White-Collar Crime, Civil Penalties, Auditors, and Section 80 of the Constitution

The Honourable Justice Dean Mildren RFD

> *"Street crimes like drug use and assault have always been relatively easy to stigmatise, with the press and law enforcement agencies ready to demonise such conduct. Guilty pleas make such crime relatively easy for the justice system to deal with and, as a result, criminal courts largely exist merely to convict such persons. However, crime in the suites or corporate crime is much less often dealt with by the courts so that the handling of such cases has not become a routine part of the criminal justice system."*
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> Professor Roman Tomasic, *Corporate Collapse, Crime and Governance – Enron, Andersen and Beyond*, (2002) 14 Australian Journal of Corporate Law 183 at 189.

The term "white-collar crime" was first used by Edwin H. Sutherland in 1939, during his presidential address to the American Society of Sociologists in Philadelphia. Precisely what Sutherland meant by this term was not made clear then or in his subsequent writings. One commentator has observed that, "Sutherland was most concerned with the abuse of power by upper-echelon businessmen in the service of their corporations, and by professional persons against the government and against their clients and patients."[1] Subsequent academic debate has raged over the meaning of the term and whether, for instance, it should include all occupational criminal behaviour (whether committed by the bosses or the employees) and even whether it should include organised crime.[2]

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[1] Gilbert Geis, *White-Collar Crime What Is It?*, (1991) 3 *Current Issues in Criminal Justice* 9 at 13.
[2] *Geis*, supra, at 17-18; Prof Ken Polk, *White Collar Crime*, Legaldate, May 1999, Vol 11(2), p 5.

In Australia, some writers have used the term very narrowly. Stephen P. Devlin (1990) wrote:

> The definitions of white collar crime are as varied as the means used to institute the crimes. The term is synonymous with fraud or embezzlement and is linked to the characteristics of the offenders, namely older, educated persons of previous good character and above average wealth, whose crimes are non-violent and involve manipulations within the financial and corporate sectors.[3]

Moreover, as George Hampel QC (1977) pointed out, "Where white collar crime is concerned however, and particularly in its more complex forms, the question more often is not who committed the crime, but whether what has occurred is a crime."[4] Indeed, some writers argue that, at least in relation to some areas of corporate misconduct, the law has gone too far in the imposition of criminal sanctions with respect to conduct which is, arguably, not criminal at all. Professor Tomasic (1994) has argued:

> All law operates in a social context; indeed the character of that law is itself moulded by the context in which it exists and out of which it has emerged. This is nowhere more true than in regard to the development of our laws governing merchants and commerce. The emergence of the corporate form as a commonplace legal form of business organisation has also facilitated the creation of different expectations and patterns of legal conduct upon the part of the business community. This picture has been somewhat complicated by the somewhat overenthusiastic application of criminal penalties to corporate law statutes. However, the general irrelevance of these penalties illustrates the basic point which I wish to make here, namely, that corporate law operates in what might be described as a civil law culture. This culture pervades both the business community and its legal advisers. Its message is that the criminalisation of corporate misconduct is generally both inappropriate and irrelevant, except for the most blatant cases.[5]

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[3] Stephen P. Devlin, *White-Collar Crime*, (1990) 64 *Law Institute Journal* 859 at 859.
[4] G. Hampel QC, *White-Collar Crime*, (1977) 51 ALJ 629 at 629.
[5] R. Tomasic, *Corporate Crime in a Civil Law Culture*, (1994) 5 *Current Issues in Criminal Justice* 243 at 245.

The whole question of what is, or what is not, white-collar crime and what should, or what should not, amount to criminal conduct in this area has become quite complex. The approach in Australia has been to control anti-social behaviour in this area by a number of initiatives other than criminal sanctions, although criminal sanctions have not been abandoned. Central to these initiatives has been the establishment of well resourced regulators, such as the ACCC, who have been given wide powers of investigation. Sanctions have been broadened to include administrative sanctions and civil penalties, which include heavy fines imposed by civil courts, as well as orders preventing perpetrators, such as company directors, from carrying on business.

Moreover, there is a move towards employing strategies designed to make self-regulation attractive, not only by employing public interest groups or insurers to use their persuasive powers, but by the creation of codes of conduct, rules and guidelines, and standards of behaviour, which set the standards for good behaviour. As Haines (2000) observed, speaking of regulatory policy in Australia in the health and safety sphere:

> The move is away from prescription, exact specifications in legislation for what a company must do to ensure compliance with a preset safety regime, towards outcome-based legislation where companies design safety systems that either adhere to a certain process or ensure a certain outcome – in this example a safe workplace. This is seen as a simplification of the regulatory process. It is argued that the focus on outcome-based legislation reduces the need for multiple (and occasionally conflicting) requirements within regulations (Johnstone 1997). However, it also means *monitoring* regulatory compliance has become infinitely more complex. Regulators need greater skills, since they no longer have a rulebook, rather they require the knowledge and training to be able to ascertain when a company's system is, or is not, satisfactory. This is well illustrated by the "safety case" regimes now prevalent in many regulatory jurisdictions.[6]

[6] Fiona Haines, *Towards Understanding Globalisation and Control of Corporate Harm: a Preliminary Criminological Analysis*, (2000) 12 *Current Issues in Criminal Justice* 166 at 168.

This approach is consistent with that to be found in the Work Health Act (NT), for example. The regulatory authority, the Work Health Authority, has, in addition to the usual functions of enforcing standards required to be observed by the Act,[7] including prosecuting offenders for breaches of the Act[8] and of developing, publishing and recommending occupational health and safety standards,[9] the power to encourage employers and workers to consult with each other about safe work practices,[10] and to advise and assist employers and workers on occupational health and safety matters.[11] However, in many other cases where the legislature has prescribed penalties for offences against Acts designed to regulate business practices, there is no regulatory authority charged with the duty to supervise and prosecute offences. Worse still, the effects of "globalisation"; ie, the weakening of national sovereignty as a result of the growth of international and global institutions including multi-national corporations, the rapidity of economic change and the primacy given to free trade policies is likely to weaken further the capacity and motivation of states to regulate corporate harm.[12]

Some Australian regulators have had considerable success in bringing proceedings, both criminal and civil, against well-known and prominent Australian businessmen. In the last few months alone, Rene Rivkin has been convicted of insider trading and John Elliott was found to have contravened s 558G of the Corporations Law in relation to the insolvent trading of a company of which he was a director, and thereby to have

[7] Work Health Act s 10(c).
[8] Ibid s 10(y).
[9] Ibid s 10(b).
[10] Ibid s 10(d).

exposed himself to a civil penalty.[13] Crikey.com.au has published, as of 21 January 2003, a list of 213 people ASIC has gaoled since its inception in January 1991. It asks:

> Is ASIC an effective corporate cop? You be the judge as this is the list of 213 people sent to jail since ASIC was set up in January 1991. Crikey reckons there are not enough big fish but ASIC will hopefully improve its record as HIH charts its natural course.[14]

The recent collapses of Enron Corporation in the United States and of HIH in Australia have shifted the focus back towards taking a tougher approach. In just 15 years, Enron grew from nothing to become America's seventh largest company, employing 21,000 staff in more than 40 countries. But the company's success, or lack of it, was enshrouded with lies about its profits and concealment of its debts, forcing it into Chapter 11 bankruptcy in December 2001, to allow it to reorganise whilst protecting it from creditors. One of the consequences of Enron's collapse was the collapse of Arthur Andersen, Enron's auditors. This collapse was felt in Australia with the resultant disappearance of the Australian firm, including the legal firm of Andersen Legal. The parent firm, Arthur Andersen LLP, was indicted in the United States District Court, Southern District of Texas, with obstruction of justice[15] and on 15 June

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[11] Ibid s 10(g).
[12] See generally, *F Haines,* supra.
[13] *ASIC v Plymin, Elliott and Harrison* [2003] VSC 123 (5/5/03 – Mandie J)
[14] www.crikey.com.au/business/200.../20030121/asicjailed.htm.

[15] The charge in the indictment presented by the grand jury reads: "On or about and between October 10, 2001 and November 9, 2001, within the Southern District of Texas and elsewhere, including Chicago, Illinois, Portland, Oregon, and London, England, ANDERSEN, through its partners and others, did knowingly, intentionally and corruptly persuade and attempt to persuade other persons, to wit: ANDERSEN employees, with intent to cause and induce such persons to (a) withhold records, documents and other objects from official proceedings, namely: regulatory and criminal proceedings and investigations, and (b) alter, destroy, mutilate and conceal objects with intent to impair the objects' integrity and availability for use in such official proceedings. (Title 18, United States Code, sections 1512(b)(2) and 3551 *et seq.*)"

2002 found guilty.[16] The collapse of HIH in Australia was, for Australians, equally dramatic and I need not dwell on its consequences which have been felt by all of us. The resulting report of Justice Neville Owen has recommended that certain matters concerning some of the leading figures in HIH, including Raymond Williams, Rodney Adler and Terence Cassidy, among others, be referred to ASIC for consideration of whether civil penalty proceedings should be instituted.[17]

As to the role of HIH's auditors, which also happened to be Arthur Andersen, Owen J was critical of Andersen's 1999 and 2000 audits. His Honour said that, "Andersen's approach to the audit in 1999 and 2000 was insufficiently rigorous to engender confidence in users as to the reliability of HIH's financial statements."[18] Whilst there were, so His Honour found, circumstances which raised a perception of a lack of independence by the auditors of HIH,[19] which included the presence of three former Andersen partners on the HIH board, as well as pressure on Andersen partners to maximise fees from non-audit work to the potential professional detriment of their professional obligations, there was a finding that this perception did not translate into a reality which reflected a "susceptibility to undue influence or pressure".[20]

The fact is that the profession of auditors is poorly regulated whilst, unlike most other professions, accountants are not really regulated at all. In the Northern Territory, there is no legislation which governs who may or may not call themselves an accountant.

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[16] U.S. Securities and Exchange Commission Statement 18 June 2002. www.sec.gov.news.press/2002-89.htm.
[17] See the report of Justice Owen, *The Failure of HIH Insurance*, Vol 111, pp s 339-341.
[18] *The Failure of HIH Insurance*, Vol 111, p 169.
[19] *The Failure of HIH Insurance*, Vol 111, p 96.

To the extent that some controls exist, they depend upon provisions in the Corporations Act which deal with accounting standards.[21] Auditors are required to have some qualifications under the Act, but auditing standards do not have the force of legislative sanction, being basically left to internal manuals which are, in turn, supposedly based upon best practice. Guidance is provided by the Australian Society of Practising Accountants and the Institute of Chartered Accountants of Australia,[22] but there is nothing equivalent to the degree of control exercised over lawyers, doctors, dentists, or other professionals who can be prevented from practising if they engage in proven unprofessional conduct.

Moreover, short of breach of statutory duty, there is no obligation on the part of auditors to report fraud where the auditors believe that the financial statements give a "true and fair" view of the accounts of the company.[23] Auditors were seen as a bloodhound but not a watchdog, to adopt the description of Lopes L.J in *In re Kingston Cotton Mill Co. (No 2).*[24] Professor Tomasic has recently reported that there are signs of long overdue change.[25] He observes:[26]

> Recent corporate collapses both in Australia and the United States have led to calls to improve the security of investors and forced us to call into question, or at least to seriously rethink, proposed deregulatory strategies in regard to corporate practices. Such corporate collapse led the

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[20] *The Failure of HIH Insurance*, Vol 111, p 168.
[21] Justice Owen observed of these standards: "In my view, poorly-worded standards that are subject to wide or inconsistent interpretation are incompatible with a system that gives them the force of law as the present standards have under the Corporations Act": *The Failure of HIH Insurance*, Vol 1, p 136. The report contains a number of recommendations designed to improve accounting standards.
[22] *The Failure of HIH Insurance*, Vol 111, pp 68-70.
[23] R. Tomasic, *Auditors and the Reporting of Illegality and Financial Fraud*, (June 1992).
[24] [1896] 2 Ch 279 at 289, 290.
[25] R. Tomasic, *Corporate Collapse, Crime and Governance – Enron, Andersen and Beyond*, (2002) 14 *Australian Journal of Corporate Law* 183.
[26] Ibid at 184.

> Australian Treasurer to call for a major overhaul of the role of auditors in detecting fraud and corporate crime. This was long overdue due to the criticisms of creative accounting that have been made for some time.

Undoubtedly, there are some changes on the way. In September 2002, the Commonwealth Government published a series of reform proposals known as CLERP 9, with a view to achieving further improvement in audit regulation and corporate disclosure.[27] Fundamental to this is the need to ensure that the auditor is truly independent from the client.[28] There is a suggestion in CLERP 9 that the Corporations Act be amended to include a general statement of principle as to when an auditor is independent. However, there is no suggestion, to my knowledge, of prohibiting a firm of auditors from also acting as accountants to the firm. Such a safeguard is, in my view, elementary. CLERP 9 contains a weak version of this, in that it allows auditors to provide non-audit services where the threat is able to be reduced to "an acceptable level". Owen J recommended that the Act should be amended to require corporate boards to provide a statement in the annual report that identifies all non-audit services provided by the audit firm and the fees applicable to each item of work, and explains why those non-audit services do not compromise audit independence.[29] The arguments in favour of complete non-separation rest on alleged pragmatic advantages to the client if the auditors are able to do at least some non-audit work. In my view, nothing short of absolute separation of audit and non-audit functions is acceptable. Auditors must not only be independent, but be manifestly seen to be so. The

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[27] *The Failure of HIH Insurance*, Vol 1, p 162.

[28] See the testimony, *Concerning Legislative Solutions to Problems Raised by Events Relating to Enron Corporation*, given by Harvey L Pitt, Chairman of the US Securities and Exchange Commission, before a House of Representatives sub-committee, 4 February 2002, published on www.sec.gov/news/testimony/020402tshlp.htm.

[29] *The Failure of HIH Insurance*, Vol 1, p 175.

accountancy profession has already demonstrated its capacity for creativity, and Chinese walls are not an acceptable safeguard.

I submit that it is not difficult to imagine who would be drafting the statements proposed by Owen J, and leaving the issue to a wishy-washy standard, such as proposed in CLERP 9, is hardly likely to be effective. To some extent, it may be that economic forces will drive audit partners out of accountancy firms, even if the legislators do not do so. The premiums for professional indemnity insurance for non-audit services are only a fraction of those for auditors, and non-audit partners may find the difference compelling. The same problems arise with multidiscipline legal and accountancy practices, both in terms of appropriateness and economic soundness, but that problem falls outside the scope of this paper.

Moreover, I detect no change to the duty of auditors to report corporate fraud. Surely, it is time for this to be reviewed, having regard to the long history of splendid and memorable corporate failures of which this country has boasted since the 1980s. The collapses of Nugan Hand Bank, Trustees and Executors Agency group of companies, Rothwalls Limited, the Quintex group, Tricontinental, Pyramid Building Society, Estate Mortgage, State Bank of South Australia, and Bond Corporation, are all examples of cases where more vigorous auditing and accounting standards might well have reduced or avoided some of the enormous losses which followed. Australia's burgeoning superannuation fund industry is ripe for picking over by corporate crooks, particularly the smaller funds, and protection of this industry by competent auditors is

pivotal.[30] Let us hope that, this time, governments get serious, not only in doing something to protect the public from creative accounting and tricky accountants, but by taking a good look at what is and what is not criminal and by prosecuting those who break the law.

Part of the solution to the problem is to rid Australia's business culture of the notion that corporate wrong-doing is not really crime at all. There clearly are significant obstacles to properly addressing this problem. To the extent that breaches of the law occur punishable by the criminal law, there are often formidable hurdles to be overcome before a conviction is obtained. The defendants are often well backed (or well financed) and protected by an army of professional advisers and public relations consultants able to stall, divert, or at least blunt, the forces of criminal prosecution. Their crimes are not easy to detect and are often disguised as legitimate transactions. They are often complicated factually. Trials can be long, extremely costly affairs, with little or no guarantee of success even in straightforward cases. There are perceived difficulties with trial by jury in relation to such matters. Even if a conviction is obtained, the maximum penalties are nowhere near the level of penalties for more traditional crimes, such as robbery, burglary or serious drug offences, and the defendants are able to point to their good records and lack of prior convictions. For example, Alan Bond AO, the 1979 Australian of the Year, got an effective head sentence of 4 years' gaol for 2 counts of fraud, to which he pleaded guilty. Bond was charged that he, with intent to defraud, failed to act honestly as a director in respect of

[30] See Arie Freiberg, *Superannuation Crime*, Australian Institute of Criminology publication No 56, June 1996.

the transfer of $994M from Bell Resources. It was the largest fraud in Australian criminal history. The maximum sentence available on each count was only 5 years' gaol. An appeal to the Court of Criminal Appeal by the prosecution resulted in the effective head sentences being increased to 7 years.[31] The High Court allowed an appeal on constitutional grounds and restored the original sentences.[32] As one commentator observed, Bond served roughly one day in prison for every million dollars he defrauded investors.[33] Contrast this with a case from the Northern Territory during the days of mandatory minimum sentencing, when a young Aboriginal man received a sentence of a year's imprisonment for stealing $23 worth of cordial and biscuits.

Cases such as these raise serious questions of comparative justice. It might be said that we have a rigorous system of policing and prosecution of crimes when they are committed by the poor or the underprivileged, but serious antisocial activity committed by businessmen and professionals is often not treated as a crime at all, or, if it is, does not result in comparable punishment. There appears to be little momentum towards change. In the recently published review of the Trade Practices Act by the Trade Practices Review Committee, chaired by Sir Daryl Dawson, there is only one recommendation affecting the introduction of criminal sanctions in respect of breaches of the provisions of Part IV (which at the moment are not subject to criminal sanctions). The Committee recommended, with some reservations, the introduction of criminal sanctions for "serious, or hard core, cartel behaviour, with penalties to include

[31] *The Queen v Bond* (1997) 95 A Crim R 246.
[32] *Bond v the Queen* (2000) 74 ALJR 597; 111 A Crim R 50; 169 ALR 607.

fines against any convicted corporation and imprisonment and fines, as appropriate, for implicated individuals".[34] It also recommended that it should be an offence for corporations to indemnify individuals for pecuniary penalties they incur.[35] But otherwise the regime of enforcement by civil penalties remains untouched. The Federal Court of Australia, which has no criminal jurisdiction, is effectively exercising a criminal jurisdiction, euphemistically called a quasi-criminal jurisdiction, under the guise of a civil action for a penalty. Penalties are usually the result of agreements reached between the parties rather than a true sanction imposed by the courts.[36] Unlike the criminal law, the principles for determining the level of the penalty are still at a relatively primitive level, with differences of opinion even over such basic questions as to whether the purpose of punishment is to deter or whether it is to punish.[37] Moreover, as Professor Fels points out,[38] heavy pecuniary penalties on corporations have adverse consequences for innocent people, including the innocent shareholders whose money is lost, the staff who are retrenched and the consumers who are asked to pay a higher price for future services in order to recoup the losses. The people who should be penalised are those actually responsible, rather than the corporation itself. When the penalty is passed on, the deterrent effect is reduced, if not minimised. The threat of prison is a more effective sanction because, as Professor Fels observes, "there is no such thing as a substitute prisoner", and because justice demands

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[33] www.law.mq.edu.au/Units/law309/bond.htm.
[34] *Review of the Competition Provisions of the Trade Practices Act*, January 2003, p 164.
[35] Ibid.
[36] For a short history of penalty agreements and the justification for it, as well as a discussion of its drawbacks, see *Australian Competition and Consumer Commission v ABB Transmission and Distribution Ltd* [2001] FCA 383 at paras 4-5 per Finkelstein J.
[37] See the discussion in the *ABB Transmission* case, supra f.n. 36 at paras 7-10.
[38] Allan Fels, *Prison is the Best Deterrent*, 18-24 July 2002 Business Review Weekly, p 26.

that those responsible should be made to pay. I note, too, the Australian Securities & Investments Commission's policy is to prefer the laying of criminal charges instead of civil penalty proceedings if there are sufficiently strong prospects of obtaining a conviction.[39]

It is not difficult for politicians to publicly express their willingness to get tough on crime, except, so it seems, when the criminals are wearing suits. Part of the justification for this culture is the alleged comparative difficulty in obtaining a conviction. In the case of offences against Commonwealth legislation, one of the reasons for this lies in s 80 of the Constitution which, since the decision of the High Court in *Cheetle v The Queen*,[40] requires a jury verdict to be unanimous in Commonwealth cases. That decision was largely based on legal history, although the court also considered matters of principle and authority. Perhaps Sir Jo Bjelkie-Petersen might disagree, but looked at today, one cannot wonder at the Court's approach which no doubt was influenced by the nature of the arguments presented. The approach to the Constitution as a living, breathing document capable of adapting to new conditions not known at the time of Federation was totally ignored. The fact, for instance, that in 1900 there were no such things as courts of criminal appeal, there was no legal aid, prisoners had only just gained the right to give evidence in their defence and criminal trials were often brutish and short, and hence the reason why in 1900 unanimous verdicts were essential, and why in 1993 they are not, is not touched upon. The result is a constitutional fossil, changeable only by referendum, and a

[39] *Annual Report 2001-02*, Australian Securities & Investments Commission, Chairman's report, p 4.
[40] (1993) 177 CLR 541.

disincentive to change in this important field. Fortunately, s 80 has not otherwise affected other reforms to trial by jury. Verdicts of less than 12, reserve jurors, and preliminary determinations of law or issues going to the admissibility of evidence, for example, have all been constitutionally upheld.[41]

The powers of a trial judge to discipline prosecutors and defence counsel who engage in time-wasting tactics have now been made abundantly clear.[42] Case-flow management techniques have been introduced into criminal procedure and appear to have been effective, thus reducing to some extent the admittedly significant costs of proceeding via the criminal justice system. As to the cost and length of trials, the issues in drug trials and cases like *Higgins*[43] can also take a long time, can also involve difficult factual issues, and can also present difficulties in obtaining favourable jury verdicts, but no-one is suggesting that we should replace such trials with trials for civil penalties in a civil court. The 1992 conviction of Sir Andrew Grimwade, which took 440 sitting days, should be seen as a rare exception not illustrative of any general rule.

Effort in the past to trade principles for expediency have not been successful. The "administrative remedy" approach which has been widely used by regulators for breaches of State laws clearly have their shortcomings. Examples of this approach include closing down unsafe premises, disqualifying those who are deceptive and misleading from government contracts, licence revocation, administrative financial penalties (such as are negotiated with the Australian Taxation Office and the like).

[41] See *Ng v The Queen* (2003) 197 ALR 10.
[42] *Higgins* (1994) 71 A Crim R 429.

Whilst there is arguably some place for such remedies, care must be taken to ensure that they are kept in their proper place. As Sarre (1995) observes, the "manners gentle" approach is capricious, largely ineffective, lacks fairness and due process, is ripe with the potential for injustice, is kept hidden from the public eye and lacks deterrent effect.[44]

It is time to take a more principled approach to white-collar crime than has been evident so far. That is not to say that there is no place for other strategies, such as civil penalties or administrative remedies, but the balance towards traditional criminal sanctions must be restored.

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[43] See f.n. 39.

[44] Rick Sarre, *Keeping an Eye on Fraud: Proactive and Reactive Options for Statutory Watchdogs*, (1995) 17 Adel LR 283 at 289-296.