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WHITE PAPER

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The Future Direction of Corporate Criminal Responsibility in Australia

On 31 August 2020, the Australian Law Reform Commission's Final Report on Corporate Criminal Responsibility was tabled in Parliament. The Final Report makes significant recommendations for reform of corporate criminal responsibility in Australia, including reforms limiting the use of the criminal law as a regulatory tool, clarifying criminal attribution methods, enhancing sentencing powers and procedures for corporate offenders, expanding the liability of directors and senior managers for corporate wrongdoing and creating new offences for failure to prevent certain transnational crimes.

The Final Report is published at a time of increased focus on corporate wrongdoing in Australia, reflected in recommendations made by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, as well as recent legislation to reform the law of foreign bribery and allow corporations to enter into deferred prosecution agreements.

This *White Paper* outlines these recent developments as well as the key recommendations of the ALRC, considering the future of corporate criminal responsibility in Australia, which will be a continued area of focus for Australian legislators and regulators in the coming years.

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INTRODUCTION

In recent years, there has been a growing focus by the Australian Government on corporate misconduct following the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry ("Financial Services Royal Commission"), which published its Final Report in February 2019. In the Final Report, Commissioner Kenneth Hayne criticised the Australian Securities and Investments Commission ("ASIC") for failing to properly hold corporations accountable for misconduct, including by failing to use the criminal law in appropriate cases.[1] As a result, ASIC has adopted a "why not litigate?" mandate, but with very mixed results.[2]

On 10 April 2019, the Attorney General of Australia asked the Australian Law Reform Commission ("ALRC") to undertake a comprehensive review of the Commonwealth corporate responsibility regime. The ALRC published a Final Report on Corporate Criminal Responsibility on 31 August 2020 ("Final Report").[3] The Final Report makes a number of significant recommendations for reform of the law in a number of different areas relevant to corporate crime.

This *White Paper* considers the future direction of corporate crime in Australia, first examining the recent *Crime Legislation Amendment (Combatting Corporate Crime) Bill 2019* ("*CLACCC*") which proposes to introduce a new offence of failing to prevent foreign bribery and a deferred prosecution agreement ("DPA") scheme.

The *White Paper* then examines five key reforms considered by the ALRC in the Final Report which indicate the future direction of corporate criminal responsibility in Australia. These are:

1. Limitation on the use of criminal law as a method of corporate regulation;

2. Reform to corporate criminal attribution methods;

3. Sentencing reform for corporate offenders;

4. Individual liability of directors and senior managers for corporate misconduct; and

5. Expansion of the "failure to prevent" model to other transnational offences.

THE CRIME LEGISLATION AMENDMENT (COMBATTING CORPORATE CRIME) BILL 2019

The *CLACCC* is currently before the Australian Senate.[4] Although the *CLACCC* appears to have been delayed due to the COVID-19 pandemic, there are no indications that the Government is no longer committed to its passage. Key elements of the *CLACCC* are:

- The introduction of a new criminal offence applicable to corporations of "failing to prevent" foreign bribery; and

- The creation of a DPA scheme.

Failure to Prevent Foreign Bribery

The "failure to prevent" foreign bribery offence is based on section 7 of the *Bribery Act 2010* (UK). The "failure to prevent" model of liability criminalises improper conduct by or on behalf of corporations which have failed to take appropriate and adequate measures to prevent serious wrongdoing. The model seeks to act as a preventative device to influence behavior and corporate culture by requiring corporations to put in place effective procedures and controls which deter wrongdoing.

If the *CLACCC* is passed, section 70.5A of the Commonwealth Criminal Code ("Code") would provide that a corporation commits an offence if:

- An "associate" commits the offence of foreign bribery under Australian law, or engages in conduct outside of Australia that would constitute an offence under Australian law if that conduct occurred in Australia; and

- That associate's conduct was "for the profit or gain" of the corporation.[5]

The term "associate" is broadly defined to include an officer, employee, agent, contractor, subsidiary or someone who otherwise performs services on behalf of the corporation.[6] The failure to prevent offence is not predicated on conviction of the wrongdoing associate, and a corporation can be prosecuted independent of the associate.[7] This allows corporations to be prosecuted in cases where their associates are outside the jurisdictional reach of the Crown.

Section 70.5A will also apply to foreign corporations and will be subject to the extended geographical jurisdiction provided for in section 15.1 of the Code. One of the consequences of this is that section 70.5A will apply to foreign corporations doing business in Australia.

Section 70.5A is an absolute liability offence, which means that, once the underlying offence of foreign bribery by the associate is proven, a corporation will be automatically liable without the need for the prosecution to establish a fault element (such as intention or recklessness) on the part of the corporation.[8] However, the corporation has a defence if it can prove, on the balance of probabilities, that it had in place "adequate procedures" that were designed to prevent foreign bribery.[9]

Although the term "adequate procedures" is not defined in the *CLACCC*, in November 2019, the Attorney General published a Consultation Draft which provided guidance on how companies could avoid liability through implementing adequate procedures, which include:

- Risk assessment and due diligence procedures;
- Monitoring and review of compliance programs;
- Board and managerial-level dedication to foreign bribery prevention;
- Whistleblower reporting mechanisms; and
- Effective communication and training of staff. [10]

While this provides some guidance as to the procedures that should be considered and implemented, it ultimately will be a matter for the court to interpret the meaning of "adequate procedures" and to determine whether such procedures were in place when foreign bribery occurs. Given that the concept of "adequate procedures" is derived from the *UK Bribery Act*, case law in the United Kingdom may provide some guidance for Australian courts.

However, the case of *R v Skansen Interiors*,[11] the only contested case of failure to prevent bribery in the United Kingdom to date, indicates that the adequate procedures defence may be difficult to satisfy in practice. The defendant in *Skansen* was a small interior design company that self-reported an incident involving domestic bribes paid by certain employees in order to secure contracts under a tender process. Despite its self-reporting, the defendant was prosecuted for failure to prevent bribery. The defendant relied on the adequate procedures defence and claimed that, given that it was a small organization of 30 employees, the procedures did not need to be sophisticated in order to qualify as "adequate". The defendant did not have any specific anti-bribery policy but relied on policies that required "honesty, integrity, transparency and ethics", arguing that it was common sense that such a policy would prohibit bribery. The jury rejected this defence and rendered a guilty verdict. No evidence was available to show that staff had been made aware or trained on the policies that Skansen did have in place, or that any staff members had positively agreed to abide by them.

At the same time, the recent deferred prosecution agreement agreed between the SFO and Airbus makes clear that effective oversight of policies and procedures is likely to be a key factor in any assessment of "adequate" procedures in the United Kingdom.

These lessons from the United Kingdom suggest that it will not be sufficient simply to have documented policies and procedures, even if such policies are expressly directed to preventing foreign bribery. There will need to be systems in place that are designed to ensure those policies and procedures are effective, including being brought to the attention of relevant associates, monitoring of compliance and conduct with consequences for noncompliance. As such, directors and officers should seek regular, documented, independent assurance that the corporation's policies and procedures are effective.

DPAs

DPAs are agreements between prosecutors and a corporation that provide for the suspension of criminal proceedings against the corporation in exchange for compliance with agreed conditions. DPAs are already used in other jurisdictions including in the United States, the United Kingdom, France and Canada.[12] DPAs are analogous to ASIC's enforceable undertaking regime, whereby corporations may agree to an administrative settlement as an alternative to civil penalty proceedings.

Under the proposed DPA scheme in the *CLACCC*, the Commonwealth Director of Public Prosecutions ("CDPP") can invite a corporation that has engaged in a serious corporate crime to negotiate an agreement to comply with a range of specified conditions.[13] These conditions include agreement to a statement of facts and payment of a financial penalty to the Commonwealth,[14] and may also include compensation to victims, donations to charities, implementation of compliance programs and cooperation in an investigation.[15] Where a condition of the DPA includes undertakings to implement a compliance program and reform its corporate culture, the DPA might provide for the appointment of an external independent monitor to oversee compliance. However, DPAs are available only in respect of a specific set of serious corporate offences which range from market manipulation to dealing in the proceeds of crime.[16]

If the corporation complies with the conditions of the DPA, it will not be prosecuted in relation to the offences specified in the DPA.[17] A material contravention of the DPA may result in the CDPP commencing proceedings against the corporation or renegotiating the terms of the DPA.[18]

DPAs provide benefits to corporate offenders who may be motivated to agree to certain sanctions in exchange for the certainty of closing out further investigations and the quantum of any penalty. Further, a DPA will not lead to any adverse court findings against the corporation and does not require admission of guilt (although relevant facts may be admitted).

However, there are also risks for corporate offenders seeking to enter a DPA.

There is no certainty that the CDPP will agree to enter into a DPA where a corporation self-reports misconduct and makes admissions. Equally, there is no certainty that a corporation that does not self-report will be effectively disqualified from being entitled to negotiate a DPA. The CDPP may elect to prosecute even where there has been a level of cooperation by the corporation directed towards securing a DPA.

Further, in the Final Report, the ALRC recommended that the *CLACCC* be amended to allow the court oversight of DPAs including by vesting the power of approval in a court and requiring the publication of reasons.[19] If adopted, this recommendation will present a further risk for corporate offenders, as there is a risk that the courts will not approve the entry into of the DPA and, even if approved by the court, reasons published by the court may be used by plaintiff firms as part of private civil proceedings against the corporation, including class actions.

LIMITING CRIMINAL LAW AS A MEANS OF CORPORATE REGULATION

A Principled Basis for Criminalisation

The ALRC found that the Australian system of corporate regulation is extremely complex and often incoherent. Criminal law is one of several methods used for regulating corporate behavior in Australia, with the most common alternative being civil penalty provisions. Although there is currently a proliferation of criminal offences which apply to corporations, there is often little principled distinction between criminal offences and civil penalty provisions. This incoherence is exacerbated by the fact that, although the criminal law is ostensibly more serious than a civil penalty, the most common penalty for a corporation convicted of a criminal offence is a fine.[20]

The ALRC reviewed the criminal offence provisions in a number of Commonwealth statutes and made some pertinent observations, including that:

- There is a significant number of criminal offences for relatively trivial conduct (for example, offences under the *Corporations Act 2001* (Cth) which criminalise a corporation that fails to place an Australian Company Number on certain company documents[21] or fails to notify ASIC of a change to company office hours[22]);

- There is no principled way of distinguishing criminal conduct from conduct in breach of civil penalty provisions, with some legislation providing that certain conduct is both a criminal offence and a breach of a civil penalty provision;[23]

- Many offence provisions are unduly complex and suffer from a tendency described by Commissioner Hayne in the Financial Services Royal Commission as involving a "piling of exception upon exception and the carving out of special rules for special interests"; [24]

- There is an over-reliance on specific rather than general prohibitions;[25] and

- Many offences are able to be resolved following the issue and payment of an infringement notice without the regulator being required to prove an offence in court.[26]

The ALRC argued for a principled approach to criminalisation, noting that in order for the stigmatisation of a criminal offence to be effective, the criminal law must be used "sparingly and appropriately".[27] The ALRC recommended that corporate conduct should be primarily regulated by civil regulatory provisions, with a criminal offence created only when:

- Denunciation and condemnation of the conduct constituting the offence is warranted;

- Imposition of the stigma that should attach to criminal offending would be appropriate;

- The deterrent characteristics of a civil penalty would be insufficient;

- It is justified by the level of potential harm that may occur as a consequence of the conduct; or

- It is otherwise in the public interest to prosecute the corporation itself for the conduct.[28]

The ALRC also recommended that infringement notices should no longer be available for criminal offences.[29]

The ALRC proposed that these principles could be applied to new legislation or legislative amendments and anticipated that it could be implemented in respect of existing legislation as part of periodic reviews.

Systematic Offences

Notwithstanding the ALRC's view about the need for civil regulation to be the default form of regulation in Australia, the ALRC also recommended the introduction of offences that criminalise contraventions of prescribed civil penalty provisions that "constitute a system of conduct or pattern of behavior".[30] Such a provision would require that the corporation have the state of mind of intention or recklessness. The ALRC argued that, despite their recommendation about the need for primacy of civil regulation, there was a need to discourage and punish systematic corporate conduct.[31]

One example of such conduct provided by the ALRC was the fees for no service conduct uncovered during the Financial Services Royal Commission, which involved the systematic charging of advisor service fees after ongoing fee arrangements had been terminated, which gave rise to thousands of potential breaches of the *Corporations Act*.[32]

Conclusion on Limiting Criminalisation

A more coherent and principled approach to the criminal law is a welcome change and will hopefully ensure that the only conduct which is criminalised is conduct that is deserving of the societal denunciation and condemnation associated with a criminal conviction. Additionally, a principled approach may reduce the regulatory burden on companies seeking to navigate complex federal legislation.

On the other hand, given the significant evidentiary difficulties associated with proving offences to the criminal standard, a growth in the number of civil penalty provisions in respect of corporate wrongdoing may further increase the already significant number of civil penalty proceedings issued by Australian regulators. This may be acutely felt in respect of civil penalty provisions under ASIC's purview given its "why not litigate" approach to enforcement.

Further, the recommendation of an offence for systematic breaches of civil penalty provisions appears to once again blur the principled distinction which the ALRC sought to draw between criminal and civil liability. It could be argued that based on the principles identified by the ALRC, an appropriate response to ongoing conduct would be the imposition of a higher civil penalty and not the criminalisation of otherwise civil breaches.

REFORM OF CORPORATE CRIMINAL ATTRIBUTION METHODS

Current Approach

Under the Code, both individuals and corporations may be liable for criminal offences.[33] Part 2.5 of the Code sets out the methods by which criminal offences can be attributed to corporations. Under section 12.2, the physical element of an

offence may be attributed to a corporation using traditional agency principles, with physical acts of "an employee, agent or officer acting within his or her actual or apparent authority" attributable to a corporation.[34]

Section 12.3 of the Code provides that when an offence requires fault elements of intention, knowledge or recklessness, this state of mind is imputed to a corporation if it "expressly, tacitly or impliedly authorised or permitted the commission of the offence".[35] The means by which "authorisation or permission" may be established include where:

- The board of directors either carried out the relevant conduct or authorised or permitted the commission of the offence;
- A "high managerial agent" either carried out the relevant conduct or authorised or permitted the commission of the offence;
- A corporate culture existed that directed, encouraged, tolerated or led to noncompliance with the relevant provision; or
- The corporation failed to create and maintain a corporate culture that required compliance.[36]

The term "high managerial agent" is defined as "an employee, agent or officer of the body corporate with duties of such responsibility that his or her conduct may fairly be assumed to represent the body corporate's policy".[37] Where authorisation or permission is established by the conduct of a high managerial agent, the corporation has a defence if it can establish that it exercised due diligence to prevent the conduct or the authorisation or permission.[38]

Limits with Current Approach

Despite the broad scope of the attribution methods under Part 2.5, its operation is excluded in many major pieces of Commonwealth legislation.[39] In the result, Part 2.5 has been rarely used, with only 13 prosecutions being brought in the 10-year period from 30 June 2009 to 30 June 2019.[40] Moreover, the ALRC identified only one recorded case in which the corporate culture provisions were considered.[41]

The scope of Part 2.5 has been criticised, including on the basis that:

- It is highly unlikely that evidence would emerge which proves that a board of directors carried out, authorised or permitted a criminal act;[42]
- Requiring the engagement, authorisation or permission of a "high managerial agent" renders the prosecution of large companies more difficult given the fact that power in large companies is often decentralised and divided into business units, resulting in many decisions being made at middle management level.[43] In this context, the task of identifying whether a person is of sufficient seniority that their conduct "may fairly be assumed to represent the body corporate's policy" is fraught with difficulties; and
- The concept of "corporate culture" is a nebulous one which is difficult to define by any objective measure, meaning that the provisions which rely on a defective corporate culture are likely to suffer from evidential burdens which are too high to meet with any practical certainty.[44] The single case in which the corporate culture provisions have been considered demonstrates that the courts require direct, relevant evidence of the corporation's actual culture and will not infer a defective culture as a result of the offending conduct.[45] Or, put another way, the defective culture does not "speak for itself".

ALRC Recommendations

The ALRC made three key recommendations about reform of Part 2.5:

A Single Legislative Attribution Model for Corporations. The ALRC opined that there were significant benefits for requiring a single legislative attribution model for corporations, which would reduce their compliance burden, create greater certainty and simplicity and lead to a body of case law which could be developed by courts to aid in nuanced and consistent application. On this basis, the ALRC recommended that Part 2.5 should be the default model of corporate liability and all Commonwealth provisions which displace Part 2.5 should be repealed unless an alternative method is necessary for that particular offence.[46]

Amendment to Physical Attribution Requirements. The ALRC recommended a minor amendment to section 12.2 to expand the persons whose physical acts could be attributed to a corporation to include "any person acting at the direction, or with the agreement or consent (express or implied), of an officer, employee or agent, acting within actual or apparent authority".[47]

Extending the physical attribution requirement in this way would clarify that the physical acts of persons who are not employed or appointed by the corporation may be attributed to it. For instance, this could arguably include an employee of the corporation's joint venture partner who is acting under the direction of the corporation's officers, employees or agents. As noted by the ALRC, while on one view the term "agent" may already have been broad enough to include such persons, the change would clarify that the class of persons whose physical acts may be attributed to a corporation is broad and that those persons do not need to fall within the definition of "agent".[48]

Amendment to Fault Attribution Requirements (Option 1 and 2). The ALRC proposed two potential models for attributing fault under Part 2.5.[49] Option 1 retains the key structure of section 12.3 but introduces a number of amendments to section 12.3 including, most importantly:

- Replacing "high managerial agent" with "'officer, employee, or agent of the body corporate, acting within actual or apparent authority"; and

- Replacing the defence of "due diligence" with "reasonable precautions".

Alternatively, Option 2 proposes a complete redraft of section 12.3 to provide that, where it is necessary to establish a state of mind (other than negligence), it is sufficient to show that:

- One or more officers, employees or agents of the body corporate, acting within actual or apparent authority, engaged in the relevant conduct, and had the relevant state of mind; or

- One or more officers, employees or agents of the body corporate, acting within actual or apparent authority, directed, agreed to or consented to the relevant conduct, and had the relevant state of mind.

Option 2 also provides a defence where the corporation took reasonable precautions to prevent the commission of the offence.

Both models propose that the state of mind should be attributable to "officers, employees and agents acting within actual or apparent authority" which the ALRC opined better reflects the reality of modern corporate decision-making which is often not readily reduced to an identifiable "senior" individual and was more agnostic to different corporate sizes and structures.[50]

Similarly, under one limb of Option 1 and both limbs of Option 2, if the corporation can prove on the balance of probabilities that it took "reasonable precautions" to prevent the offence, then it has a defence. The ALRC suggested that the current language of "due diligence" has caused confusion given the connection that phrase has with commercial transactions, which has led some to associate it with expensive and forensic examination.[51] The ALRC suggested that "reasonable precautions" instead focuses on the reasonableness of the policies and procedures which have been put in place by a corporation to prevent criminal activities.

Conclusion on Attribution Methods

The ALRC's recommendation that a single model of attribution be introduced for all Commonwealth offences should be welcomed and will provide corporations with much greater certainty and reduce their current compliance burden, particularly if a body of case law emerges which provides greater certainty as to the meaning and effect of the attribution provisions.

On the other hand, if the second recommendation and either Option 1 or Option 2 of the third recommendation are implemented, this would raise serious concerns that corporations may be held criminally liable based on the physical acts of persons who are not appointed to the corporation, such as the employees of joint venture partners, and/or the states of mind of low-level employees, with the only protection an untested "reasonable precautions" defence.

Essentially, wherever there is misconduct by employees that could give rise to criminal liability for a corporation, the onus would fall on the corporation to establish that the corporation took "reasonable precautions" to prevent the commission of the offence.

Although the language of "reasonable precautions" is somewhat more flexible than the potentially onerous existing requirement of due diligence, it introduces a further nebulous concept into corporate criminal law in circumstances where corporations are already grappling with the concept of "adequate procedures" in a foreign bribery context. The legislature

should harmonise these principles to reduce compliance burdens on corporations and increase certainty.

Further, notwithstanding the potentially broader application of a reasonable precautions defence, in circumstances where offending by employees or agents has been proven, satisfying the "reasonable precautions" criteria will be no easy task for the corporation. It will be difficult for corporations to determine in advance of an incident occurring, and without the benefit of the type of hindsight analysis deployed by regulators, what measures would constitute a "precaution" and what level of proportionality applies when designing and implementing those measures.

The case for substantive reform of Part 2.5 is not a strong one, as the paucity of proceedings issued under Part 2.5 does not necessarily indicate that it is ineffective and requires reform, but may instead be reflective of other more practical factors which often impede prosecution, including resource limitations and the difficulty of prosecuting corporate crime in general. As a result, many regulators may be reticent to use Part 2.5 and may reasonably prefer to bring civil penalty proceedings given their lower standard of proof.

As such, significantly reforming the physical and fault attribution methods under Part 2.5 in the way suggested by the ALRC would unnecessarily tip the balance in favour of prosecutors and is unwarranted in circumstances where there is no evidence that Part 2.5 is ineffective in its current form or could not be improved without dispensing with the requirement that the offending conduct was authorised or permitted by an officer or employee of sufficient seniority.

SENTENCING REFORM FOR CORPORATE OFFENDERS

Although corporations are treated the same as natural persons under the criminal law and may be convicted of a criminal offence, unlike natural persons, they have "no soul to damn, no body to kick".[52] Therefore, sentencing processes and penalties need to be appropriately adapted to corporate offenders. However, the current law provides little real appreciation of the fact that, when sentencing corporations, different considerations must be taken into account and different outcomes might be sought than when sentencing individuals.

The ALRC made a number of recommendations to address these deficiencies, including:

Providing Statutory Guidance on the Factors which are Relevant to Sentencing Corporations. The *Crimes Act 1914* (Cth) contains no specific statutory guidance on what factors a court must take into account when sentencing corporations for criminal offences, with courts applying the factors which can be applied to natural persons[53] or drawing on case law relevant to civil penalties.[54] The ALRC recommended that the *Crimes Act* be amended to set out specifically relevant factors in sentencing corporations, which would include:

- The type, size and financial circumstances of the corporation;
- Whether the corporation had a corporate culture conducive to compliance at the time of the offence;
- The extent to which the offence or its consequences ought to have been foreseen by the corporation;
- The involvement in, or tolerance of, the criminal activity by management;
- Whether the unlawful conduct was voluntarily self-reported by the corporation;
- Any advantage realized by the corporation as a result of the offence;
- The extent of any efforts by the corporation to compensate victims and repair harm;
- The effect of the sentence on third parties; and
- Any measures that the corporation has taken to reduce the likelihood of its committing a subsequent offence, including:
    - internal investigations into the causes of the offence;
    - internal disciplinary action; and
    - measures to implement or improve a compliance program.[55]

To ensure coherence and consistency, the ALRC also recommended that legislation be enacted to ensure those additional factors were also considered by a court when considering an appropriate civil penalty.[56]

Empowering Courts to Make a Range of Non-Monetary Penalty Orders. For most Commonwealth offences, the only available sentencing option is a fine. The ALRC recommended expanding the court's current toolkit for sentencing corporations convicted of Commonwealth offences and recommended that the *Crimes Act* be amended to provide the court with the power to make orders:

- Requiring the corporation to publicise or disclose certain information;
- Requiring the corporation to undertake activities for the benefit of the community;
- Requiring the corporation to take corrective action within the organization, such as internal disciplinary action or organizational reform;
- Requiring the corporation to facilitate redress of any loss suffered, or any expense incurred, by reason of the offence;
- Disqualifying the corporation from undertaking specified commercial activities; and
- Dissolving the corporation if it has been convicted on indictment of a Commonwealth offence and the court is satisfied that dissolution represents the only appropriate sentencing option.[57]

The ALRC also recommended that the court be provided with the power under the *Corporations Act* to make an order disqualifying a person from managing corporations if that person was involved in the management of a corporation which was dissolved under a sentencing order.[58]

Developing a National Debarment Regime. The ALRC opined that allowing criminally convicted corporations to enter into government contracts may undermine public trust in government, endanger public health and safety and increase the risk of misuse of public funds.[59] The ALRC recommended the introduction of a debarment regime which makes exclusion from government contracts a potential consequence of a corporation being convicted of a criminal offence.[60] This may be similar to regimes which are operational in the European Union, Canada and the United States.[61]

Reforms to specify the considerations which a court may take into account upon sentencing and enhancements of the court's sentencing powers to more closely reflect the differences between corporate offenders and natural persons will increase certainty for corporate offenders by flagging steps they can take in mitigation.

However, any national debarment regime should be carefully considered and must be appropriately limited to certain convictions and allow corporations to cease to be debarred in appropriate circumstances.

LIABILITY OF INDIVIDUALS

Management Accountability under Current Law

The ALRC was asked to consider the liability of individuals, such as directors and senior managers, for corporate misconduct. Under the *Corporations Act*, there are a number of provisions under which directors and other officers may incur civil or criminal liability for involvement in corporate misconduct including:

- Direct liability for breaches of directors' or officers' duty;[62]
- Accessorial liability for directors or officers involved in a corporation's contravention;[63] and
- Extended management liability provisions which deem directors or officers as liable based on a corporation's contravention[64] or based on their failure to prevent a contravention.[65]

The ALRC highlighted ASIC and ACCC data[66] which indicated that it was rare for criminal or civil proceedings to be brought against senior management of very large corporations, which is said to lead to an "accountability gap".[67] This is due to the difficulty regulators consider they face in attributing responsibility to senior management of large corporations, which often employ levels of delegation and risk taking which do not easily fit within existing concepts of law.[68] In large corporations, responsibility is

diffused as a matter of fact and necessity, and not in a deliberate attempt to avoid individual accountability. However, the result can be that it is difficult to locate in one individual the necessary elements of an offence or civil penalty provision.

Submissions to the ALRC supported the view that board members are already exposed to significant liability given their oversight role, and the appropriate subjects of any extension of liability may be those senior executives below C-suite level (usually comprising the CEO, CFO, CRO, COO and CIO, etc.), who direct and control significant aspects of the corporation's business on a day-to-day basis, such as those in middle management positions or divisional heads.[69] However, this year there have been two significant developments affecting the obligations of middle management in large corporations.

ASIC v King

The first is the recent High Court case of *ASIC v King*,[70] where the High Court overturned a decision of the Queensland Court of Appeal, finding that King, the CEO of the parent company, was an officer of its subsidiary despite no formal appointment, as he fell within the definition of "officer" which includes "a person who has the capacity to affect significantly the corporation's financial standing".[71] The High Court confirmed that the definition of "officer" in the *Corporations Act* is a functional one which does not require that the putative officer has a named office in the corporation with rights and duties attached to it.[72]

Although the case did not specifically deal with how far down the management chain liability for officers' duties extends, the emphasis on the functional nature of the definition suggests that the court may adopt a broad approach. Therefore, persons in middle management positions who have the capacity to significantly affect the corporation's financial standing are likely to already owe officers' duties under the *Corporations Act*.

Financial Accountability Regime

The second development is the Federal Government's announcement of the Financial Accountability Regime ("FAR"). The FAR is a proposed extension and replacement of the Banking Executive Accountability Regime ("BEAR"), which first came into effect on 30 June 2018.[73]

The BEAR applies to all Authorised Deposit Taking Institutions ("ADIs"), including banks, credit unions and building societies licensed by APRA. It requires them to, among other things, identify directors and senior executives responsible for particular parts or aspects of the ADI's business (which are described under the BEAR as "accountable persons").[74] The list of prescribed accountable persons is broad and includes persons beyond the C-suite including executives responsible for the ADI's internal audit function, compliance function, human resources function and anti-money laundering function.[75]

The BEAR requires those persons to:

- Act with honesty and integrity and with due skill, care and diligence;
- Deal with the regulator in an open and cooperative way; and
- Take reasonable steps in conducting their responsibilities to prevent matters from arising that would adversely affect the prudential standing or prudential reputation of the ADI.[76]

When an accountable person breaches their obligations, the BEAR requires banks to impose a proportionate reduction in remuneration and allows APRA to disqualify them from being an accountable person in the future.[77]

On 22 January 2020, the Australian Government published a Proposal Paper for the FAR, which was in accordance with recommendations made by the Financial Services Royal Commission.[78] The proposed FAR would replace the BEAR and extend the obligations to all APRA-regulated entities,[79] with the potential for later expansion to ASIC-regulated entities.[80]

The FAR will be broader than the BEAR and include:

- Joint administration by ASIC and APRA;[81]
- A stronger penalty framework including the introduction of civil penalties for accountable persons which is consistent with the newly introduced[82] maximum penalties for individuals;[83] and
- An increased number of roles over which a senior executive may be an accountable person including persons responsible for the entity's "significant" business divisions, dispute resolution function, remediation programs, end-to end product management, service provision, incentive setting and breach reporting.[84]

In light of the COVID-19 pandemic, the Department of Treasury has deferred the legislation implementing the recommendations of the Financial Services Royal Commission for six months.[85] At present, it is not clear whether the FAR draft legislation will be released at the end of 2020 as initially planned.

ALRC's Recommendation

Although the ALRC initially proposed reforms to hold individuals accountable for the criminal conduct of corporations,[86] these received little support.[87] The ALRC ultimately agreed that no further reform was necessary, opining that the proposed FAR had the potential to address issues of diffused responsibility that make it difficult to ensure individual accountability and, when appropriate, legal liability and would also provide a greater degree of certainty for both responsible individuals and regulators as to where accountability should lie.[88]

However, the ALRC recommended that the Australian Government undertake a wide-ranging review of the FAR within five years of its introduction to determine whether it should be extended to other highly regulated industries with accountability gaps.[89]

Conclusion on Individual Liability

In light of the considerable obligations already undertaken by directors and senior managers under Australian law, the ALRC's decision not to make any recommendations to impose additional duties was undoubtedly the correct one.

The recent decision of *ASIC v King* has clarified that officers' liability extends to a vast array of individuals in large corporations, which may lead to increased prosecutions of officers beyond the boardroom and the C-suite. As such, any further extension of the liability of officers, including under the proposed FAR, should be approached with caution.

EXPANSION OF FAILURE TO PREVENT OFFENCES

In recent years, there has been a growing international focus on the regulation of transnational business.[90] In an increasingly globalized world, many multinational corporations conduct substantial parts of their operations in developing countries. However, developing countries can have weak or corrupt regulatory systems or inadequate labour and environmental protections which present unique risks for multinational corporations.

Concerns about the involvement of Australian corporations in wrongdoing in offshore jurisdictions recently led to the passage of the *Modern Slavery Act 2018* (Cth), which requires "reporting entities" to publish annual modern slavery statements describing the actions they have taken to address modern slavery risks in their operations and supply chains.[91]

The Code already provides means by which corporations can be prosecuted for certain transnational crimes. The Code provides a number of categories of extraterritorial jurisdiction, which apply to certain offences when they occur wholly or partly outside of Australia.[92] However, in practice, the CDPP rarely (if ever) prosecutes corporations for transnational crime,[93] which could be attributable to evidentiary difficulties associated with proving the elements of a criminal offence which took place in a foreign jurisdiction.

The ALRC has recommended that the Australian Government expand the proposed "failure to prevent" offence in the *CLACCC* beyond foreign bribery to other Commonwealth offences that arise in the context of transnational business. These offences may include tax evasion,[94] slavery and slavery-like offences,[95] human trafficking,[96] violation of foreign sanctions,[97] torture,[98] crimes against humanity,[99] war crimes,[100] genocide[101] and financing of terrorism.[102] The ALRC noted that the Crown already has extraterritorial jurisdiction over each of these offences, which indicated an intention by the legislature that they should be regulated domestically even when the offending conduct takes place offshore.[103]

The ALRC opined that the "failure to prevent" model better captured the nature of corporate offending in a transnational setting, given that transnational crimes such as foreign bribery and slavery generally occur in the form of an omission or a failure to prevent the relevant conduct by the corporation, rather than as a specific act knowingly involved in by the corporation.[104] The ALRC argued that expanding the "failure to prevent" offence would incentivize corporations to create and maintain a culture which engages with relevant risks, including by adopting procedures and controls to prevent wrongdoing in offshore operations by associates of the corporation.[105]

Expanding the "failure to prevent" offence is consistent with other jurisdictions. In addition to introducing an offence for failing to prevent foreign bribery, the United Kingdom also introduced an offence of failing to prevent the facilitation of

domestic and foreign tax evasion offences.[106] Further, the UK Government recently considered the creation of an offence of failing to prevent economic crime,[107] and there have been calls in the United Kingdom for the creation of an offence of failing to prevent human rights abuses.[108]

The ALRC suggested that the expansion of the "failure to prevent" offence would have support in the business community, who view it as a means of "levelling the playing field" in favour of corporations that are already taking steps to reduce risk of involvement in crime in their offshore operations.[109]

However, any expansion of the failure to prevent model under *CLACCC* to other offences should be subject to a defence for when corporations have adopted reasonable measures/precautions to prevent the occurrence of those offences. Additionally, as in the case of foreign bribery, this defence should be augmented by detailed guidance from the Government setting out how corporations can rely on the defence, including the steps they might take to ensure that they are not held liable for the conduct of rogue actors. The question of what constitutes reasonable measures/precautions will vary depending on the different foreign jurisdictions in which a corporation operates and will require corporations to have a deeper understanding of the risk profile of the countries they do business in.

FUTURE EXPECTATIONS FOR CORPORATE CRIMINAL RESPONSIBILITY IN AUSTRALIA: FOUR KEY TAKEAWAYS

The COVID-19 pandemic and its significant economic impact may affect the priority given by the Government to enacting any legislation to implement recommendations contained in the Final Report. Delays in implementation will be exacerbated by the overarching nature of some of the proposed amendments, particularly those which seek to overhaul the distinction between civil and criminal offences, which may be implemented gradually on a piecemeal basis. This may lead to further confusion, incoherence and compliance burdens in the short term.

If the recommendations in the Final Report are implemented, we expect there to be a number of significant impacts:

1. Over time there is likely to be an increase of both civil penalty proceedings and criminal prosecutions against corporations. This is primarily due to the fact that the recommendations overall would create a greater number of civil penalty provisions, while at the same time making it easier for the CDPP to bring prosecutions in respect of those provisions which create criminal offences.

2. Corporations and their boards will need to place greater focus on the design and implementation of measures and procedures intended to prevent criminal conduct in order to establish defences. This will require the implementation or strengthening of independent assurance processes which can be relied upon to evidence and test the efficacy of policies and procedures in place.

3. With the implementation of the DPA regime under the *CLACCC*, there may also be greater scope for self-reporting of misconduct and co-operation with prosecutors. Co-operation will be enhanced if there is greater certainty as to factors relevant to the penalty for criminal conduct, as well as increased flexibility in the range and type of orders which might be available to remedy or compensate for the consequences of criminal conduct.

4. Given the ALRC's recommendation that the law in respect of individual director and senior manager accountability be reviewed within five years of the implementation of the FAR, there is likely to be a significant focus on its effectiveness as a model to identify accountable persons and to hold them responsible for corporate misconduct. This will place further scrutiny on ASIC's "why not litigate?" approach to enforcement. Given the mixed results of this approach to date, it remains to be seen whether the FAR will ultimately be viewed as an effective model. In the meantime, corporations and their boards should review closely the requirements of the FAR even if they are not yet within its anticipated scope.

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ENDNOTES

1 Commonwealth of Australia, *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (February 2019) Vol 1, 152.

2 See Jones Day, "*ASIC v Mitchell*: Another Reason for ASIC Not to Litigate" (August 2020).

3 Australian Law Reform Commission, *Final Report: Corporate Criminal Responsibility* (ALRC Report 136, April 2020) ("ALRC Final Report").

4 The *CLACCC* is the second iteration of the original *Crimes Legislation Amendment (Combatting Corporate Crime) Bill 2017* (Cth). The 2017 Bill was introduced in the Senate on 6 December 2017 and lapsed on 1 July 2019. After it lapsed, the Bill was reintroduced in December 2019. The *CLACCC* is substantively similar to the earlier Bill, but incorporates some amendments in light of the report by the Senate Legal and Constitutional Affairs Legislation Committee in 2018; *see* Senate Legal and Constitutional Affairs Legislation Committee, *Crimes Legislation Amendment (Combatting Corporate Crime) Bill 2017* (2018).

5 *Crimes Legislation Amendment (Combatting Corporate Crime) Bill 2019* (Cth) ("*CLACCC*"), Schedule 1 (proposed Criminal Code, s 70.5A).

6 *CLACCC,* Schedule 1 (proposed Criminal Code, s 70.1).

7 *CLACCC*, Schedule 1 (proposed Criminal Code, s 70.5A(3)). See also *Bribery Act 2010* (UK), s 7(3)(a).

8 However, the Crown must establish that the associate had the requisite *mens rea*: *CLACCC*, Schedule 1 (proposed Criminal Code, s 70.5A(2)). *See* Jones Day, "'Absolute Liability' for a Failure to Prevent Foreign Bribery: Significant Change Ahead in Australia?" (December 2017).

9 *CLACCC*, Schedule 1 (proposed Criminal Code, s 70.5A(5)).

10 Australian Government, Attorney General's Department, *Draft guidance on the steps a body corporate can take to prevent an associate from bribing foreign public officials* (Consultation Draft, November 2019). This guidance was provided for under section 70.5B of the *CLACCC.*

11 *R v Skansen Interiors Limited*, Southwark Crown Court, Case Number: T20170224, 21 February 2018 (unreported judgment).

12 Australian Law Reform Commission, *Corporate Criminal Responsibility* (Discussion Paper 87, November 2019), [9.7]-[9.35].

13 *CLACCC*, Schedule 2 (proposed *Director of Public Prosecutions Act 1983* (Cth), s 17A, 17C(1)).

14 *CLACCC*, Schedule 2 (proposed *Director of Public Prosecutions Act 1983* (Cth), s 17A, 17C(1)).

15 *CLACCC*, Schedule 2 (proposed *Director of Public Prosecutions Act 1983* (Cth), s 17C(2)).

16 *CLACCC*, Schedule 2 (proposed *Director of Public Prosecutions Act 1983* (Cth), s 17B).

17 *CLACCC*, Schedule 2 (proposed *Director of Public Prosecutions Act 1983* (Cth), s 17A(2)).

18 *CLACCC*, Schedule 2 (proposed *Director of Public Prosecutions Act 1983* (Cth), s 17A(3)).

19 ALRC Final Report, Recommendation 20.

20 Australian Law Reform Commission, *Principled Regulation: Federal Civil & Administrative Penalties in Australia* (Report No 95, 2002), [2.40].

21 *Corporations Act 2001* (Cth), s 153.

22 *Corporations Act 2001* (Cth), s 145(3).

23 *See e.g.*, *Therapeutic Goods Act 1989* (Cth) ss 14, 14A; *Environmental Protection Biodiversity Conservation Act 1999* (Cth) ss 142, 142B.

24 Commonwealth of Australia, *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (February 2019) Vol 1, [1.5.3].

25 For example, the variety of false or misleading representation provisions: *Australian Securities and Investments Commission Act 2001* (Cth), ss 12DB, 12DC; *Australian Consumer Law* pt 3-1 div 1.

26 ALRC Final Report, [3.39]-[3.43].

27 ALRC Final Report, [5.1].

28 ALRC Final Report, Recommendation 2.

29 ALRC Final Report, Recommendation 3.

30 ALRC Final Report, Recommendation 8. See generally *Australian Securities and Investments Commission v AGM Markets Pty Ltd (in liq) (No 3)* [2020] FCA 208 at [386]-[392].

31 ALRC Final Report, [7.8].

32 ALRC Final Report, [7.49].

33 Criminal Code, s 12.1.

34 Criminal Code, s 12.2.

35 Criminal Code, s 12.3(1).

36 Criminal Code, s 12.3(2).

37 Criminal Code, s 12.3(6).

38 Criminal Code, s 12.3(3)

39 *See e.g.*, *Environment Protection and Biodiversity Conservation Act 1999* (Cth); *Excise Act 1901* (Cth), *Fair Work Act 2009* (Cth); *Fisheries Management Act 1991* (Cth); *National Consumer Credit Protection Act 2009* (Cth); *Protection of the Sea (Prevention of Pollution from Ships) Act 1983* (Cth), *Superannuation Industry (Supervision) Act 1993* (Cth), *Taxation Administration Act 1953* (Cth); *Telecommunications Act 1997* (Cth).

40 ALRC Final Report, [1.20].

41 *R v Potter & Mures Fishing Pty Ltd* (Transcript, Supreme Court of Tasmania, Blow CJ, 14 September 2015).

42 Jonathan Clough and Carmel Mulhern, *The Prosecution of Corporations* (Oxford University Press, 2002), 141.

43 Jonathan Clough and Carmel Mulhern, *The Prosecution of Corporations* (Oxford University Press, 2002), 90.

44 Olivia Dixon, "Corporate Criminal Liability: The Influence of Corporate Culture" (Sydney Law School Legal Studies Research Paper No 17/14, University of Sydney, February 2017) 16.

45 *R v Potter & Mures Fishing Pty Ltd* (Transcript, Supreme Court of Tasmania, Blow CJ, 14 September 2015).

46 ALRC Final Report, Recommendation 5.

47 ALRC Final Report, Recommendation 6.

48 ALRC Final Report, [6.25].

49 ALRC Final Report, Recommendation 7.

50 ALRC Final Report, [6.90].

51 ALRC Final Report, [6.169].

52 John C. Coffee, "'No Soul to Damn: No Body to Kick': An Unscandalized Inquiry into the Problem of Corporate Punishment" (1981) 79 *Michigan Law Review* 386, citing words attributed to Baron Thurlow LC.

53 *Crimes Act 1914* (Cth), s 16A(2).

54 *Commonwealth Director of Public Prosecutions v Nippon Yusen Kabushiki Kaisha* (2017) 254 FCR 235 at [220].

55 ALRC Final Report, Recommendation 10.

56 ALRC Final Report, Recommendation 11.

57 ALRC Final Report, Recommendation 12 and 13.

58 ALRC Final Report, Recommendation 14.

59 ALRC Final Report, [8.126].

60 ALRC Final Report, Recommendation 15.

61 OECD Working Group on Bribery, *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Australia* (October 2012) [149]; OECD Working Group on Bribery, *Implementing the OECD Anti-Bribery Convention Phase 4 Report: Australia* (December 2017) [135].

62 *Corporations Act 2001* (Cth), s 180.

63 *Corporations Act 2001* (Cth), s 79, 1317E(4); Criminal Code, s 11.2.

64 *See e.g.*, *Corporations Act 2001* (Cth), s 188.

65 *See e.g.*, *Environment Protection and Biodiversity Conservation Act 1999* (Cth) ss 494–5.

66 The ASIC data indicated that, between 1 January 2015 and 20 March 2020, only seven ASIC cases involved allegations against directors in the largest corporations: ALRC Final Report, Table 9-2. Similarly, the ACCC data from the same period indicated that only five cases had been brought against directors of the largest corporations: ALRC Final Report, Table 9-3.

67 ALRC Final Report, [9.125]-[9.145].

68 ALRC Final Report, [9.153].

69 ALRC Final Report, [9.19].

70 [2020] HCA 4. *See* Jones Day, "Indemnity Arrangements for Directors and Officers: Implications of *ASIC v King*" (March 2020).

71 *Corporations Act 2001* (Cth), s 9(b)(ii).

72 *Australian Securities and Investments Commission v King* [2020] HCA 4 at [24]-[25] (Kiefel CJ, Gageler and Keane JJ), [87]-[88] (Nettle and Gordon JJ).

73 *Banking Act 1959* (Cth), Part IIAA. *See* Jones Day, "Australia's Banking Executive Accountability Regime: A Dangerous Bill" (October 2017).

74 *Banking Act 1959* (Cth), s 37BA.

75 *Banking Act 1959* (Cth), s 37BA(3).

76 *Banking Act 1959* (Cth), s 37CA.

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78 Australian Government, *Implementing Royal Commission Recommendations 3.9, 4.12, 6,6, 6.7 and 6.8 Financial Accountability Regime*: *Proposal Paper* (22 January 2020).

79 These entities are (aside from ADIs) general and life insurance licensees, private health insurance licensees, Registrable Superannuation Entity licensees and licensed non-operating holding companies: Australian Government, *Implementing Royal Commission Recommendations 3.9, 4.12, 6,6, 6.7 and 6.8 Financial Accountability Regime*: *Proposal Paper* (22 January 2020), 4.

80 Australian Government, *Implementing Royal Commission Recommendations 3.9, 4.12, 6,6, 6.7 and 6.8 Financial Accountability Regime*: *Proposal Paper* (22 January 2020), 10.

81 Australian Government, *Implementing Royal Commission Recommendations 3.9, 4.12, 6,6, 6.7 and 6.8 Financial Accountability Regime*: *Proposal Paper* (22 January 2020), 3.

82 *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019* (Cth).

83 The maximum penalty will be the greater of the following: (i) 5,000 penalty units; or (ii) if the court can determine—the benefit derived or detriment avoided because of the contravention, multiplied by three. Australian Government, *Implementing Royal Commission Recommendations 3.9, 4.12, 6,6, 6.7 and 6.8 Financial Accountability Regime*: *Proposal Paper* (22 January 2020), 9.

84 Australian Government, *Implementing Royal Commission Recommendations 3.9, 4.12, 6,6, 6.7 and 6.8 Financial Accountability Regime*: *Proposal Paper* (22 January 2020), 14.

85 The Honorable Josh Frydenberg MP, "Update on the implementation of the Banking, Superannuation and Financial Services Royal Commission" (Media Release, 8 May 2020).

86 Australian Law Reform Commission, Corporate Criminal Responsibility, (Discussion Paper 87, November 2019), Proposals 9 and 10.

87 ALRC Final Report, [9.168].

88 ALRC Final Report, [9.174]-[9.185].

89 ALRC Final Report, Recommendation 18.

90 *See* United Nations Office of the High Commissioner for Human Rights, *Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework* (2011).

91 A "reporting entity" is an Australian entity or an entity carrying on business in Australia which has consolidated revenue of at least $100 million for the reporting period. *Modern Slavery Act 2018* (Cth), s 5.

92 Criminal Code, ss 15.1-15.4.

93 Australian Law Reform Commission, *Corporate Criminal Responsibility*, (Discussion Paper 87, November 2019), [12.63].

94 Criminal Code, ss 134.1(1), 134.2(1), 135.4(3).

95 Criminal Code, Div 270.

96 Criminal Code, Div 271.

97 *Autonomous Sanctions Act 2011* (Cth) ss 16, 17; *Charter of the United Nations Act 1945* (Cth) ss 27, 28.

98 Criminal Code, Div 274.

99 Criminal Code, ss 268.8-268.23.

100 Criminal Code, ss 268.24-268.101.

101 Criminal Code, ss 268.3-268.7.

102 Criminal Code, ss 102.6-103.2.

103 ALRC Final Report, [10.9].

104 ALRC Final Report, [10.12].

105 ALRC Final Report, [10.13].

106 *Criminal Finances Act 2017* (UK), ss 45, 46.

107 UK Ministry of Justice, "Corporate liability for economic crime: call for evidence" (13 January 2017).

108 See UK Joint Select Committee on Human Rights, *Human Rights and Business 2017: Promoting responsibility and ensuring accountability* (5 April 2017), [191]-[193].

109 ALRC Final Report, [10.19].