

Introduction

15.1 This report recommends that certain acts and omissions by the operators of collective investment schemes and, in some cases, by other persons, should constitute contraventions of the Corporations Law. This chapter deals with the consequences of such contraventions. It discusses which contraventions ought to be punishable as offences and whether the recently enacted civil penalty regime¹ ought to be applied to any of these contraventions. The chapter also covers issues related to the construction of those offences and a number of problems flowing from the fact that scheme operators will be companies.

Issues about criminal offences

Constructing offences

15.2 If contraventions of the Law are to be made criminal, careful consideration needs to be given to the construction of the relevant offences. In particular, the mental and 'fault' elements of the offence will have to be carefully considered.² The Review **recommends** that the fault element of each contravention should be expressly stated in the Corporations Law. The legislation in Volume 2, giving effect to the Review's recommendations, does this in one of two ways:

- for contraventions that should not require a fault element — by specifying in the provision defining the contravention that fault is not an element of the contravention
- in other cases — by stating precisely the fault element required.

Where a provision does not expressly address the fault element, the normal rule requiring *mens rea* will apply.

Fault element for particular contraventions

15.3 *Some contraventions have no fault element.* Determining what fault element is required for a particular statutory offence is often a difficult matter. These problems were identified in the ALRC's report *Customs and excise* (ALRC 60, 1992).³ The draft legislation in Volume 2 has been prepared on the basis that the general principle that, in the absence of an evident intention to the contrary, a

1. Corporations Law Pt 9.4B.

2. A fault element is present when the prosecution or applicant must prove that what the defendant did not accord with some standard, say a standard of reasonable care or recklessness. The mental element is present when it is necessary to prove that the defendant had a particular belief, suspicion or other state of mind in relation to the matter. For mental or fault elements for offences committed by companies, see para 15.17, which makes recommendations about the circumstances in which the acts and states of mind of a corporation's servants and agents can be attributed to the corporation.

3. ALRC 60 vol 2 para 9.3-9.5.

statute that creates an offence is to be read as requiring the offence to include a fault element will apply. However, the Review recommends that, for a number of these contraventions, there should be no fault element. These include, among others:

- failure to use the scheme's registration number
- acting as scheme operator without being licensed or without the scheme being registered
- failure to notify the ASC of licence contraventions
- failure to return a revoked licence
- failure to observe the buy back or redemption restrictions
- failure to observe the requirements about keeping registers
- failure to maintain the minimum net value prescribed
- failure to observe the prescribed borrowing limits.

In these cases, the draft legislation specifies that the defendant's state of mind, intentions and beliefs and the degree of care, if any, that the defendant exercised, do not need to be proved by the prosecution and cannot be relied on by way of defence. One consequence is that, for these contraventions, the rule that the defendant has a defence if it can show that it had a reasonable but mistaken belief that a state of affairs existed that, if true, would have meant that there was no contravention will not apply.⁴ These 'no fault clauses' should not necessarily exclude other defences, for example, the defence discussed below that the defendant was taking reasonable measures to prevent relevant contraventions.

15.4 *Justification for 'no fault' clauses.* These departures from the normal rule requiring fault are justified on several grounds.

- *Regulatory offences.* The offences or contraventions for which fault is excluded are in most cases largely regulatory and are not intended to involve any real criminality.
- *Professional corporate entities.* The defendants will in all instances be corporations who will be professional operators.
- *Link with compliance measures.* In almost all cases where fault is excluded, a defence is included that the defendant was taking all reasonable measures to prevent contraventions of the relevant kind.⁵ Exclusion of fault, together with such a defence, will encourage scheme operators to devote adequate resources to compliance.

Form of the compliance measures defence

15.5 The Review recommends that the defence just mentioned, that the defendant was taking all reasonable measures to prevent relevant contraventions, should apply in most instances. Two points need to be made.

4. See *Proudman v Dayman* (1941) 67 CLR 536.

5. See para 10.40.

- The defence is independent of the conditions of a licence to which the operator has agreed, specifying particular compliance measures. The fact that the licence has been issued should not be relevant to the question whether what the defendant was doing by way of compliance measures was reasonable for the purposes of this defence.⁶
- If compliance measures are working effectively, they will bring to attention likely contraventions. In the light of this, if the executive officers of the defendant company have reasonable grounds to suspect that a contravention would occur, the corporation should not be able to rely on the defence.

Penalties

15.6 *Penalty levels not recommended.* The Review has not suggested the appropriate level of penalty in respect of any of the offences recommended. This should be decided in the light of Commonwealth policy on fixing penalties generally and the levels of penalty prescribed for other contraventions of the Corporations Law.

15.7 *Administrative penalties.* The Corporations Law s 1313 provides for a penalty notice system under which the ASC can issue a penalty notice alleging a contravention and specifying a penalty fixed by the Corporations Law for that offence. If the penalty fixed in the notice is paid, the matter is regarded as closed and further proceedings cannot be taken in respect of the alleged contravention. The ALRC considered such schemes in two recent reports⁷ and recommended that they continue to be available in appropriate cases. The Review recommends that the penalty notice provision be available for appropriate offences recommended in this report.

Civil penalties for contraventions

Present law

15.8 Recent amendments to the Corporations Law have established a 'civil penalty' regime which applies to directors of companies.⁸ Under the regime, a director who

- breaches the statutory fiduciary duties imposed on directors by s 232(2), (4), (5), or (6)
- breaches the rules governing related party transactions (s 243ZE(2) or (3))
- fails to take reasonable steps to ensure that the company keeps the required accounting records and prepares appropriate financial statements (s 318(1))
- fails to prevent the company from engaging in insolvent trading (s 588C)

6. And other relevant defences within the Corporations Law, for example, s 1002H.

7. ALRC 57 para 9.12 - 9.16; ALRC 60, vol 1, proposed Pt 33.

8. See Corporations Law Pt 9.4B.

is liable to be penalised by the court.⁹ The kinds of penalties that can be imposed are any of the following:

- a declaration that a contravention has occurred
- an order imposing a pecuniary penalty of up to \$200 000 (but only if the contravention is a serious one)
- an order prohibiting the person from managing a corporation (civil penalty disqualification)
- an order for compensation to be paid to the affected company
- an order for punitive damages.

The proceedings in which any of these orders may be made are civil proceedings, not criminal proceedings. The contraventions involved are not offences unless the defendant, in contravening the relevant provision, acted knowingly, intentionally or recklessly or either dishonestly and intending to gain an advantage for himself or for some other person or with an intent to deceive or defraud. If the contravention is the subject of a criminal prosecution, rather than a civil penalty, and is proved to be an offence, the same maximum pecuniary penalty may be imposed (of up to \$200 000) and imprisonment of up to five years is also available. The Corporations Law provides that taking civil proceedings for any of the civil penalty orders will operate as a bar on later criminal proceedings but taking criminal proceedings will not necessarily operate as a bar on subsequent civil proceedings for recovery by the company.

Contraventions by officers

15.9 *Applying the civil penalty regime.* The Review has adopted the principle that, wherever possible, there should not be a divergence between the regulatory approach adopted in relation to companies and that adopted in relation to collective investment schemes. This applies in the context of enforcement. The Review therefore recommends that the civil penalty regime be applied to contraventions by the directors and other executive officers of a company that is the operator of a collective investment scheme of the duties that they owe to the investors that are analogous to the duties set out in the Corporations Law s 232.¹⁰ These are the duties

- to use the degree of diligence and care that a reasonable person in a like position would exercise in similar circumstances
- to act honestly in all matters concerning the scheme
- not to act in his or her own interest if that is not the same as the investors' interest
- not to make improper use of his or her position or of information acquired by virtue of his or her position.

15.10 *Dissent.* One member of the ALRC¹¹ disagrees with this recommendation so far as it contemplates that it should be possible to impose on an individual a pecuniary penalty otherwise than after conviction for an offence. In his view, such a

9. Corporations Law s 1317DA.

10. See para 10.18, 10.19, 10.20, 10.21.

11. Stephen Mason.

recommendation would be contrary to the requirement of the International Covenant on Civil and Political Rights (ICCPR) art 26 to accord equal protection of the law to all persons.¹² The imposition of a pecuniary penalty is in substance no different from the imposition of a fine. It is designed to punish those who contravene the law. The procedure for deciding whether there has been a contravention, and therefore whether punishment should be imposed, is, however, different from the procedure which must be followed before a court may find that a contravention of some other kind has occurred for which a similar punishment can be imposed. In the latter case, the court must be satisfied beyond reasonable doubt that the contravention has occurred. Under the Corporations Law Pt 9.4B Div 3 the court need only be satisfied on the balance of probabilities. It is true that, under the Corporations Law s 1317EA(5), the court may only impose a pecuniary penalty if satisfied that the offence is a 'serious' one. Under the *Briginshaw* test, the court will generally have regard to that fact in deciding whether it is so satisfied.¹³ This does not alter the fact that the standard to which it must be satisfied before imposing a punishment of a similar type and severity to punishments for offences, is the civil standard. This member considers that it is contrary to art 26 to provide for the imposition of punishments — particularly similar punishments — on different standards of proof. The anomaly is compounded by the recommendation that similar obligations to those imposed on officers, breach of which will render the officers liable to a penalty on the civil standard, are also recommended to be imposed on the corporation that is the operator of the scheme. The ICCPR does not extend to protect bodies corporate: they do not have human rights. But, while exactly the same level of penalty is available to be imposed on an operator for a contravention, the standard of proof for the corporate operator is to be beyond reasonable doubt. In this member's view, the standard of proof for directors and officers ought to be the same, and ought to be the criminal standard.

Contraventions by scheme operators

15.11 Civil penalties are available in the corporate sphere chiefly in relation to a breach of the duties that the officers of a company owe to the company itself. The Review has recommended that they also be available in relation to a breach by officers of the operator of a collective investment scheme of the duties that the Review has recommended the officers owe directly to the investors in the scheme. The question now arises whether the civil penalty regime should be applied to the operator itself (the company) in relation to a breach by it of its obligations to investors.¹⁴ The Review recommends that it not apply. The regime was designed in the context of breach by individuals of duties that they owe as individuals. It was not designed for breaches by bodies corporate. As the ALRC noted in its report *Sentencing* (ALRC 44, 1988), sanctions against corporations should be developed in the light of an overall policy about enforcement of regulatory laws and the

12. Under the *Law Reform Commission Act 1973* (Cth) s 7(b), the ALRC is bound to ensure that its recommendations in reports are consistent, so far as possible, with the articles of the International Covenant on Civil and Political Rights.

13. See *Briginshaw v Briginshaw* (1938) 60 CLR 336.

14. eg the obligation to act in the investors' interests, to treat investors equally and fairly: see para 10.8, 10.12.

traditional criminal law against corporations.¹⁵ The ALRC has been asked by the federal Attorney-General to report on the most appropriate way to enforce the provisions of the *Trade Practices Act 1974* (Cth). That review will address the question of the appropriateness of civil penalty regimes in the corporate context. Whether some form of civil penalty regime should apply to corporations for breach of the collective investment provisions of the Corporations Law should await the outcome of that review.

The general power to excuse contraventions

15.12 The Corporations Law s 1318 allows the court to excuse a breach of the law, or negligence, default or breach of trust by an officer of a corporation. The provision is only available in civil proceedings, and is not a defence to a criminal proceeding.¹⁶ The Federal Court or a Supreme Court may grant such relief prospectively. This provision will extend to officers of collective investment scheme operators in relation to the duties that the Review has recommended they should owe directly to investors.¹⁷ No legislation is needed to achieve this. The result of this will be that an operator (the company) and its officers will need to obtain an exemption from the ASC to protect itself and themselves against criminal proceedings for a contravention, but that officers may also protect themselves against civil liability for breach of their special obligations by approaching the court.

Problems posed by corporate form

Introduction

15.13 Scheme operators, some temporary scheme operators apart, must be companies.¹⁸ A number of problems arise in enforcing laws against bodies corporate simply because of their corporate form. These problems are most acute when the laws are criminal laws, but they are present also when the laws are civil laws, to be enforced through civil process. A body corporate is a legal fiction. It does not act itself but only through human agents. However, a corporation should not be liable for everything that its human agents do. That would be unjust to the shareholders of the corporation. Rules are needed to determine which acts of its agents will be attributed to the corporation. If an element of the offence or cause of action the subject of the proceeding is a 'fault' element or a 'mental element', rules will also be needed to determine whose fault or state of mind will be attributed to the corporation.

Attributing acts to the body corporate

15.14 *Present law.* The present law that determines when a body corporate will be criminally liable was summarised in ALRC 60 in the following way.

15. ALRC Report No 44 *Sentencing* AGPS Canberra 1988, para 198.

16. It is available in civil penalty proceedings under Corporations Law Pt 9.4B.

17. See para 10.18-10.22: these duties are analogous to the duties that the officers owe the company.

18. See para 10.2.

- Decisions of the company in general meeting, and decisions of the board of directors, are decisions of the company.
- Directors can only act collectively as a board; the function of the individual director is to participate in discussions of the board.
- No director acting on his or her own, other than one appointed as a governing managing director, has authority to bind the company.
- A director as such is not a servant of the company. The managing director is a servant of the company 'and so generally a managing director combines the position of a director and employee'.

Under the principles laid down by the House of Lords the fault element of an offence will only be attributed to the company if the relevant knowledge or lack of care was on the part of

the board of directors, the managing director and perhaps other superior officers of the company (who carry out the functions of management and speak and act as the company).¹⁹

This test is widely accepted as inadequate. The Commonwealth Review of Criminal Law commented:

Having regard to these considerations, the Review Committee has concluded that the common law, largely because of the emergence of large corporations in modern times, does not make appropriate provision for the criminal liability of corporations. Further, the change required in the law to accommodate this development is of such dimensions that legislative action, rather than reliance on the evolution of the common law, is required.²⁰

15.15 *Reform.* The Corporations Law s 762 provides for the attribution of acts and states of minds of officers to companies. It only has effect, however, in relation to Chapter 7 of the Corporations Law, not in relation to other provisions. It also attributes to the corporation acts done by persons at the direction of persons with relevant authority. It does not, however, prevent a 'defence' in circumstances where the body corporate was taking steps to prevent the acts being done. Subject to this comment, s 762 represents a significant improvement on the general law. There have been several recent reports which have considered the inadequacies of the present law. The Criminal Law Officers Committee (CLOC) of the Standing Committee of Attorneys-General reported in December 1992 on what general principles ought to apply uniformly in relation to criminal offences.²¹ The Officers' proposal attributes the physical element of an offence to a corporation if the relevant act was done by a servant, agent, employee or officer acting in the scope of his or her employment or authority. If intention or knowledge is an element of

19. *Tesco Supermarkets Ltd v Natrass* [1972] AC 153.

20. Review of Commonwealth Criminal Law, *Interim Report, Principles of Criminal Responsibility and Other Matters* AGPS Canberra 1990, para 26.7.

21. Criminal Law Officers Committee of the Standing Committee of Attorneys-General, *Final Report Model Criminal Code, Chapter 2, General Principles of Criminal Responsibility* AGPS Canberra 1992.

the offence, it is to be attributed to the body corporate if the body corporate expressly tacitly or impliedly authorised or permitted the commission of the offence. Several means of proving this are provided for, including

- that the board of directors or a high managerial agent of the body corporate did or authorised the act (but there is a due diligence defence)
- that a corporate culture existed within the body corporate that directed, encouraged, tolerated or led to the contravention
- that the body corporate failed to create and maintain a corporate culture that required compliance.

ALRC 60 suggested similar provisions to those in the CLOC draft. However, there are some differences.

- Directors, servants, agents etc of a body corporate who act within their actual or apparent authority from the body corporate will have their acts attributed to the body corporate unless acting only for their own benefit.
- Directors, servants and agents of a body corporate who do an act with a particular state of mind, intention or belief will have that state of mind, intention or belief attributed to the body corporate.
- Directors, servants and agents of a body corporate who
 - within their actual or apparent authority from the body corporate, authorise another director, servant or agent to do an act and
 - have a particular state of mind, intention or belief
 will have that state of mind, intention or belief attributed to the body corporate.

Again, the ALRC report would allow a 'due diligence' defence to the attribution of responsibility for the act to the body corporate:

... it is a defence if it is established that the body corporate had taken all reasonable precautions, and had exercised due diligence, to prevent its officers, including its directors and employees, and its agents from doing the act.

However, the ALRC report expressly negates this defence if the person who did the act believed on reasonable grounds that reporting the matter to the board of directors or in accordance with the body corporate's reporting system would not have led to the body corporate taking effective measures to prevent the offence or would have led to the person being prejudiced.

15.16 Recommendation. The Review accepts the underlying principle of the Corporations Law s 762 and the thrust of the reform proposals that have been made. The Review **recommends**, consistently with ALRC 60, that all the acts of a body corporate's officers and agents that are within their actual or apparent authority should be attributed to the body. The automatic attribution of an act of a body corporate's servant or agent to the body would, however, produce injustice in two cases.

- *Where the servant or agent acted only for his or her own benefit.* If the servant or agent acted only for his or her own benefit and the body corporate did not benefit, it would be unjust to attribute liability to the body corporate.
- *Where the body corporate took reasonable precautions.* If the body corporate has taken reasonable precautions to prevent its servants and agents doing the act, it is unfair and unrealistic to attribute the act to the body. It is, in a practical sense, impossible for a corporation to prevent its servants and agents acting illegally. All that can be expected is that the corporation takes reasonable precautions and uses due diligence to prevent it. ALRC 60 recommended that it should be a defence to a prosecution if it is established that the accused took reasonable precautions and exercised due diligence to prevent its officers and agents from acting in the relevant way. The corporation would have to establish a system and monitor its operation regularly.²² The Review agrees that an act done in defiance of the instructions of a body should not be attributed to the body if the body is making reasonable efforts to see that its instructions are adhered to.

The fact that the operator is licensed, and that some or all of the measures that it is taking have been imposed as conditions of the licence should not be taken into account in determining whether they were reasonable.

Attributing fault to the body corporate

15.17 Similar considerations apply to the attribution of the fault element of an act to the body corporate. The Review recommends that the state of mind of, or standard of care exercised by, the person who does an act that, under the previous recommendations, is attributed to the body corporate should also be attributed to the body. One further refinement is needed. Given the chain of command that usually exists in large corporations, the Review recommends that the state of mind of, or standard of care exercised by, the person who, within his or her actual or apparent authority, authorises or directs an act to be done should be attributed to the body as well.

Attributing knowledge to the body corporate

15.18 These recommendations apply in relation to criminal proceedings or civil penalty proceedings. There will however be the need from time to time to determine when a scheme operator has knowledge of a matter relevant to its obligations under the constitution or the Corporations Law in connection with civil proceedings, for example, civil actions for damages for breach of certain obligations, such as the obligation to act honestly, or certain actions based on constructive trusts, or where a person receives money knowing it to be paid in breach of trust.

22. ALRC 60 vol 2 para 9.25.

The Review recommends that attribution rules similar to those just recommended should apply in these cases. The knowledge possessed by, or the standard of care exercised by, a person who does an act with the authority of a scheme operator ought to be attributed to the scheme operator.