Law Council
OF AUSTRALIA

Business Law Section

17 November 2017

ASIC Enforcement Review
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ASICenforcementreview@Treasury.gov.au

Dear Sir/Madam,

Law Council submission on *ASIC Enforcement Review Positions Paper 7 – Strengthening Penalties for Corporate and Financial Sector Misconduct*

1. The Corporations Committee of the Business Law Section of the Law Council (the **Committee**) welcomes the opportunity to provide this submission to the ASIC Enforcement Review in relation to 'Positions Paper 7 – Strengthening Penalties for Corporate and Financial Sector Misconduct' (***Positions Paper***).

2. Comments in this submission focus upon the proposals and questions put forward in the Positions Paper so far as they relate to the *Corporations* and the *Australian Securities and Investments Commission* Acts in particular, and do not respond to specific proposals or questions in relation to the *Credit Act*, *Credit Code* and other Acts, although most general comments are largely apposite across the board.

3. The Committee has the following specific comments on and responses to the Positions Paper. In the very limited time available to review and comment upon such a comprehensive paper, the Committee has been selective in its comments/responses in relation to the issues upon which the Taskforce seeks input, and to highlight proposals with which it disagrees and issues that it believes require further consideration.

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Response to Positions 1 and 2: maximum penalties for criminal offences in ASIC-administered Acts

Is it appropriate that maximum terms of imprisonment for offences in ASIC-administered Acts be increased as proposed?

4. The Committee understands, and in general supports, the proposed increases in the maximum term of imprisonment where the relevant offence clearly involves dishonesty, or the deliberate commission of the offence. This is the argument put in the Position Paper to justify the increases to maximum terms for the offences in Annexure B. However, there are a number of the offences which are listed in Annexure B which do not necessarily involve dishonesty. There is no proper justification given in the paper to increase the maximum term of imprisonment for those types of offences.

5. For example:

   - Annexure B proposes that the maximum term of imprisonment for a breach of section 952C(3) be increased from 2 years to 5 years. This section can be breached as a result of a failure to provide a financial services guide or statement of advice, even if there is no dishonest failure to do so;

   - Annexure B proposes that the maximum term of imprisonment for a breach of section 911A(1) be increased from 2 years to 5 years. This section requires a person who carries on a financial services business to hold an Australian financial services licence. The definition of financial services business in the Act is extremely broad, such that the section may be breached without any dishonesty or knowing contravention;

6. The Committee is opposed to the increases in imprisonment penalties in Annexure B unless there is a dishonesty element to the offence, or unless there is some deliberate commission of the offence. The Paper does not give any proper justification for increases to other offences.

Should maximum fine amounts be set by reference to a standard formula? If so, is the proposed formula appropriate?

7. The Committee does not have an issue with setting the maximum fine amounts by reference to a formula, or with the formula proposed, subject to the exception below.

8. The Committee strongly opposes the proposed change to the extent it would allow the courts to derive a maximum pecuniary penalty based on 10% of annual turnover, even where the Court can readily determine the value of the benefits obtained (or loss avoided).

9. On this point, the Committee notes that as recently as 2010, when Parliament increased penalties for insider trading and market manipulation offences, the 10% of annual turnover test was only to be used where the Court cannot determine the value of the benefits obtained (or loss avoided), not as a standalone test. The ability of the court to use 10% of annual turnover as a limit on the penalty, which may be a very large amount well in excess of the other limbs, and which may not correlate in any way to the seriousness of the offence or the actual benefit obtained, is inappropriate.

10. This issue also comes up in the discussion below on civil penalty provisions, and is dealt with in more detail there.

Response to Position 3: maximum penalty for a breach of section 184

Is it appropriate that the penalty for offences under section 184 of the Corporations Act be increased as proposed?

11. Subject to the comments above about having a separate limb of the maximum penalty calculated by reference to 10% of annual turnover, the Committee does not object to the increase in penalty for offences under section 184.

Response to Position 4: application of the Peters test to dishonesty offences

Is the Peters Test appropriate to apply to dishonesty offences across the Corporations Act?

12. The Committee supports the adoption of a consistent test for dishonesty offences across the Corporations Act (and other associated legislation) and supports adoption of the Peters test.

Response to Positions 5 to 8: strict and absolute liability offences and the introduction of ordinary offences

Should imprisonment be removed from all strict and absolute liability offences in the Corporations Act (such as sections 205G and 606)?

13. The Committee supports the proposal to remove imprisonment as an available penalty in relation to offences of strict or absolute liability where no criminal intent or fault is required to be shown, for the reasons advocated in the Positions Paper.

Should all pecuniary penalties for Corporations Act strict and absolute liability offences have a 30 penalty unit minimum for individuals and 300 penalty unit minimum for corporate bodies?

14. This question refers to 30 and 300 penalty units, whereas Position 7 and paragraph 16 of Section 3 propose a minimum of 20 penalty units for individuals and 200 penalty units for corporations. Despite the inclusion of 'maximum' in Position 7 and paragraph 16 of Section 3, we understand that the Taskforce is in fact suggesting 20 penalty units/200 penalty units as a minimum.

15. The Committee supports the proposal as it has interpreted it. The Committee also supports the change for penalties for non-strict liability offences to 30 and 300 as set out in paragraph 19 of the Positions Paper.

Is it appropriate to introduce the new 'ordinary' offences as outlined in Annexure C? Are there any other strict/absolute liability offences that should be complemented by an ordinary offence?

16. The Committee understands the rationale for the introduction of the new 'ordinary' offences listed in Annexure C, based on current corresponding strict and absolute liability offences. While the Committee does not object to those new 'ordinary' offences, it believes the creation of new 'ordinary' offences should be limited to those in Annexure C.

Should all Corporations Act strict and absolute liability offences be subject to the proposed penalty notice regime? Is the proposed penalty appropriate?

17. The Committee does not object to ASIC having power under section 1313 to issue penalty notices in relation to strict liability offences under the Corporations Act, but believes that the penalty notice should be set at one-fifth of the maximum pecuniary penalty in respect of the underlying offence, consistent with the AGD guide.

Response to Position 9: increase maximum civil penalty amounts in ASIC-administered legislation

Should maximum civil penalties be set in penalty units in the Corporations Act, ASIC Act and Credit Act?

18. As a general comment, the use of penalty units is prevalent across the legislative spectrum and the concept is well understood by those subject to the imposition of fines calculated in penalty units and their advisers. The extension of the concept into the civil penalty regime would seem to be an efficient method of determining the relevant maximum amount. Now that the indexation of the amount every three years is now mandated by recent legislative changes this also seems to have efficiency advantages in avoiding the need to make more frequent legislative changes to the quantum of the civil penalty amounts.

19. The Committee has no strong objection to adoption of penalty units as the calculation methodology for civil penalties but would be more concerned if the numbers of penalty units set for civil penalty matters were set at levels which implied equivalence with criminal conduct of the same type. Differentiation between the maximum criminal and civil penalties for similar type conduct should be maintained and reflected in the absolute maximum amounts.

a) Should the maximum civil penalty for contravention of the consumer protection provisions in the ASIC Act be aligned with proposed increases to the Australian Consumer Law, although set by reference to penalty units?

20. If the penalties for offences under the substantially similar provisions in the Australian Consumer Law are to be increased as proposed, then the Committee sees the benefit of having aligned penalties for those provisions in the ASIC Act.

b) Should the maximum civil penalty in the Corporations Act and Credit Act be increased as outlined in paragraph 29(c) of Section 4?

21. The Committee does not object to the increases in the maximum civil penalties under the Corporations Act, except as set out below.

22. As discussed above, the Position Paper proposes that the maximum civil penalty for a corporation could be 10% of annual turnover in the 12 months preceding the contravening conduct, even where the Court can readily determine the value of the benefits obtained (or loss avoided). The Committee does not support adoption of this stand-alone maximum penalty alternative. The civil penalty should only be based on a percentage of turnover in cases where the value of the benefits gained cannot be quantified.

23. The reason for this is that prior period turnover bears little or no relationship to the conduct, and will send a confused message to courts where the maximum penalty

based on turnover is out of all proportion to the other measures of the maximum penalty prescribed by legislators. The courts will not know in this situation which is the appropriate range of penalties to be applied in sentencing the spectrum of criminal conduct covered by the offence.

24. By fixing upon a maximum penalty amount the legislators provide courts with guidance as to the seriousness of the offence and the appropriateness of the 'price' of offending. While it is also reasonable to provide that if the criminal conduct produces corporate benefits (or avoids losses) greater than the fixed maximum penalty, then the perpetrator of the conduct should be exposed to a matching maximum penalty so as not to profit from its conduct (with, perhaps less reasonably, a proportion of turnover able to be taken as a proxy where the value of the advantages gained from the conduct cannot be determined), it seems wholly arbitrary and unreasonable to expand the potential penalty range for some corporate offenders in relation to the relevant offences by what may be, in some cases, many orders of magnitude by reference to a benchmark likely in most cases to be unrelated to the conduct in question.

25. In such cases, courts will be presented with at three potential penalty ranges of potentially vastly different width applying to exactly the same conduct where the available maximum penalty will vary according to the circumstances of the relevant offender, without reference to any connection between the conduct and the benchmark used to determine the penalty.

26. Take for example a standard retailing company with $2 billion of annual turnover and $100 million of annual net profit which contravenes a Corporations Act civil penalty provision where the benefit gained by it through the contravention is $5 million. Here, the appropriate maximum civil penalty is $15 million (3 times the value of benefits obtained), not $200 million. A $200 million maximum penalty in these circumstances bears no correlation at all to the seriousness of the offence or the benefits gained.

27. For these reasons, the Committee does not support this aspect of the proposed change in the formulation of maximum penalties.

c) Should the maximum penalty for an individual be greater than 2,500 penalty units? If so, would $1 million (or equivalent penalty units) be an appropriate penalty?

28. The Committee supports alignment of consumer protection provisions to avoid differentiation based upon whether financial services and products or others goods and services are the subject of the consumption. Accordingly the Committee sees little merit in adopting a misaligned regime.

Should the maximum penalty for an individual be the greater of a monetary amount or 3 times the benefits gained or losses avoided?

29. The Committee does not have an objection to this, but notes that there is a practical difficulty inherent in individuals and their circumstances which may militate against being able to readily ascertain benefits gained or losses avoided in the absence of the more familiar accounting which occurs in corporations. Further, if disgorgement remedies are available in civil penalty proceedings, these would substantially prevent individuals from retaining benefits in excess of the civil penalty.

Should any provisions of the Corporations Act or Credit Act be aligned with the proposed increases to the Australian Consumer Law? In particular, should civil penalty provisions in Part 7.7A of the Corporations Act be so aligned?

30. The Committee understands the argument, but believes that it would be preferable to have one consistent maximum for civil penalty provisions across the Corporations Act, being that set out in paragraph 29(c) (subject to 10% of annual revenue test only being available where the benefit gained cannot be determined).

Response to Position 10: availability of disgorgement remedies in civil penalty proceedings brought by ASIC under the Corporations, Credit and ASIC Acts

Should ASIC be able to seek disgorgement remedies in civil penalty proceedings under the Corporations Act, ASIC Act and/or Credit Act?

31. The Committee questions whether disgorgement remedies are necessary, and whether they would be used in practice given the availability of pecuniary penalties (where the penalty can be three times the benefit gained or loss avoided), and the availability of compensation orders. The Committee does not believe that the case for an additional set of remedies has been made out.

If so, should the making of the payment and where it is to be paid be left to the court's discretion?

32. If disgorgement remedies are to become available, the Committee supports leaving these matters to the courts discretion.

Response to Position 11: courts to give priority to compensation

Should the Corporations Act expressly require courts to give preference to making compensation orders where a defendant does not have sufficient financial resources to pay compensation and a civil pecuniary penalty?

33. The Committee supports this proposed requirement.

Response to Position 12: civil penalty consequences extended to a range of conduct

Should the provisions in Table 6 of the Positions Paper be civil penalty provisions?

34. The list of civil penalty provisions in section 1317E was determined by Parliament after proper consultation and detailed consideration as to whether the particular provisions should be civil penalty provisions. In the Committee's view, Parliament should be slow to add to this list (with the attendant consequences of making a provision a civil penalty provision) without clear evidence that it is necessary to meet the policy objectives of the relevant provision. General statements that it might be useful for ASIC to have an additional set of remedies for certain provisions are not evidence of the policy need for the change.

35. In Table 6, the Committee queries whether misstatements or omissions in takeover documents or disclosure documents should be civil penalty provisions. In the case of takeover documents, those documents are within the jurisdiction of the Takeovers Panel which can make a declaration of unacceptable circumstances and a range of

consequent remedial orders, including pecuniary orders. It is not clear why those provisions need to be civil penalty provisions as well.

Should there be an express provision stating that where the fault elements of a provision and/or the default fault elements in the Criminal Code can be established the relevant contravention is a criminal offence?

36. The Committee notes that parallel criminal proceedings can already be brought by the authorities in relation to much of the conduct and circumstances in question and suggests that if the regulators have elected to bring civil penalty proceedings then those proceedings should be conducted as civil proceedings under the current rules without becoming more quasi-criminal in nature. Much of the benefit of flexibility noted by the Law Reform Commission will be dissipated if participants perceive such proceedings as involving greater risks of criminality than already exist.

Should any of the provisions in Table 7 of the Positions Paper be civil penalty provisions?

37. Consistent with the comments above, the Committee does not support this material extension of the scope of civil penalty provisions. In particular, the Committee does not believe it is appropriate to make sections 205G, 606 and 671B civil penalty provisions. Section 205G and section 671B are strict liability offences, and s606 is an offence of absolute liability. The Committee does not see any benefit in adding civil penalty alternatives for those provisions.

Should any other provisions of ASIC-administered Acts be civil penalty provisions?

38. Again, consistent with the comments above, the Committee does not believe that the case has been made out for the types of provisions in paragraph 80 of Section 4 to become civil penalty provisions.

Should section 180 of the Corporations Act be a civil penalty provision?

39. So far as we are aware, s 180(1), (together with s 344(1) and s 601FD(1)(b), to which this question should also apply) are the only Commonwealth statutory provisions that apply a civil penalty regime to ordinary negligence. No-one else in the community is subject to civil penalties for ordinary negligence under Commonwealth laws.

40. The decision to apply the civil penalty regime to cases of ordinary negligence (that do not require proof of any conscious wrongdoing by or collateral advantage to the defendant) does not seem to have been considered, as a policy matter, in any explanatory memorandum or speech in the legislature: it seems to have happened (without real reflection or debate) when the former s 232 was decriminalized in 1992.[1]

[1] Civil penalties were first applied to directors' duties (then contained in s 232 of the Corporations Law) by the *Corporate Law Reform Act 1992* (Cth). The 1992 reforms gave effect to the recommendation by the Senate Standing Committee on Constitutional and Legal Affairs, made in its report entitled 'The Social and Fiduciary Duties of Company Directors' (November 1989), that criminal liability under the Corporations Law not apply in the absence of criminality, and that civil penalties be provided in the Corporations Law for breaches where no criminality is involved: see the Explanatory Memorandum to the Corporate Law Reform Bill 1992 at [61]. Each of the civil penalty provisions created by the 1992 Act, including s 232, was said to 'relate to an important aspect of the role of a company director in the management of the company': at [66].

41. There is a real policy question about whether any form of ordinary negligence on the part of anyone, including corporate officers, ought to form the basis for action by the state against them, particularly where that action has the potential to result in the imposition of pecuniary penalties payable to the state (on the application of civil rules of evidence and procedure), and to the person being disqualified from pursuing their livelihood.[2]

42. In our submission, it should not: s 180, together with s 344(1) and s 601FD(1)(b), should be removed from the list of civil penalty provisions in s 1317E.

43. The position in relation to s 180 has become a critical issue for directors and officers as a consequence of ASIC's use of the "stepping stone" approach in proceedings against directors, alleging that s 180 is breached by directors who fail to prevent a contravention of the law by their company. No proof of involvement in the contravention is required. This results in a three particularly anomalous outcomes for directors and officers:

    - Section 180 is being used by ASIC as an "end run" to avoid the need to prove the elements of accessorial liability, either under s 79 of the Corporations Act and the principles stated by the High Court in *Yorke v Lucas*[3], or under express provisions for liability of directors involved in a breach, such as s 674(2A) relating to continuous disclosure.

    - This technique also prevents directors from being able to utilise statutory defences in specific "involvement" provisions, such as the "reasonable steps" defence in s 674(2B).

    - Civil penalties are being imposed against directors and officers, and they are being disqualified, for failing to prevent contraventions of the Corporations Act by the company, where the contravention itself carries no penalty, or where the company has not been prosecuted for the contravention. In other words, the "accessory" is being penalised more harshly than the primary offender, under a provision that does not even require ASIC to prove involvement. The *James Hardie* litigation[4], in which the directors were penalised and disqualified over a contravention of s1041H that carries no penalty, is a good example. So is the *Citrofresh* case[5].

44. If s 180 ceased to be a civil penalty provision, it is likely that ASIC would stop taking "stepping stone" cases against directors: directors would still be liable to civil damages for a breach of s 180 under the now well-established stepping stone theory, but not to civil penalties and disqualification. Directors would, of course, remain liable as

[2] An essential starting point to thinking about when a civil penalty regime is appropriate is the discussion in Ch 25 of the Australian Law Reform Commission (ALRC) *Report 95: Principled Regulation – Federal Civil and Administrative Penalties in Australia* (December 2002). That discussion demonstrates the tension between the regulatory goal, which focuses on general and specific deterrence, and considerations of fairness and 'just deserts' in penalty setting. Because breach of a civil penalty provision can also be a basis for disqualification under s 206C of the Corporations Act, considerations related to 'hygiene' also arise (if disqualification serves to protect the community against the possibility of 'repeat offending' by negligent directors); but see in particular *Rich v Australian Securities and Investments Commission* (2004) 220 CLR 129; 50 ACSR 242; [2004] HCA 42 at [41] per McHugh J. This adds a further element to this complex debate.

[3] (1985) 158 CLR 661; 61 ALR 307; [1985] HCA 65.

[4] *Australian Securities and Investments Commission v Hellicar* (2012) 286 ALR 501; 88 ACSR 246; [2012] HCA 17; *Gillfillan v Australian Securities and Investments Commission* (2012) 92 ACSR 460; [2012] NSWCA 370 (penalties).

[5] (2010) 77 ACSR 69; [2010] FCA 27.

accessories if they have actually been involved in a contravention by the company, in the same way as every other member of the community.

45. There are other issues that are relevant to this question.

- Officers who are not directors are subject to duties under s 180, carrying civil penalties, but do not have the benefit of the "defences" in s 187 and s 189 (which are available only to directors).

- Further, following the decision of the High Court in *Shafron v Australian Securities and Investments Commission*[6] , there is uncertainty about which employees of a company are "officers". It is unsatisfactory that there is no clear demarcation between those employees who are subject to civil penalties and disqualification for ordinary negligence, and those who are not.

These issues would also be resolved if s 180 ceased to be a civil penalty provision.

Response to Position 13: obligations on licensees should be civil penalty provisions

Should the provisions that impose general obligations on licensees be civil penalty provisions? If so, should this only apply to some obligations?

46. The Committee agrees with the Taskforce that each obligation that is a civil penalty provision should be separately identified so that the appropriateness of attaching a civil penalty can be considered. Attaching a civil penalty to the general obligation to comply with all applicable financial services laws converts every obligation into a civil penalty provision without this consideration occurring, particularly where the penalty regimes are proposed to be altered significantly.

Response to Positions 15 and 16: infringement notices

Which current and new civil penalty provisions are suitable for infringement notices (see Annexure D)?

47. As noted by the Taskforce in paragraph 12 of Section 7, the Law Council has previously made clear its strong opposition to the use of infringement notices, and particularly to broadening the application of infringement notices in a Corporations Act context.

48. The Committee maintains its position and accordingly reiterates its opposition to the extension of the infringement notice regime to any additional civil penalty offences.

49. In particular, the Committee notes the comments in the paper that infringement notices are suitable for relatively minor offences of the strict or absolute liability type and where a high volume of contraventions may be expected and/or it is easy to assess guilt/innocence. Civil penalty provisions, by their very nature, are inherently not of this type and we do not support ASIC's view that the provisions listed in Annexure D are suitable for infringement notices.

50. It should also be noted that ASIC is proposing that the infringement notice regime be extended to all current civil penalty provisions, together with its proposed new civil penalty provisions. At the moment, use of infringement notices for alleged

[6] (2012) 286 ALR 612; 86 ALJR 584; 88 ACSR 126; [2012] HCA 18 (*Shafron*).

contraventions of the Corporations Act is relatively limited (e.g. in areas such as continuous disclosure). If all of the provisions in Annexure D can be enforced through infringement notices, this would have the result that the infringement notice regime could apply to a substantial part of the conduct regulated by the Act. This change would be very material, and should not be made without a complete assessment, with full public consultation, of the appropriateness or effectiveness of the current use of infringement notices.

Are the 12 penalty unit (individuals) and 60 penalty unit (corporations) default levels for infringement notices appropriate? Is the Credit Act model of a default proportion of the maximum penalty more appropriate for all ASIC-administered Acts?

51. As discussed above, the Committee does not favour expansion of the existing infringement notice regime. The Committee agrees with the Taskforce's preliminary position that infringement notice amounts should generally be set at the prescribed maximums in the AGD guide; 12 penalty units for individuals and 60 penalty units for corporations.

Responses to questions re peer disciplinary review panels

Would it be appropriate for ASIC to delegate to a peer review panel additional administrative functions in relation to financial services and credit sector (apart from banning individuals from these industries as currently proposed by ASIC)?

If so, should the Panel be able to exercise powers, such as the power to issue infringement notices and/or the power to accept enforceable undertakings?

Should the Panel be comprised of industry and non-industry participants (for example, lawyers, or academics) only or should members of ASIC be included?

Should the Panel be subject to minimum procedural standards? For example, should publication of panel decisions be automatically stayed if an appeal is lodged?

52. The Committee has reservations around ASIC delegating administrative functions to a peer review panel in relation to financial services, even if it is clear that the peer review panel has no power to ban individuals from these industries. The administrative functions to be delegated would need to be clearly defined to respond to this. ASIC's Consultation Paper 281 referred to matters such as issuing infringement notices; refusing an AFS licence or credit licence application; imposing conditions on an AFS licence or credit licence; and/or cancelling or suspending an AFS licence or credit licence. The Committee believes that these are matters more appropriately dealt with by ASIC, rather than being delegated to a peer review panel.

53. The Committee also notes the questions in the Paper around how to set appropriate procedural safeguards etc. These issues will be magnified if a broad range of administrative functions was to be delegated to this type of panel.

15. Additional Issue – false or misleading statements

54. The Committee has no objection per se to capturing additional types of representations in section 12DB of the ASIC Act, subject to proper consultation on what those additional representations will be.

Thank you for the opportunity to provide these observations.

Please contact Guy Alexander at guy.alexander@allens.com.au in the first instance should you require further information or clarification.

Yours sincerely

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