



White Paper

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Managing a Corporation

Abstract

Managing a corporation is not an easy task. It is made more difficult by the imposition of responsibilities under new and changing laws impacting on corporations and the manner in which the business operates. The roles of directors and other officers of a corporation are under close scrutiny by regulators, members and the public generally. They need to know the law and to ensure compliance in all their actions including in their dealings with corporate assets, securities and interests. Advisers need to ensure their corporate clients fully understand their duties and obligations in particular under the Corporations Act 2001.

The paper deals with trading of corporate securities by company officers and maintaining corporate control to promote the integrity of the corporation's management in a globalised trading world.

Managing a corporation in a globalised environment

Many Australian corporations are doing business overseas, operating from overseas premises, trading securities across national borders or dealing with overseas clients, customers and businesses. These activities make the task of managing a corporation more complex and managers need to know the risks of conducting business in a globalised context.

Particular risks for corporate managers involve the trading of the corporation's shares by company officers for profit at the detriment of the integrity of financial markets locally and overseas and the consequent damage to investor confidence in the corporation's shares. Also, dealings of the corporation's shares in foreign stock exchanges could be open to abuse in market manipulations or other improper activities leading to detrimental consequences for the price of the corporation's shares in those markets. These risks are in addition to the risks of trade in goods and services but they have potentially greater detriment for the corporation as their impact can be very quick and damaging. Knowledge is needed of overseas financial markets, their regulation and the facilities and mechanisms available to managers of Australian corporations to deal with improper conduct affecting shares.

What is globalisation?

Globalisation has been described as a "process of denationalization of clusters of political, economic and social activities"¹. It is clearly not a legal term and it can take on the characteristics of whatever is thought appropriate. In terms of trading in securities across national borders, globalisation has often been linked with internationalisation. Internationalisation is the cooperative activity between nations fostered by capital movement and cross-border financial arrangements and facilities to accompany trade in goods and services. Under internationalisation nation states have a measure of control and supervision whereas globalisation implies the free movement. Globalisation provides opportunities for corporations and individuals. They are able to market products and services in other countries and be paid in their home jurisdiction. A major feature of globalisation is the ease and speed of information flows and transfers anywhere. This is facilitated by communications and computing technologies that have merged to make information exchange easy and at very low costs compared with the situation not very long ago let alone say 10 years. In many instances a business in Australia can post a web site on the internet and attract business from any part of the world.

Persons are able to operate their businesses overseas and they can avoid compliance requirements in their home jurisdictions. They can use mechanisms and structures to affect their corporation's business and value in the local market and profit from it. A company officer could buy and sell the company's securities in an overseas financial market using an overseas vehicle based on insider information². This approach is possible thus avoiding the sanctions under the Corporations Act in relation to insider trading³.

¹ Delbruck J, "Globalization of Law, Politics, and Markets: Implications for Domestic Law: A European Perspective" (1993) 1(1) IJGLS 14.

² The usual approach taken for insider trading as identified in case law involves an anonymous vehicle is used to acquire shares or the shares are purchased by a third person (*Regina v I R Hall [No 2]* [2005] NSWSC 890 at para 91).

³ Corporations Act 2001, s 1042A.

Insider trading in a globalised world

Differences between the laws of countries regulating insider trading based on different theories and customs can play a significant role in assisting persons who seek to trade in their company's shares that would not be allowed in Australia. This situation is gradually changing as the impact of the work of the International Organization of Securities Commissions (IOSCO) has greater impact in regulating domestic financial markets⁴ together with other international bodies supervising capital and financial markets and disclosure of financial information⁵. Better international cooperation among national regulators and international bodies using the latest technology are making illegal and improper practices more difficult. However, the cleverness of persons to devise more complex and less transparent mechanisms will always be present causing problems for regulators and national governments⁶. The rush of corporate takeovers and mergers provides avenues for clever mechanisms to take advantage of values in shares and other securities in relation to cross-border activities⁷.

It is clear that international cooperation extends to market surveillance and prosecutions. This can be seen in the region of the European Community where the Market Abuse Directive⁸ requires the exchange of information between member states together with investigative cooperation of insider trading and the manipulation of markets. The purpose of actions like this by regulatory authorities in member countries is to maintain market integrity by providing "greater certainty on what constitutes insider information."

The Market Abuse Directive contains provisions for notifying persons who have access to insider information such as "issuers or persons acting on their behalf or for their account" performing managerial functions and "persons working for them under a contract of employment or otherwise having access to inside information relating, directly or indirectly, to the issuer". In addition, the notification of transactions by persons who are professionally arranging the transactions is also a part of the process under the Market Abuse Directive. These persons are investment firms or credit institutions. Similar requirements are contained in the Corporations Act for transactions involving confidential information about a corporation that is regulated under Part 7.10 Div 3.

Dealing with insider trading

The insider trading provision under section 1043A of the Corporations Act is supported by section 1311(1) to make a contravention a criminal offence and subject to criminal prosecution with a penalty, imprisonment or both. The main purpose for this provision has been stated as⁹:

⁴ Tunstall IC, *International Securities Regulation*, Lawbook Co 2005 at 2.193.

⁵ In addition to IOSCO other international bodies include the Financial Stability Forum (FSF), Basel Committee, International Bank for Reconstruction and Development (World Bank), Bank for International Settlements (BIS), International Association of Insurance Supervisors (IAIS), International Federation of Accountants (IFAC), International Accounting Standards Board (IASB), International Auditing and Assurance Standards Board (IAASB).

⁶ Tunstall IC, *International Securities Regulation*, Lawbook Co 2005 at 5.30, 6.100.

⁷ IOSCO Emerging Markets Committee, *Insider Trading: How Jurisdictions Regulate It* (May 2003).

⁸ Commission Directive 2004/72/EC of 29 April 2004.

⁹ *ASIC v Petsas* [2005] FCA 88 at para 11.

“to ensure that the securities market operates freely and fairly so that one party to a transaction does not, because of the possession of asymmetric information, have an advantage over the other party: Australian Financial System: *Final Report of the Committee of Inquiry*, Canberra, 1981 at 382; House of Representatives Standing Committee on Legal and Constitutional Affairs, *Fair Shares For All – Insider Trading in Australia*, 1989 at 16-17; *R v Firns* (2001) 51 NSWLR 548, 558.”

The court in *ASIC v Petsas* attempted to find guidance from cases involving “sentences imposed by criminal courts for breaches of the insider trading provisions”. The survey recognised that the insider trading provisions of the Corporations Act have changed over the survey period from 1992. The court made the following comments and applied it to the case¹⁰:

“This survey suggests that even a first time offender who pleads guilty is likely to suffer a term of imprisonment. Putting to one side the personal considerations relating to an offender that a sentencing judge must take into account, the sentence that could be imposed in this case if it had been heard in a criminal court would be a minimum of between three to six months imprisonment, together with an order for restitution.”

It is interesting to note the observations of Wood CJ in *R v Rivkin*¹¹:

“It is not, however, the case that much benefit is ever gained by an attempt to draw a comparison with other sentences, having regard to the differences in the objective and subjective circumstances involved, and to the need for any such exercise to assume that the other decisions were correct, or were such as to provide effective guidance for later cases: *R v Morgan* (1993) 70 A Crim R 368; *R v Salameh* (NSW CCA, 9 June 1994) and *R v Ellis* (1993) 68 A Crim R 449).”

The court in *ASIC v Petsas* then examined the value of a prison sentence in terms of a monetary fine in addition to the civil penalty for violating section 1043A. It is interesting to note the view expressed about academic economists at para 15. But the comments about the purpose of the civil penalty are interesting as it is imposed on business persons¹²:

“The purpose could be as simple as imposing a punishment (in the sense of exacting retribution) on the offender. But it is not as simple as that. I think it clear that parliament intended the penalty to act as a deterrent as well. There is a generally held view that society can discourage criminal behaviour by imposing penalties which will demonstrate that the price to be paid for an offence if the offender is caught is so great that it is not worth taking the risk of engaging in the proscribed conduct. It is difficult to know if this view is correct as I know of no empirical research to support it. I myself suspect that it may be possible to deter some crimes (especially so called ‘white collar’ crimes) by imposing heavy sentences as most businessmen do not want to end up in jail, but that is as far as it goes. Real deterrence is likely to come about only if there is a high degree of certainty of apprehension and conviction: *R v Dixon* (1975) 22 ACTR 13, 22.”

Also, it was suggested that an extremely high penalty may have a deterring effect in some instances where there is low risk of detection¹³. This comment recognises the nature of the

¹⁰ *ASIC v Petsas* [2005] FCA 88 at para 13.

¹¹ *R v Rivkin* [2003] NSWSC 447 at para 415.

¹² *ASIC v Petsas* [2005] FCA 88 at para 17.

¹³ *ASIC v Petsas* [2005] FCA 88 at para 17.

insider trading provisions and the risk of being caught. This is supported by the number of cases in the courts involving insider trading contraventions. They tend to make the media headlines when they do come before the courts.

The amount of the penalties applying to the defendants in *ASIC v Petsas* took into account the personal circumstances of each defendant. The key issues considered were¹⁴:

- seriousness of the offence
- imparting of confidential information in breach of trust or the recipient of the information
- size of the profit made
- committing of offence with sole object of making a profit
- prison sentence if tried in a criminal court
- need to make it clear to others that this kind of crime will not be allowed to pay
- employment prospects following the case
- feeling of remorse
- unlikely to offend again.

In addition a case involving a guilty plea would be considered a mitigating factor as it would save the state the cost of a trial.

The case, *Regina v I R Hall [No 2]*, identified the factors to determine whether or not a person knew that they had confidential information that was not generally available to the public and hence price sensitive information. The factors were¹⁵:

- maturity and intelligence of the person
- experience in trading shares on the stock exchange
- role of the person in the corporation whose shares are traded
- events showing the importance of the information to the market
- board's appreciation (or knowledge) to present positive information about the corporation to the market
- knowledge of proposed dividend announcement
- influence of the person in delaying an announcement of a dividend payment

¹⁴ *ASIC v Petsas* [2005] FCA 88 at paras 18-19.

¹⁵ *Regina v I R Hall [No 2]* [2005] 890 at para 88.

- influence of the person to control the timing to announce information that would affect the share price
- sensitivity of the price information to the market.

The sensitivity of the price information in *Regina v I R Hall [No 2]* was identified by the Crown in correspondence of the corporation's auditors who expressed an opinion about a potential overstatement of profits of \$15 million and that the company was trading while insolvent.

The nature of the arrangement in this case was described by the court:

“Here...the shares were being sold. They were held by [other related corporations]. It was necessary that someone with authority give the brokers instructions. It would not have been obvious to the brokers that an offence was being committed. When the instructions were given, they did not know the information which had been disclosed to Mr Hall, since it was not generally available. There was no reason for covert action. Had the company somehow survived, the share dealing by Mr Hall may never have become known. The dealings became known because of the collapse.”

The observation by the court that the insider trading activity may never have been identified because of the arrangement is pertinent to insider trading. There is no comprehension of the extent to which insider trading occurs unless, of course, it is brought to light by some other activities or by observant persons.

The courts will take a “stern approach” to offences of insider trading¹⁶. The reasons for this approach are:

- element of general deterrence is important in white collar crimes
- difficulty in detecting white collar crime (and insider trading is particularly hard to detect)
- sentencing process to provide a firm disincentive to the carrying out of illegal activities especially by those engaged in the securities industry.

In relation to the disincentive the court in *R v Rivkin* (supported by *Regina v I R Hall[No 2]*) stated¹⁷:

“There is a need to sound, in effect, a clarion call to discourage illegal and unethical behaviour among company directors, company officers, brokers, traders, advisors and those who have a close connection through, for example, merchant banking, to the stock market.”

A person contravening the insider trading provisions of the Corporations Act “seeks to profit from information that comes into his possession. Ordinarily, in such cases, the profit is confiscated once the crime has been detected. Such cases involve no monetary loss to an

¹⁶ *R v Doff* [2005] NSWCCA 119 para 56; *Regina v I R Hall [No 2]* [2005] 890 at para 122.

¹⁷ *R v Rivkin* [2003] NSWSC 447 at para 44; *Regina v I R Hall [No 2]* [2005] 890 at para 121; *Regina v Pantano* (1990) A Crim R 328 at 380.

individual. There is, nonetheless, damage to the investing public's confidence in the integrity of the market. Such damage is serious enough."¹⁸

In the case of *Regina v I R Hall [No 2]* the damage to the confidence of investors was worse as the court observed that many investors who bought shares in good faith in the relevant corporations had lost their money.

Ease of trading

The use of more sophisticated computing and communications technology and accompanying software is making the trading in shares and other equities easier. Persons trading in shares through the Internet are able to buy, sell, use options and other vehicles in local and overseas stock markets. Persons working for corporations, banks and other financial institutions, and financial service providers are exposed to confidential information on their computer screens and they have access to databases of confidential and other information. Depending on security mechanisms and the ability of the person to understand the technology, this information can be used in a concealed manner by routing it to other destinations around the world or through other organisations and corporations. At any point, a person can access confidential information and be tempted to use it for personal profit. A person hacking this information from within an organisation holding the information would be subject to the sanctions under the Corporations Act for contravening the insider trading provisions. However, it is likely that a person who hacks this information from outside the organisation would not be considered to be an insider trader¹⁹.

Access to facilities such as on-line transactions and trading accounts through banks and other institutions²⁰ aids the process of trading in shares. This can be used by persons undertaking insider trading to conceal profits made from transactions using confidential information. Elements of a transaction can be implemented in many different jurisdictions where different privacy, banking and securities transactions laws apply²¹. These jurisdictions can be local or overseas making the task of surveillance more difficult and costly.

Technology is used by stock exchanges and regulatory authorities to track trading and identify improper activities on the exchange. This surveillance may uncover insider trading when matched with other data in relation to a corporation's shares. The major problem in the use of computing technology and communications in surveillance activities is the risk that multiple authorities could delay the process through differences in interpretation or rush to lay charges without verifying the data with other information. The first part of the problem could allow a person time to cover tracks and leave the jurisdiction and the latter part is the failure of a successful prosecution due to lack of evidence or misunderstanding of the transaction.

International surveillance

The task of the regulator is to cooperate with overseas counterparts to undertake surveillance activities, exchange information and to pursue prosecution and civil actions and impose penalties. The Australian Securities and Investments Commission (ASIC) can use its powers under the *Mutual Assistance in Business Regulation Act 1992* to provide assistance to and

¹⁸ *Regina v I R Hall [No 2]* [2005] 890 at para 124.

¹⁹ Dugan B & Dugan B, "The Internet and the Law", [2002] VUWLRev 37.

²⁰ Dugan B & Dugan B, "The Internet and the Law", [2002] VUWLRev 37.

²¹ Dugan B & Dugan B, "The Internet and the Law", [2002] VUWLRev 37.

receive assistance from foreign regulatory authorities. However, this action by ASIC relies on the extraterritorial application of the Mutual Assistance in Business Regulation Act and this could present problems as the actions go beyond Australia's border and where there are international law implications

The International organization of Securities Commissions (IOSCO) has gone part of the way to facilitate cooperation among national regulators of securities and financial markets. IOSCO's Multilateral Memorandum of Understanding Concerning Consultation and the Exchange of Information (MMOU) contain articles for²²:

- general principles for mutual assistance and the exchange of information
- scope of assistance for the "fullest assistance permissible to secure compliance with the respective Laws and Regulations" of the parties
- requests for assistance made in writing except for urgent requests
- execution of requests for assistance
- permissible uses of information
- confidentiality of requests and their contents and the non-disclosure of non-public information
- unsolicited assistance
- final provisions dealing with the addition of parties, effective date, termination of party participation.

Despite its multilateral approach the MMOU is limited in its ability to provide for a legal basis for national regulatory authorities to effectively supervise activities in financial markets. Information that can be exchanged can be used for surveillance, enforcement activities, conducting investigations, civil and criminal prosecutions²³. However, the collection, exchange and use of information under the MMOU would be subject to international law and in particular the International Covenant on Civil and Political Rights, Universal Declaration of Human Rights, International Covenant on Economic, Social and Cultural Rights in addition to customary law and the domestic laws of countries implementing these international covenants. One such domestic law is privacy law concerning the collection, storage and use of personal information.

The implications of these international law issues can be seen in the operation of the Mutual Assistance in Business Regulation Act. Section 14 a person has a person has no reasonable excuse to "refuse or fail to give information or evidence, or to produce documents, in accordance with a requirement under section 10, that the information, evidence or production of the documents might tend to incriminate the person or make the person liable to a penalty." This is tempered by section 14(2) where the person "claims that the information or evidence might tend to incriminate the person or make the person liable to a penalty" or might in fact do so. However, the person must make this claim before giving the information or evidence. The

²² Tunstall IC, *International Securities Regulation*, Lawbook Co 2005 at 5.140.

²³ Multilateral Memorandum of Understanding Concerning Consultation and the Exchange of Information, art 10(a)(ii).

question that must be considered is the implication for a person where a foreign regulatory authority is seeking the information or evidence that may only be used in an investigation and no further action is taken by the foreign authority. However, the person may be put at risk in Australia.

It is clear that a more fuller multilateral agreement is needed as a framework to expand the level of cooperation²⁴ and to protect individuals not only under Australian law but also international law.

Improper use of information to gain an advantage

Information gained by directors and other company officers can be used for purposes to gain a personal advantage without necessarily for use in insider trading. However, distinguishing between insider trading use of confidential information and its use for other improper purposes can be difficult in some cases. This can be seen in the case of *ASIC v Vizard*²⁵. Vizard was a non-executive director of Telstra Corporation Limited that is 50.1% owned by the Commonwealth government with the balance of the shares listed on the Australian Stock Exchange. The corporation invests in companies listed on the Australian Stock Exchange and large sums of money are involved in these transactions. Highly confidential information explaining the nature of proposed transactions and analyses of a transaction's strengths and weaknesses are given to the board of directors that decides whether an investment should be bought or sold²⁶.

The fiduciary duties of the corporation's directors are to keep the confidential information secret and to not make any use of the information for their own purposes. These duties have been codified requiring directors to "act honestly and not make use of any information acquired in that office to gain an improper advantage for himself or to cause detriment to the company."²⁷ According to the court in *ASIC v Vizard*, the provision of deterrents: *Angas Law Services Pty Ltd (in liq) v Carabelas* (2005) 53 ACSR 208, 225. The deterrents were the imposition of criminal and civil liability for a contravention."

It was also noted that the deterrents was not effective in the case of Mr Vizard as shown by the facts show and conceded by Mr Vizard. He contravened section 232(5) on one occasion and section 183(1) on two occasions during 2000.

ASIC v Vizard reveals that Mr Vizard wanted to avoid publicity in his acquisition of shares. The court expressed the situation as follows:

"Share trading is a very public activity. Every listed company must maintain a share register and the register is available for public inspection. The defendant wanted to avoid publicity surrounding his trading activities. That was not too difficult to achieve. Many methods are available, and most are perfectly legitimate."

The elements of contraventions by Mr Vizard were²⁸:

²⁴ Tunstall IC, *International Securities Regulation*, Lawbook Co 2005 at Ch 11.

²⁵ *ASIC v Vizard* [2005] FCA 1037.

²⁶ This summary is drawn from *ASIC v Vizard* [2005] FCA 1037.

²⁷ *ASIC v Vizard* [2005] FCA 1037 at para 2.

²⁸ *ASIC v Vizard* [2005] FCA 1037 at para 24.

- he was a director of Telstra
- he obtained confidential information by virtue of his position as a director
- he made improper use of that information by basing his decision to purchase or sell shares on that information
- improper use was made to obtain an advantage for a personal investment vehicle and through it for a trustee company and Mr Vizard and his family.

The court observed the following about Mr Vizard's actions:

"His breach of trust was carefully concealed and was only discovered by chance. Everything was done for personal gain. There was no element of need on the defendant's part. By all accounts the defendant is a very wealthy man. Perhaps from his perspective the amounts the defendant stood to gain were not enormous, but most members of the community will think otherwise. It was only because of the vagaries of the marketplace that the defendant did not realise his gain."

The seriousness of white collar crime was discussed in *ASIC v Vizard*. The court said after examining a case differentiating the penalties applying to white collar crime and other crimes²⁹:

"The reason some people believe that white collar crimes are not serious is not only because of the absence of violence but, I suspect, because of the invisibility of the losses caused, which are usually spread among consumers and shareholders rather than concentrated on a few victims. The reality is, however, that the cost of white collar crime is often extremely high, causing many people to suffer greatly. Just ask the creditors and shareholders of the Pyramid Group and Estate Mortgage in Victoria, of the Bond and Connell Groups in Western Australia, of the State Bank of South Australia in South Australia, of Quintex in Queensland, and of HIH and One.Tel in New South Wales. The list is not exhaustive."³⁰

²⁹ *ASIC v Vizard* [2005] FCA 1037 at para 25: "In 1995, Gleeson CJ, then Chief Justice of New South Wales, drew attention to comments often made about the apparent leniency shown to "white collar" offenders (he did not use that description) in contrast with sentences imposed in respect of violent crime: *R v Hassen Mohammed El-Rashid* (unreported, Supreme Court of New South Wales Court of Criminal Appeal, Gleeson CJ, Mahoney and Sperling JJ, 7 April 1995). Gleeson CJ did not deny that there was differential treatment. He explained that the difference was the result of two factors, first, that Parliament has provided lower penalties for "white collar" offences and, second, that violent crimes, such as armed robbery for example, are usually far more serious."

³⁰ It is interesting to note Finkelstein J's views about white collar crime. It is interesting because of its revelation of the nature of the crime and the activities that it constitutes and the possibility that future cases will be influenced by this view. Finkelstein J said:

"I have also referred to the widely held view that "white collar" offenders are treated lightly. The reason seems to be this. Traditional sentencing holds that factors such as an unblemished past life, a reputation for honesty, an involvement in and a contribution towards community affairs, and so on (generally referred to by the umbrella expression "good character") are important factors in mitigation of sentence. I do not wish to deny the relevance of those factors, but in some cases they may result in the imposition of a very lenient sentence. At any rate there must be a limit to how far good character can be taken into account when dealing with a "white collar" offender, especially where the contravention concerns dishonesty or the abuse of a position of trust. Those convicted of such offences rarely have a criminal record. It is their good character that has enabled them to occupy the position of trust which

A further comment was given in relation to “offences ‘which ... are not criminal in any real sense, but are acts which in the public interest are prohibited under a penalty’: *Sherras v De Rutzen* [1895] 1 QB 918, 922. These latter offences are commonly referred to as regulatory offences.”³¹ Regulatory offences concern results rather than values:

“Their object is to induce compliance with rules that benefit society as a whole. It is commonly said that a conviction for a regulatory offence, much like a conviction for a white collar crime, carries with it less culpability than a conviction for a ‘true crime’. See the discussion in *R v Wholesale Travel Group Inc* [1991] 3 SCR 154, 219.”

On one level the court considered that sections 283 and 183 can “be regarded as prohibiting conduct which is not regarded as serious” as the maximum penalty that could be imposed in a civil proceeding was \$200,000. This was “despite the fact that a contravention holds great potential for profit and may cause much harm.” This compares with a criminal prosecution where the maximum penalty is more severe (imprisonment for a period not exceeding five years plus a fine not exceeding \$200,000). Section 1317P of the Corporations Act provides for criminal proceedings following civil proceedings for “for conduct that is substantially the same as conduct constituting a contravention of a civil penalty provision”.

As regulatory offences section 283 and 183 bear the authority given as described by the court³²:

“On a daily basis, a director of a large public company will come across information that is not available to the public or even to the company’s shareholders. According to the common law a director is denied the ability to use such information for his or her own purposes. It does not matter that the director’s action causes no harm to the company or does not rob it of an opportunity which it might have exercised for its own advantage: *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134. This rule admits of few exceptions. Parliament realised that the common law was too often ignored. The temptation to make an improper profit was too great. So Parliament decided to act. The Companies Acts were amended to create an offence if a director misused information obtained by reason of his fiduciary position. It is in this sense that the sections are regulatory in character, directed to avoiding the potential harmful consequences of a particular type of conduct.”

In addition sections 232 and 183 have an equally important purpose of establishing “a norm of behaviour that is necessary for the proper conduct of commercial life and so that people will

they have ultimately breached. Indeed, it is their good character that is often used to facilitate the offence.

So while good character cannot be ignored it should only play a minor role in sentencing for most white collar corporate crime. At a general level, corporate crimes committed by prominent business people have a tendency to erode the moral base of the law and provide an opportunity for other offenders to justify their misconduct. At a more immediate level corporate crime is diffuse in its impact, is easily concealed with seemingly legitimate business transactions and is difficult to detect, control and punish. Corporate crimes are usually committed to accumulate wealth and power and are almost always the result of deliberate and calculated conduct. I have said in another context that, for this kind of offence, it is the nature of the offence rather than the character of the offender that should be the principal consideration for the punishment to be imposed: *Australian Competition and Consumer Commission v ABB Transmission and Distribution Ltd (No 2 – Distribution Transformers)* (2002) ATPR ¶41-872. I continue to hold that view.”

³¹ *ASIC v Vizard* [2005] FCA 1037 at para 26.

³² *ASIC v Vizard* [2005] FCA 1037 at para 28.

have confidence that the running of the marketplace is in safe hands.” Consequently, a contravention these provisions “carries with it a significant degree of moral blameworthiness. There is moral blameworthiness because a contravention involves a serious breach of trust.”³³

It is pertinent to note the consideration of the courts when applying penalties in relation to contravention of these and other provisions under the Corporations Act. The court in *ASIC v Vizard* referred to them as “principles that underlie sentencing, being principles that also guide the determination of civil penalties.”³⁴ The court said:

“For most offences (and contraventions of s 232(5) and s 183(1) are no exception) the punishment imposed by the court is the means by which society expresses its moral condemnation of the offender. It also affirms that the particular law is worthy of obedience. If the punishment is unduly lenient there is the risk that the court will be perceived as endorsing the offender’s conduct.”

In Mr Vizard’s case, the court made the following comments:

“In the present case, punishment need not take into account personal deterrence or rehabilitation. The defendant admitted his wrongdoing prior to the institution of this proceeding and, through his counsel, has made a statement in open court expressing his unreserved contrition for his wrongdoing. He apologised to his family, his colleagues, his friends and the community as a whole. His brother, himself a man of high repute, has said that the defendant is deeply remorseful for his wrongdoing, has faced up to the fact that what he did was utterly wrong and intends to make it up to the community he has so badly let down. Professor Vizard said that in his opinion the defendant will not make the same mistake again. ASIC accepts this to be a correct assessment of the situation and so do I.”

The reference to Professor Vizard’s opinion is interesting as it carries more than one meaning. If Mr Vizard undertakes share transactions using confidential information in the future his experience would cause him to structure the arrangement to avoid detection as seems to be the situation with insider trading.

The sentence in *ASIC v Vizard* was based on punishment for Mr Vizard’s “moral culpability” as the contraventions involved a breach of trust. Consequently, the court considered that the sentence “must be exemplary and sufficient so that members of the business community are put on notice that if they break the trust which has been reposed in them they will receive a proper punishment. It is vital not only in the interests of the business community but in the interests of society that leaders of that community will act honestly in all their dealings. Any slip from the high standards demanded of directors can put at risk the fortunes of their company and also the fortunes (large or small) of those who invest in them. In extreme cases the misconduct can affect the economy as a whole.”

The court also recognised that those directors and other company officers of publicly listed corporations who contravene these provisions are few in relative terms and that they are sensitive to risk:

³³ *ASIC v Vizard* [2005] FCA 1037 at para 29.

³⁴ *ASIC v Vizard* [2005] FCA 1037 at para 30.

“It could hardly be denied that, as a rule, directors of publicly listed companies are sensitive to risk. The few that may be tempted to gain prestige, wealth and security by illegal means can be dissuaded from that course if the risk of detection and serious punishment is too great. Although the civil penalties are not substantial when compared with the possible gains from corporate crime, other penalties may act as a better deterrent.

This is where the possibility of disqualification from office can play an important function.”

Disqualification from office is a significant measure for deterrence. *Rich v Australian Securities and Investments Commission*³⁵ made it clear that “a disqualification order can be imposed not only to protect the company’s shareholders against further abuse, but also by way of punishment and, importantly, for general deterrence.”³⁶ Its deterrence effect was significant for the court in *ASIC v Vizard* as it provided confidence in the court that such action would not be contemplated by the person for a long time as the “risk of a long period of disqualification, for example so long that it will keep the director forever out of public corporate life, may well tip the scales.” Also, as a deterrence “the fear of losing both their position from business life, as well as their good reputation, will be an effective deterrent in the case of many a director who is contemplating a dishonest course for gain.”

The court also noted: “Few corporate crimes are spontaneous. There is always time to consider the consequences.” This is a proposition that needs testing.

Mitigating the penalty by pleading guilty

ASIC v Vizard provides hope for a company officer who breaches their duties under the Corporations Act to act honestly and to not misuse the position for personal gain by pleading guilty to the contraventions of the Corporations Act provisions and assisting the prosecuting agency. This is important for advising corporate clients where a breach of duty has been detected.

In *R v Howard*³⁷ the court said about guilty pleas:

“The law takes a pragmatic approach to pleas of guilty. They save the court time. They also save the expense of a trial. The offender is entitled to a discount for the utilitarian value of that plea. He thereby assists the administration of justice. The discount for pleading guilty does not take account of the strength of the Crown case. The earlier the plea, the greater the saving to the court system. The longer and more complex the likely trial, the greater the utilitarian value.”

The court in *ASIC v Vizard* said: “Similar considerations demand a separate ‘discount’ when the offender has cooperated with the enforcing agency’s investigations. The agency’s time is saved, its costs are kept down and its funds can usefully be employed elsewhere.”³⁸

³⁵ *Rich v Australian Securities and Investments Commission* (2004) 50 ACSR 242.

³⁶ *ASIC v Vizard* [2005] FCA 1037 at para 35.

³⁷ *R v Howard* (2003) 48 ACSR 438 at 446-447.

³⁸ *ASIC v Vizard* [2005] FCA 1037 at para 41.

The court will start at the maximum penalty and then “discount” for mitigating circumstances that are drawn from *ASIC v Vizard*³⁹:

- public disgrace which has been suffered by the defendant and his family
- genuine and unreserved contrition expressed by the defendant and the admissions made by him
- saving time and expense of what might otherwise have been a rather lengthy trial
- submissions by ASIC, supported as it is by the defendant, that the appropriate penalty for each contravention is \$130,000
- cases, including decisions of the Federal Court in *NW Frozen Foods Pty Ltd v Australian Competition and Consumer Commission* (1996) 71 FCR 285 and *Australian Competition and Consumer Commission v Colgate-Palmolive Pty Ltd* (2002) ATPR ¶41-880, hold that the court should not depart from the penalty recommended by the parties unless it is clearly out of bounds.

It was observed also that Telstra did not suffer loss as a consequence of my Vizard’s actions.

The court noted that the 13 year old penalty regime may be in need of review by the Parliament and that it alone should exercise the power to review the penalty if the public considers that the penalty is insufficient⁴⁰.

Assessing disqualification period

In *ASIC v Vizard*, ASIC suggested a disqualification period of five years for Mr Vizard while its counsel suggested a qualification period of 10 years but subject to discounts. The court chose a ten year ban based on the deterrence:

“Indeed general deterrence is of primary importance in cases of this kind. A message must be sent to the business community that for white collar crime “the game is not worth the candle”, to use the language of a Canadian judge, McDermid JA, in *R v Jaasma* (1976) 1 AR 553, 555. It is permissible to impose punishment with a general deterrent content even if the case does not call for specific deterrence. In *R v Thompson* (1975) 11 SASR 217, 222 Bray CJ said, in a somewhat different context:

‘I realise to the full that the appellant is a man of good character and worthy of respect, that he is not, in the ordinary sense of the word, a criminal, that he had no intention of harming anyone, and that imprisonment will be to him a great hardship and a great indignity. He does not stand in need of reformation or rehabilitation. But ... there are offences where the deterrent principle must take priority and where sentences of imprisonment may properly be imposed, even on first offenders of good character, to mark the disapproval by the law of the conduct in question and in the hope that other people will be deterred from like behaviour.’”

³⁹ *ASIC v Vizard* [2005] FCA 1037 at paras 44-45.

⁴⁰ *ASIC v Vizard* [2005] FCA 1037 at para 45.

The court also said:

“If the imposition of a ten year ban causes some hardship an order may be made giving the defendant leave to be involved in the management of a particular corporation (for example, a private family trustee or the Vizard Foundation) or a particular class of corporations. The power to make orders of this kind is now located in s 206G of the Corporations Act.”⁴¹

The disqualification period would have been longer but for the factors attributing discounts from the longer period, arriving at ten years⁴².

Unacceptable circumstances and insider trading

Issues involving insider trading (or other improper use of information) have been raised in takeover matters for a declaration under section 657A of the Corporations Act.

The Takeovers Panel considered arguments relating to alleged breaches of provisions of the Corporations Act outside of the takeover chapters namely, Chapters 6, 6A, 6B or 6C⁴³. The Takeovers Panel considered the arguments in light of its jurisdiction saying:

“The Panel’s jurisdiction to make a declaration of unacceptable circumstances is not restricted where breaches of provisions outside the Takeovers Chapters ... have occurred and where those breaches are part of circumstances which meet the tests set out in subsection 657A(2). However, the Panel will not normally have regard to such breaches in determining whether unacceptable circumstances exist. This is in contrast to the Takeovers Chapters where the existence of breaches of the Takeovers Chapters is expressly relevant to a Panel’s decision as to whether or not unacceptable circumstances exist. This is because under paragraph 657A(2)(b), the Panel is able to declare circumstances unacceptable because they constitute, or give rise to, a contravention of a provision of the Takeovers Chapters.”

Despite this consideration the Takeovers Panel said that the proper forum for such action where a breach of a provision of the Act has occurred is the court:

“Indeed, the Courts are often the appropriate jurisdiction for matters arising from a breach of provisions other than those in the Takeover Chapters.”

*In the matter of Coopers Brewery Limited 01*⁴⁴ the Takeovers Panel affirmed that a matter alleging contravention of the insider trading provisions could be considered. The jurisdictional basis for this is the “legislation governing the Panel’s proceedings”. The legislation allows the Panel to determine:

- what is the appropriate form for an application⁴⁵

⁴¹ *ASIC v Vizard* [2005] FCA 1037 at para 50.

⁴² *ASIC v Vizard* [2005] FCA 1037 at para 49.

⁴³ *In the matter of Crescent Gold Limited* [2004] APT 28 at para 12.

⁴⁴ *In the matter of Coopers Brewery Limited 01* [2005] ATP 18 at para 25.

⁴⁵ ASIC reg 19.

- once such an application is received the Panel has the responsibility for defining the scope of the inquiry through the process of deciding whether it wishes to conduct proceedings⁴⁶
- setting the terms of the investigation to be conducted in those proceedings through the preparation of a brief⁴⁷
- distribution of the brief to the parties.⁴⁸

Encouraging good corporate governance

The court in *ASIC v Vizard* said that the purpose of fiduciary duties was to encourage good corporate governance. This proposition was drawn from the High Court case, *Angas Law Services Pty Ltd (in liq) v Carabelas*⁴⁹. That case considered the meaning of the provision in section 229 of the *Companies (South Australia) Code*. The relevant provisions are:

Section 229(3)

An officer or employee of a corporation, or a former officer or employee of a corporation, shall not make improper use of information acquired by virtue of his position as such an officer or employee to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the corporation.

Section 229(4)

An officer or employee of a corporation shall not make improper use of his position as such an officer or employee, to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the corporation.

Both provisions carried a penalty of \$20,000 or imprisonment for 5 years, or both.

The provisions are sections 182-184 of the Corporations Act:

- section 182 use of position – civil obligations
- section 183 use of information – civil obligations
- section 184(2) use of position – criminal offence
- section 184(3) use of information – criminal offence.

The criminal offence provisions in force now require dishonesty rather than impropriety as for the civil obligation provisions.

Gummow and Hayne JJ examined the legislative history of the provisions saying:

⁴⁶ ASIC reg 20(a).

⁴⁷ ASIC reg 20(b).

⁴⁸ ASIC reg 22 .

⁴⁹ *Angas Law Services Pty Ltd (in liq) v Carabelas* (2005) 53 ACSR 208 at 225 per Gummow and Hayne JJ.

“The progenitor of s 229(3) and (4) is s 107(2) of the *Companies Act* 1958 (Vic) (‘the 1958 Act’). This dealt only with the use of information by an officer of a company. Section 107 provided:

(1) A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office.

(2) Any officer of a company shall not make use of any information acquired by virtue of his position as an officer to gain an improper advantage for himself or to cause detriment to the company.

(3) Any officer who commits a breach of the foregoing provisions of this section shall be guilty of an offence against this Act and shall be liable to a penalty of not more than Five hundred pounds and shall in addition be liable to the company for any profit made by him or for any damage suffered by the company as a result of the breach of any of such provisions.

(4) Nothing in this section shall prejudice the operation of any other enactment or rule of law relating to the duty or liability of directors or officers of a company.”

Their Honours noted that the introduction of the provision in the Victorian Act was the first of its kind to standards for the behaviour and actions of company officers⁵⁰:

“The second reading speech introducing the Bill that became the 1958 Act noted that s 107 was the first statutory provision of its kind in either Australia or the United Kingdom⁵¹. It attempted to set standards of honesty (sub-s (1)) and propriety (sub-s (2)), and give remedies (sub-s (3)) for any breach of those standards.”

The second reading speech referred to by their Honours said about the provisions:

⁵⁰ *Angas Law Services Pty Ltd (in liq) v Carabelas* (2005) 53 ACSR 208 at 225 per Gummow and Hayne JJ. Their Honours gave this legislative history:

“The provision was introduced as a result of the report of the Statute Law Revision Committee of Victoria, which examined the provisions of the *Companies Act* 1938 (Vic) with respect to certain actions taken by the directors of Freighters Limited. The impugned actions arose from Freighters’ acquisition of Australian Machinery Co and the directors’ formation of companies that would re-sell products produced by Freighters. First, in order to raise the necessary monies to fund the acquisition of Australian Machinery, Freighters issued shares. However, rather than offering the shares pro rata to existing shareholders for the market price of 50s, the directors of Freighters, without informing the shareholders, themselves took up the necessary shares at a reduced price of 40s. Secondly, the board of directors took over personal responsibility for distributing some of the products of Freighters by forming separate companies for this purpose. This action was taken also without informing the shareholders. The net result was that the directors fixed the prices at which Freighters’ products were to be sold to the newly formed companies for resale by them. Thus the directors dealt with Freighters through the cloak of those companies.

It also later transpired that the inspector appointed by the Attorney-General of Victoria to investigate these activities faced difficulties ascertaining the full facts because of his limited powers. Thus, the Statute Law Revision Committee’s primary focus was on recommending provisions regarding disclosure of interests and provisions regarding powers of investigation with respect to preventing what is now called ‘insider trading’.”

⁵¹ Victoria, Legislative Assembly, *Parliamentary Debates* (Hansard), 9 September 1958 at 324.

“To a large extent the clause is declaratory of the existing law, but it is believed that a restatement of the principles of honesty and good faith that should govern directors’ conduct, clearly set out in the Act, will be an effective deterrent to misconduct and will free the courts from the technicalities of the existing law in dealing with all forms of dishonesty and impropriety by directors.”

Examination of these developments in company law in Victoria led their Honours to this summary:

“These materials, together with s 107(4) which preserved ‘the operation of any other enactment or rule of law relating to the duty or liability’ of directors and company officers, suggest that s 107 was designed to encourage good corporate governance by provision of deterrents. It did so by imposing criminal and civil liability with respect to actions that would be considered dishonest or improper. The standards of dishonesty and impropriety were to be determined by reference to the existing law. By ‘existing law’ was meant the civil law; the joinder of civil and criminal remedies meant that the section could not be described simply as declaratory of the law as a whole.”

The evolution of section 107 is given in their Honours’ judgment showing that the provision became section 124 under the Uniform Companies Act (of 1961). Section 124(2) was later amended in 1971 to become:

“An officer of a corporation shall not make improper use of information acquired by virtue of his position as such an officer to gain directly or indirectly an advantage for himself or for any other person or to cause detriment to the corporation.”

Impropriety was the issue in the use of a position or information by a company officer that concerned their Honours. They looked at the High Court case, *R v Byrnes*⁵², to illustrate the issue. They noted the findings of the South Australian Court of Criminal Appeal that section 229(4) required an element of criminal intent:

“In that case, the trial judge had found that there was no such intent. Rather the defendants mistakenly believed that their actions would be of benefit to the company.”

The High Court in *R v Byrnes* said that “holding that intention or purpose is only a necessary element of the second limb of s 229(4), namely, that the officer acted in order to gain an advantage for himself or another person, or cause a detriment to the company⁵³.” Consequently, the court turned to impropriety issue saying that “intention or purpose does not form part of the requirement of improper use of position, yet it may be relevant in assessing impropriety⁵⁴.” A company officer honestly believing that their actions did not involve the improper use of office or information could be found to have improperly used the position. The test for determining impropriety was given in *R v Byrnes* as:

“Impropriety does not depend on an alleged offender’s consciousness of impropriety. *Impropriety consists in a breach of the standards of conduct that would be expected of a person in the position of the alleged offender by reasonable persons with knowledge of the duties, powers and authority of the position and the circumstances of the case.*

⁵² (1995) 183 CLR 501. See Austin, Ford and Ramsay, *Company Directors: Principles of Law and Corporate Governance*, (2005) at §9.14-§9.18.

⁵³ See *Chew v The Queen* (1992) 173 CLR 626 at 633.

⁵⁴ (1995) 183 CLR 501 at 512, 513-515.

When impropriety is said to consist in an abuse of power, the state of mind of the alleged offender is important: the alleged offender's knowledge or means of knowledge of the circumstances in which the power is exercised and his purpose or intention in exercising the power are important factors in determining the question whether the power has been abused. But impropriety is not restricted to abuse of power. It may consist in the doing of an act which a director or officer knows or ought to know that he has no authority to do. (emphasis added)"

The significance of the emphasis of the second sentence was particularly important in *Angas Law Services Pty Ltd (in liq) v Carabelas*. Gummow and Hayne JJ said:

"The question in each case is what content is to be given to the standards of conduct that would be expected of the officer, having regard to the position occupied by the officer in the company and the circumstances surrounding the impugned conduct (ie, the commercial context⁵⁵)."

The starting point for Gummow and Hayne JJ was "the general duty of a director to act in the best interests of the company⁵⁶." This is a corporate governance requirement.

Kirby J in *Angas Law Services Pty Ltd (in liq) v Carabelas* added this pertinent observation about the word, impropriety:

"That is a word, like 'dishonesty', which always involves a practical judgment based on all the facts and circumstances of the case. Amongst them, the acquisition by an officer of a corporation of a personal advantage, secured at the cost of the corporation, would often be powerful evidence of wrongdoing, especially if full disclosure and formal consent were not duly observed when that was the prudent and proper course."

The prudent and proper course of action is the role of good corporate governance. It is part of the role of corporate governance which is "the responsible management and control of a company."⁵⁷

Good corporate governance

The Report of the Committee on The Financial Aspects of Corporate Governance⁵⁸ described corporate governance as "the system by which companies are directed and controlled."

The Australian Stock Exchange Limited Corporate Governance Council issued *Principles of Good Corporate Governance and Best Practice Recommendations* in March 2003. It describes corporate governance in these terms:

⁵⁵ This term was used in *Grove v Flavel* (1986) 43 SASR 410 at 420 and applied in *R v Byrnes* (1995) 183 CLR 501 at 514.

⁵⁶ *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 at 289, 300-301.

⁵⁷ Tunstall IC, *International Securities Regulation*, Lawbook Co 2005 at 5.10.

⁵⁸ Committee on the Financial Aspects of Corporate Governance (Cadbury Committee), *The Financial Aspects of Corporate Governance* (The Committee on the Financial Aspects of Corporate Governance and Gee and Co Ltd, London, 1992).

“Corporate governance is the system by which companies are directed and managed. It influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimised.

Good corporate governance structures encourage companies to create value (through entrepreneurship, innovation, development and exploration) and provide accountability and control systems commensurate with the risks involved.”

It is stressed that there “is no single model of good corporate governance.” Core principles for good corporate governance are presented so that they can be implemented by managers of a corporation. A significant role for the corporation’s board of directors is stated to be overseeing the company which includes “its control and accountability systems”⁵⁹.

Principles of Good Corporate Governance and Best Practice Recommendations states the ultimate requirement of leadership for managing the corporation under good corporate governance:

“Good corporate governance ultimately requires people of integrity. Personal integrity cannot be regulated. However, investor confidence can be enhanced if the company clearly articulates the practices by which it intends directors and key executives to abide.”

A recommendation is for a corporation to introduce a code of conduct “to guide the behaviour of directors and key executives and demonstrate the commitment of the company to ethical practices.” A check box is given to guide the preparation of a code of conduct:

Box 3.1: Suggestions for the content of a code of conduct

1. Conflicts of interest – managing situations where the interest of a private individual interferes or appears to interfere with the interests of the company as a whole.
2. Corporate opportunities – preventing directors and key executives from taking advantage of property, information or position, or opportunities arising from these, for personal gain or to compete with the company.
3. Confidentiality – restricting the use of non-public information except where disclosure is authorised or legally mandated.
4. Fair dealing – by all employees with the company’s customers, suppliers, competitors and employees.
5. Protection of and proper use of the company’s assets – protecting and ensuring efficient use of assets for legitimate business purposes.
6. Compliance with laws and regulations – active promotion of compliance.
7. Encouraging the reporting of unlawful/unethical behaviour – active promotion of ethical behaviour and protection for those who report violations in good faith.

⁵⁹ ASX Corporate Governance Council issued *Principles of Good Corporate Governance and Best Practice Recommendations* in March 2003 at 16.

It must be remembered that corporate governance “is not a legal concept but it incorporates legal structures, processes and mechanisms.”⁶⁰ However, despite its non- legal nature, the corporate governance of a corporation “needs to be seen as the proper(that is, legal) governance of an entity for the benefit of owners, employees, directors, and others with whom the company interacts. This means that a company needs to have processes in place to ensure that it performs well for the benefit of shareholders.”⁶¹ The confidence that good corporate governance engenders will ultimately benefit the corporation⁶²:

“Potential investors will direct their investments into, and creditors will lend money to, companies that are well managed and have a clear plan of action for the operations of the corporation.”

Good corporate governance is prudent and proper management of a corporation where there are clear responsibilities to maintain the integrity of its managers and the board of directors. The measure of trust invested in each director and other key company officers is understood and upheld.

⁶⁰ Tunstall IC, *International Securities Regulation*, Lawbook Co 2005 at 5.10.

⁶¹ Tunstall IC, *International Securities Regulation*, Lawbook Co 2005 at 5.20.

⁶² Tunstall IC, *International Securities Regulation*, Lawbook Co 2005 at 5.20.



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