ss 997 and 998, provided existing difficulties with their operation could be solved.[81] In particular, any extension should be coupled with clearer guidelines about how civil penalties should be used. There was a general view that the *Corporations Law* and regulatory sanctions need to be more inter-linked and packaged and that civil penalties have the potential to contribute to a more systematic approach to enforcement. Respondents favoured running civil penalties in conjunction with other proceedings, whether in the civil or criminal

81 Section 997 prohibits stock market manipulation while s 998 prohibits false trading of securities and market rigging transactions.

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.

Apart from the impediments under the *Corporations Law* itself, respondents cited the impact of time issues, the doubtful utility of 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 corporate investigations within 12 months.[82] This increased strategic priority being given to the time element is likely to boost the selection of civil law procedures by ASIC personnel.

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 (for example, by challenging some aspects of an ASIC investigation in the courts or AAT) was also seen as an issue. Use of due process is an acceptable element of the regulatory paradigm and respondents saw 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 elements of time and complexity. The negative effect of this interaction was described by one respondent in this way:

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82 Note 55 *supra* at 23.

> 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.[83]

X. 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 perception of the government. 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 IX of the article identified the factors nominated by those interviewed as responsible for this state of affairs. To reiterate, 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 investigators' point of view, appear to be more viable, such as injunctions and management banning orders. For example, injunctions not only provide a 'real time' remedy, but also have the additional advantage that the public can see the direct effects within a short time of injunctions freezing assets and shutting down rogue companies. The desire of 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 many alternative civil remedies.

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

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) was the reservations expressed by a number of those interviewed about delays associated with use of the courts in the area of enforcement and some of the difficulties of interpretation that have resulted from certain judgments. 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 such as management banning orders.

Thirdly, 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.

Fourthly, those interviewed indicated that the requirement to liaise with the DPP over significant enforcement matters impacts on the use of civil penalties. The consequences resulting from the requirement to liaise with the DPP were 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 can 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 the enforcement of directors' duties. However, as the research set out in this article 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 penalty proceedings?

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

(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

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 *Corporations Law* s 232 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 *Corporations Law* s 232(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	s 588G	Lester 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	s 588G	Same details as for Keith Lester	ASC MR 98/170; ASIC MR 98/335

Respondent	Date of Orders	Pecuniary Penalty	Banning Period	Sections Contravened	Brief Description	Sources
John Phillip Donovan	20/8/98	$40 000	10 yrs	s 232	Donovan, a director of the Good Life Company and Friends Pty Ltd, breached *Corporations Law* s 232 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	s 232	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	-	s 232(6) s 79(a)	Spencer was involved in a contravention of s 232(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

Respondent	Date of Orders	Pecuniary Penalty	Banning Period	Sections Contravened	Brief Description	Sources
Satya Nandan	10/4/97	$20 000	3 years	s 232(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	s 588(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	s 588(G) s 79(c)	Same action as against Wardell, ASC alleging that Gdanski was knowingly concerned in and party to the breaches of the *Corporations Law* by Wardell.	ASC MR 97/066
Allen Cooke	29/11/96	-	5 yrs	ss 292 and 293 and 318	Cooke contravened s 318 by failing to maintain proper balance sheets and profit and loss accounts for a number of companies.	ASC MR 96/270

Respondent	Date of Orders	Pecuniary Penalty	Banning Period	Sections Contravened	Brief Description	Sources
Roger Keith Brock	18/11/96	-	10 yrs	s 588(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