

JAMES HARDIE AND THE PROBLEMS OF THE AUSTRALIAN CIVIL PENALTIES REGIME

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I INTRODUCTION

In May 2012, the civil penalty proceedings that Australia's 'company law watchdog' – the Australian Securities and Investments Commission ('ASIC')¹ – had brought in the James Hardie saga² culminated in the decision of the High Court of Australia in *ASIC v Hellicar*,³ which reinstated the Supreme Court finding that the directors were liable for misleading the market and breaching their duties.⁴ However, just when it seemed that the door had successfully closed on a dark chapter in James Hardie's history, the New South Wales Court of Appeal in *Gillfillan v ASIC*,⁵ in determining the remaining issues in the appeal that the High Court had remitted to it,⁶ reduced

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1 This article focuses on ASIC's original and primary role as corporate regulator: see *Australian Securities and Investments Act 2001* (Cth) s 1(2) ('ASIC Act'), although today as Australia's corporate, markets, financial services and consumer credit regulator, ASIC has many other functions. See ASIC's website for a description of its responsibilities in these different roles: ASIC, *About ASIC: Our Role* (1 November 2011) <<http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Our%20role>>.

2 On 14 February 2007, ASIC filed civil penalty proceedings in the Supreme Court of New South Wales relating to disclosure by James Hardie Industries Ltd ('JHIL'), the former Australian listed entity, in respect of the adequacy of the funding of the Medical Research and Compensation Foundation ('MRCF') for asbestos victims. The action, also, sought declarations that JHIL and James Hardie Industries NV ('JHINV'), based in the Netherlands, made misleading statements and contravened continuous disclosure requirements. In addition, ASIC alleged that JHINV failed to act with the requisite care and diligence concerning its then subsidiary, JHIL. ASIC also commenced civil penalty proceedings against 10 former directors and officers of JHIL, alleging multiple breaches of their duties under the corporations legislation and seeking declarations of contravention, pecuniary penalties and orders disqualifying them from acting as company directors: see ASIC, 'ASIC Commences Proceedings Relating to James Hardie' (Media Release, 07–35, 15 February 2007).

3 (2012) 247 CLR 345 (French CJ, Gummow, Hayne, Heydon, Crennan, Kiefel and Bell JJ) ('*Hellicar*'). See also *Shafron v ASIC* (2012) 247 CLR 465 (French CJ, Gummow, Hayne, Heydon, Crennan, Kiefel and Bell JJ).

4 The trial judge, Gzell J, gave judgment on contravention: *ASIC v Macdonald* [No 11] (2009) 256 ALR 199 ('*Macdonald* [No 11]'); and on relief from liability for contravention, pecuniary penalties and disqualification: *ASIC v Macdonald* [No 12] (2009) 259 ALR 116 ('*Macdonald* [No 12]').

5 (2012) 92 ACSR 460, 538–41 [363]–[365] (Beazley, Barrett JJA and Sackville AJA) ('*Gillfillan*').

6 The remaining issues were about claims to be relieved from liability, penalty and disqualification.

the penalties.⁷ In the case of the former US directors and CFO, Morley, the pecuniary penalties payable were as low as \$20 000.⁸ This outcome is concerning not only because of the criticism that *Gillfillan* understandably attracted,⁹ but because it also appears to be part of a developing trend in civil penalty cases for light or no penalties to be imposed.¹⁰ Notwithstanding the reputational damage or ‘public opprobrium’,¹¹ as Sackville J in *Gillfillan* describes it,¹² that defendants invariably suffer as a result of civil penalty proceedings,¹³ the author maintains that for civil penalties to secure effective enforcement, they must be, and crucially, *must be seen to be*, serious enough to act as a deterrent and to deliver the appropriate level of moral culpability for the wrong done. This will only occur if they are imposed at a sufficiently high level.¹⁴

Accordingly, the imposition of low penalties, particularly in such a serious and high profile case as James Hardie arguably raises questions about the credibility of the civil penalty regime, currently contained in part 9.4B of the *Corporations Act 2001* (Cth) (*‘Corporations Act’*),¹⁵ to achieve effective enforcement and deter potential corporate wrongdoers. This is reminiscent of

7 The bans that were originally imposed on each of the seven non-executive directors disqualifying them from management were reduced from five to two years and three months with even shorter bans for the United States (‘US’) directors. The pecuniary penalties payable were also reduced from \$30 000 to \$25 000 and \$20 000 for the US directors. As far as the executive directors, Peter Shafron, former Company Secretary and General Counsel, and Philip Morley, former Chief Financial Officer (‘CFO’), were concerned, the Court reimposed the penalty and disqualification as determined by the trial judge, namely \$75 000 and seven years, on Shafron. In the case of Morley, the New South Wales Court of Appeal had earlier on 6 May 2011, reduced the penalty from \$35 000 to \$20 000 and disqualification from five to two years: *Morley v ASIC [No 2]* (2011) 83 ACSR 620, 651 [5] (Spigelman CJ, Beazley and Giles JJA). But note that the original civil penalties imposed on the former Chief Executive Officer (‘CEO’), Peter Macdonald, remain undisturbed. This is because Macdonald was the only Hardie defendant not to pursue any appeal.

8 See above n 7.

9 See, eg, Hannah Low, ‘Hardie Directors’ Penalties Slashed’, *The Australian Financial Review* (Sydney), 13 November 2012, 9. See also the TV Mini-Series: *Devil’s Dust* (Directed by Jessica Hobbs, ABC Television, 2012).

10 See, eg, *ASIC v Healey [No 2]* (2011) 196 FCR 430 (Middleton J) (*‘Healey [No 2]’*) and *ASIC v Ingleby* (2013) 275 FLR 171 (Weinberg and Harper JJA, Hargrave AJA) (*‘Ingleby’*), discussed below nn 67–8. This is to be contrasted with earlier cases, eg, *ASIC v Vizard* (2005) 145 FCR 57 (Finkelstein J) (*‘Vizard’*), discussed below n 129.

11 [2012] NSWCA 370, [253].

12 Even though Sackville J said that the behaviour of the directors – specifically that of Meredith Hellicar and Michael Brown – was ‘very serious indeed’, his Honour treated the ‘public opprobrium’ suffered and factors, such as the exemplary records of the directors prior to their contraventions and contributions to the community, as mitigating factors.

13 A judgment effectively ends a career as a public company director. However, there are reports that some of the Hardie directors may now be working in the US, where the judgment has no force: see, eg, Low, above n 9.

14 See Treasury, Australian Government, *Review of Sanctions in Corporate Law* (2007) [2.27] <http://archive.treasury.gov.au/documents/1182/PDF/Review_of_Sanctions.pdf>. See also *Vizard* (2005) 145 FCR 57, 64, 67–8 (Finkelstein J), discussed below n 129.

15 The civil penalty regime (now as amended) was integrated into the corporations legislation by the *Corporate Law Reform Act 1992* (Cth) and came into effect on 1 February 1993.

the way the earlier criminal regime¹⁶ for enforcement of the statutory duties of company officers¹⁷ was not regarded as an effective enforcement regime. The Senate Standing Committee on Legal and Constitutional Affairs, for instance, which had conducted an inquiry into the reform of directors' duties in 1989 ('Cooney Committee'), heard evidence that criminal penalties for breaches of directors' duties which involved gaol terms appeared too 'draconian'.¹⁸ The courts were reluctant to impose gaol terms. The lenient fines that were imposed in their place gave the impression that the law was 'weak'.¹⁹

After briefly discussing the history and theory of the civil penalty regime, the aim of this article will be to seek to assess the extent to which ASIC, armed with the civil penalty structure, can and does effectively regulate corporate misconduct. It will be argued that, although ASIC has made increasing use of civil penalty litigation²⁰ and met with some success in using the civil penalty regime against directors in high profile cases,²¹ a number of problems have arisen that are undermining ASIC's ability to continue to use

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- 16 The criminal sanctions which could be imposed were a fine, imprisonment for up to five years or both under *Corporations Law* s 1311 sch 3 (the *Corporations Law*, now superseded, was part of the *Corporations Law* scheme, a complex legislative framework of Commonwealth legislation applied as state law. This scheme, which involved the cooperation of the states and which came into force on 1 January 1991 resulted after several states had successfully challenged the constitutional validity of the *Corporations Act 1989* (Cth) by which the Commonwealth attempted to take over sole control of companies and securities regulation from the states in the High Court in *New South Wales v Commonwealth* (1989) 169 CLR 482, repealing *Companies Code* s 570 (the *Companies Code* was the *Companies Act 1981* (Cth), applied in each state by application legislation: see, eg, *Companies (Application of Laws) Act 1981* (NSW) providing for the *Companies (New South Wales) Code 1981* (NSW)). Civil remedies, which enabled recovery for loss or damage resulting from the breach were also available: *Corporations Law* ss 232(7)–(8), (11), repealing *Companies Code* ss 229(6)–(7), (11).
 - 17 The provisions relating to the duties of company officers are now found in the *Corporations Act*, ss 180–4, repealing *Corporations Law* s 232, repealing *Companies Code* s 229.
 - 18 Senate Standing Committee on Legal and Constitutional Affairs, 'Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors' (Parliament of Australia, 1989) 17, 188 ('Cooney Report'). This was especially the case for breaches of the duty to act with care, which is now found in *Corporations Act* s 180(1), repealing *Corporations Law* s 232(4), repealing *Companies Code* s 229(2).
 - 19 *Cooney Report*, above n 18, 17, 188.
 - 20 In recent years, this has also occurred in a range of contexts with ASIC alleging a breach of directors' duties arising from approval of misleading financial reports in *ASIC v Healey* (2011) 196 FCR 291 (Middleton J); announcements to the Australian Stock Exchange: see, eg, *Forrest v ASIC* (2012) 247 CLR 486 (French CJ, Gummow, Hayne, Heydon and Kiefel JJ) ('*Forrest*'); engaging in conduct contrary to United Nations resolutions: see, eg, *Re AWB Ltd: ASIC v Lindberg* [No 5] [2009] VSC 258.
 - 21 Those cases include *ASIC v Adler* (2002) 41 ACSR 72 (Santow J); *ASIC v Plymin* (2003) 46 ACSR 126 (Mandie J); *R v Williams* (2005) 216 ALR 113 (Wood CJ at CL).

the civil penalty approach and to be an effective regulator.²² Principal amongst them are the evidential, procedural and enforcement difficulties that have emerged with the use of civil penalties under part 9.4B, which will be the focus of this article.

Despite Parliament mandating in section 1317L of the *Corporations Act* to apply civil, not criminal, processes in civil penalty proceedings,²³ the courts are treating civil penalties as *quasi-criminal* offences by imposing criminal procedural protections. This has been the case particularly since the majority of the High Court of Australia in *Rich v ASIC*²⁴ held that the privilege against exposure to penalties and forfeiture (the penalty privilege) was available in civil penalty proceedings.²⁵ As a result, evidential, procedural and enforcement difficulties have developed in civil penalty proceedings, that this article contends have set back ASIC's attempts to use civil penalties for sanctioning.²⁶

In addition to the problem of low penalties discussed above, James Hardie showcases the types of evidential, procedural and enforcement obstacles ASIC has confronted in recent years when it has chosen to bring civil penalty proceedings. In the first place, there was what occurred as a result of the decision of the New South Wales Court of Appeal in *Morley v ASIC*.²⁷ By holding that to

22 Some of these problems have been explored elsewhere: see, eg, Vicky Comino, 'The Challenge of Corporate Law Enforcement' (2009) 23 *Australian Journal of Corporate Law* 233, 233. There, it is argued that ASIC's ability to effectively rely on the civil penalty approach has also been weakened because ASIC itself has had difficulties with implementing the 'pyramid of enforcement' model discussed below nn 56–9. It has been suggested that if ASIC wishes to retain its reputation as a credible regulator and use pyramidal enforcement, it must be more consistent in its application of this approach and be seen to be more prepared than it is currently to escalate 'up' the pyramid to use criminal sanctions at the apex when serious contraventions are discovered, particularly in high profile cases. Criminal sanctions will not be a potent deterrent unless potential violators know that ASIC will do more than merely threaten their use. Part of the solution might be for ASIC to establish its own prosecutorial division, rather than having to liaise with the Commonwealth Director of Public Prosecutions ('DPP') over significant enforcement matters as is presently the case. This occurs in accordance with a Memorandum of Understanding between the DPP and ASIC: see ASIC and DPP, *Memorandum of Understanding* (1 March 2006) <[https://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/mou_dpp_mar_2006.pdf/\\$file/mou_dpp_mar_2006.pdf](https://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/mou_dpp_mar_2006.pdf/$file/mou_dpp_mar_2006.pdf)>.

23 Section 1317L of the *Corporations Act* requires that courts 'must apply the rules of evidence and procedure for civil matters when hearing proceedings for (a) a declaration of contravention or (b) a pecuniary penalty order', with the standard of proof being the civil standard (on the balance of probabilities): *Corporations Act* s 1332; not the criminal standard (beyond a reasonable doubt): *Criminal Code Act 1995* (Cth) s 13.2.

24 (2004) 220 CLR 129 (Gleeson CJ, McHugh, Gummow, Hayne, Callinan and Heydon JJ) ('*Rich*').

25 The complications to ASIC's case in the proceedings it had brought against the founder of One.Tel Ltd ('One.Tel'), John David (Jodee) Rich, and former finance director, Mark Silbermann, as a result of these defendants not having to comply with the usual requirement to make discovery and file affidavits before trial on the ground of the penalty privilege are discussed below in Part VI(A). Amendments have resulted in the removal of the penalty privilege in regard to disqualification proceedings: *Corporations Act* s 1349, as inserted by *Corporations Amendment (Insolvency) Act 2007* (Cth) sch 2 item 12, which came into force on 31 December 2007. However, the procedural problems when ASIC is seeking a pecuniary penalty remain.

26 See generally Vicky Comino, 'Effective Regulation by the Australian Securities and Investments Commission: The Civil Penalty Problem' (2009) 33 *Melbourne University Law Review* 802.

27 (2010) 274 ALR 205 (Spigelman CJ, Beazley and Giles JJA) ('*Morley*'). See below Part IV(B)(3).

discharge the duty of fairness ASIC owes to defendants in civil penalty proceedings, ASIC should call all material witnesses, the Court in *Morley* raised the bar, resorting to requirements which up until then had been the preserve of criminal law to the detriment of the overall aim of part 9.4B.²⁸ In being granted special leave to appeal to the High Court from *Morley*, ASIC had argued:

The New South Wales Court of Appeal ‘changed the entire framework’ of whether regulators must call key witnesses in civil penalty trials ... ‘Such future litigation will bear the burden of the likely additional expense of attempting to satisfy the obligation as well as the likely interminable debate as to compliance.’²⁹

Other problems evidenced in the James Hardie matter are the complications of ASIC’s case in an application for a civil penalty resulting from defendants having the right to claim various protections, particularly the effects of the penalty privilege on pre-trial disclosure. This was the subject of *Macdonald v ASIC*,³⁰ which concerns a procedural issue raised by one of the defendants, Macdonald, a former director and CEO of JHIL and JHINV. While ASIC has been successful in obtaining significant civil penalties against Macdonald,³¹ it will be argued that this decision of the New South Wales Court of Appeal and the more recent decision of the Queensland Court of Appeal in *Anderson v ASIC*³² do not augur well for ASIC’s future use of civil penalty proceedings that attract the penalty privilege. As a consequence of diminished disclosure by defendants, ASIC may not be aware of what matters will be raised in defence of the allegations it is making. This is why ASIC has to prepare its case to meet a high standard of proof,³³ as Austin J emphasised in his judgment in *ASIC v Rich*.³⁴

Further, defendants making procedural challenges, as in *Macdonald*, and the fact that the appeals in the Hardie matter³⁵ turned on procedural points,³⁶ show that in a number of recent cases when ASIC has chosen to bring civil penalty proceedings, instead of those proceedings being the cost-effective and timely enforcement response to contravening conduct initially contemplated,³⁷

28 See especially below nn 105–9. See also Clifford Einstein and Mark Sheldon, ‘ASIC – How Far Does Its Obligation of Fairness Extend’ (2011) 26 *Australian Journal of Corporate Law* 112, 114, 118–19.

29 See Elisabeth Sexton, ‘ASIC Questions Fairness Obligation in Appeal’, *Sydney Morning Herald* (Sydney), 11 May 2011, 31.

30 (2007) 73 NSWLR 612 (Mason P, Giles JA and Spigelman CJ) (‘*Macdonald*’).

31 See *Macdonald [No 12]* (2009) 259 ALR 116, 201–2 (Gzell J).

32 [2013] 2 Qd R 401 (Holmes and White JJA and McMurdo J) (‘*Anderson*’).

33 Even though as noted above n 23, the standard of proof is the civil standard (on the balance of probabilities): *Corporations Act* s 1332, it can often be very close to the criminal standard in (serious) civil penalty cases: see below Part VI(B).

34 (2009) 236 FLR 1, 26–8.

35 First to the Court of Appeal in *Morley* and finally to the High Court in *Hellicar*.

36 This has also occurred in other matters, eg, the appeal by Rich and Silbermann to the High Court on the penalty privilege point in the One.Tel matter: *Rich* (2004) 220 CLR 129.

37 See below n 63 for further discussion on this point.

proceedings have been expensive.³⁸ The time taken to resolve them has also been ‘extreme and ... unfortunate from a regulatory perspective.’³⁹ Moreover, they underscore the uncertainty surrounding the applicable rules of procedure in civil penalty cases and lack of consistency in the manner that cases are dealt with by different courts and judges.⁴⁰ This would certainly resonate with ASIC given the High Court’s strong criticism of the way ASIC pleaded its case in its recent defeat against Fortescue Metals Group Ltd (‘Fortescue’) and its chairman and former CEO, Andrew ‘Twiggy’ Forrest, in *Forrest v ASIC*,⁴¹ especially after ASIC had engaged as many as seven senior counsel to review its pleadings and spent a reported \$30 million pursuing the action.⁴² The High Court lambasted what it regarded as the ‘confusion’ in ASIC’s statement of claim, mixing as it did allegations of fraudulent misrepresentations with allegations of negligent misrepresentations.⁴³ As then ASIC deputy chairman, Belinda Gibson, commented:

on one view [the High Court decision] really calls into question how you bring civil proceedings. An individual does not have to tell you what their defence is until you actually get to the courtroom floor. People have previously thought that is why you do pleadings in the alternative but the High Court did not seem to like that approach so we will have to take a lot of advice about what that means for civil penalty actions against individuals.⁴⁴

38 See, eg, below n 42.

39 Greg Golding and Laura Steinke, ‘Directors in the Regulatory Enforcement Pyramid – Recent Developments’ (Paper presented at the Directors’ Duties Seminar, University of New South Wales, 20 March 2012) 27. According to Golding and Steinke, they are taking on average about seven years to finalise.

40 See also Tom Middleton, Thomson Reuters, *ASIC Corporate Investigations and Hearings*, [8.1520]; Peta Spender, ‘Negotiating the Third Way: Developing Effective Process in Civil Penalty Litigation’ (2008) 26 *Company and Securities Law Journal* 249, 257.

41 (2012) 247 CLR 486 (French CJ, Gummow, Hayne, Heydon and Kiefel JJ). In the civil penalty proceedings ASIC launched against Fortescue and Forrest in 2006, ASIC alleged that, contrary to s 1014H of the *Corporations Act*, Fortescue engaged in misleading and deceptive conduct by making a series of announcements to the market and investors in 2004 that certain framework agreements with three major state-owned Chinese companies to build and finance the company’s massive Pilbara Iron Ore and Infrastructure Project in Western Australia were ‘binding contracts’. ASIC further alleged that Fortescue contravened the continuous disclosure requirements of s 674 of the *Corporations Act* and that, contrary to s 180(1), on each occasion Fortescue contravened the *Act*, Forrest had not exercised his powers or discharged his duties as a director of Fortescue with the degree of care and diligence required by s 180(1).

42 See Patrick Durkin, Alex Boxsell and Jonathan Barrett, ‘How Regulator Blew \$30m on Twiggy’, *The Weekend Australian Financial Review* (Sydney), 6–7 October 2012, 50–1. ASIC’s practice when it has decided to bring difficult and complex cases has been to use external lawyers.

43 *Forrest* (2012) 247 CLR 486, 501–2 [22]–[23]. ASIC’s allegations ‘mixed two radically different and distinct ideas’. These were that ‘Fortescue *knew* that the statements were false (it had no *genuine* basis for making them)’, ie, fraudulent misrepresentation; and that ‘Fortescue *should have known* that the statements were false (it had no *reasonable* basis for making them)’, ie, negligent misrepresentation: at [22] (emphasis in original).

44 Quoted in Patrick Durkin, ‘ASIC to Rethink its Legal Strategy’, *The Weekend Australian Financial Review* (Sydney), 6–7 October 2012, 8.

For ASIC, after its very public loss in *Forrest*, reviewing its litigation processes⁴⁵ may be a step in the right direction. However, neither this step, nor *Hellicar* (removing the hurdle created by *Morley* discussed above – obliging ASIC to call all material witnesses to discharge its duty of fairness),⁴⁶ will be enough to enable ASIC to use civil penalties under part 9.4B to deal effectively with corporate wrongdoing. The ideal solution is, as the author has urged, for Parliament to pass legislation to resolve the evidential and procedural obstacles facing the use of civil penalties.⁴⁷ Legislative intervention is needed because, as this article’s examination of these obstacles will highlight, the danger remains that leaving it up to the courts to try to shape a hybrid process for civil penalties, variously referred to as a ‘third way’⁴⁸ or ‘middleground’⁴⁹ (which currently draws on civil and criminal law), on a case-by-case basis, will ‘lead to indeterminacy or default to criminal procedure.’⁵⁰

II THE HISTORY AND THEORY OF THE CIVIL PENALTY REGIME

Much has been written concerning the history and theory of the civil penalty regime,⁵¹ which was introduced into the corporations legislation on 1 February 1993,⁵² and amended by the *Corporate Law Economic Reform Program Act 1999* (Cth) (*CLERP Act*), with the current part 9.4B coming into force in March 2000.⁵³ In short, the regime was adopted as a result of the

45 Some commentators have suggested this: see, eg, Alex Boxsell and Patrick Durkin, ‘ASIC Loss Raises Queries’, *The Australian Financial Review* (Sydney), 5 October 2012, 37. See also Durkin, Boxsell and Barrett, above n 42, 51, where it was reported that ASIC has also promised to review its litigation strategy.

46 See below Part IV(B)(4).

47 This legislation should apply not just to ASIC’s civil penalty proceedings, but to those of all regulators who are empowered to bring such proceedings, such as the Australian Competition and Consumer Commission (‘ACCC’) and the Australian Prudential Regulatory Authority (‘APRA’): see Comino, ‘The Civil Penalty Problem’, above n 26, 807. Others have made similar calls for reform to develop a special procedure to govern civil penalties: see, eg, Spender, above n 40, 257; Anne Rees, ‘Civil Penalties: Emphasising the Adjective or the Noun’ (2006) 34 *Australian Business Law Review* 139, 155. See also Australian Law Reform Commission (‘ALRC’), *Principled Regulation: Federal Civil and Administrative Penalties in Australia*, Report No 95 (2002) 25.

48 See Rees, above n 47, 139; Spender, above n 40, 249.

49 See Kenneth Mann, ‘Punitive Civil Sanctions: The Middleground between Criminal and Civil Law’ (1992) 101 *Yale Law Journal* 1795, 1799.

50 Comino, ‘The Civil Penalty Problem’, above n 26, 829, agreeing with Spender, above n 40, 257.

51 See, eg, Helen Bird, ‘The Problematic Nature of Civil Penalties in the Corporations Law’ (1996) 14 *Company and Securities Law Journal* 405; Michael Gething, ‘Do We Really Need Criminal and Civil Penalties for Contraventions of Directors’ Duties?’ (1996) 24 *Australian Business Law Review* 375; George P Gilligan, Helen Bird and Ian Ramsay, ‘Civil Penalties and the Enforcement of Directors’ Duties’ (1999) 22 *University of New South Wales Law Journal* 417.

52 See above n 15.

53 The *CLERP Act* was passed in October 1999, but came into operation in March 2000.

recommendation of the *Cooney Report*.⁵⁴ The Government's purpose in fundamentally reforming the regime of sanctions for enforcement of the directors' duties provisions when it introduced part 9.4B was to address perceived deficiencies in the earlier criminal penalty regime⁵⁵ and to provide ASIC with an enforcement regime that relied on 'strategic regulation theory' and the 'pyramid of enforcement' model.⁵⁶ This theory recognises that it is impossible for regulators to detect and enforce every contravention of the law they administer and offers insights into how regulatory compliance can be secured most effectively. It posits that compliance is most likely when the practice of a regulatory agency displays an explicit enforcement pyramid, which contains a range of enforcement sanctions.⁵⁷ Regulators should escalate the severity of sanctions in the pyramid according to the seriousness of the

54 *Cooney Report*, above n 18, 188, 190–1. It recommended that criminal liability be retained for *only* the most serious contraventions, those 'genuinely criminal in nature' and that civil penalties be available to deal with non-criminal contraventions.

55 See especially *Cooney Report*, above nn 18–9 and accompanying text; Commonwealth, *Parliamentary Debates*, Senate, 28 November 1991, 3616 (Senator Richardson); ALRC, above n 47, 75.

56 The ALRC noted that '[t]he use of civil penalties in the Corporations Law emerged as a response to the considerable work on regulatory enforcement undertaken in the 1980s and 1990s by theorists such as [Ian] Ayres and [John] Braithwaite': ALRC, above n 47, 76. The pivotal concept of a 'pyramid of enforcement' was developed by Braithwaite: see John Braithwaite, *To Punish or Persuade: Enforcement of Coal Mine Safety* (State University of New York Press, 1985); and subsequently expanded by Ayres and Braithwaite, who coined the phrase 'responsive regulation': see Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992). The terms 'strategic' and 'responsive' regulation are used interchangeably in the regulation literature: see, eg, Chris Dellit and Brent Fisse, 'Civil and Criminal Liability under Australian Securities Regulation: The Possibility of Strategic Enforcement' in Gordon Walker and Brent Fisse (eds), *Securities Regulation in Australia and New Zealand* (Oxford University Press, 1994) 580. This chapter was not retained in a later edition (1998).

57 See Braithwaite, above n 56, 142–7. See also Ayres and Braithwaite, above n 56, 35–8.

contraventions, with criminal liability at the apex⁵⁸ *only* for continued non-compliance or the most serious contraventions.⁵⁹

By adopting this approach and introducing new civil penalty sanctions,⁶⁰ there were high expectations that part 9.4B would enable ASIC to enforce directors' duties more effectively. This was because of civil, rather than criminal, rules of evidence and procedure, being a feature of civil penalty proceedings,⁶¹ and the potential deterrent impact of civil penalties, but without the drastic consequences of criminal enforcement, such as the 'stigma of a criminal conviction attaching to the director'.⁶² Furthermore, since civil penalty sanctions are not constrained by criminal procedure, it seemed likely that imposing them would be cheaper and more efficient than imposing criminal sanctions.⁶³

58 Incarceration for individuals and permanent licence cancellation or deregistration for corporate offenders may be at the apex of the pyramid.

59 For a fuller explanation of strategic regulation theory and the pyramid model, see, eg, Gilligan, Bird and Ramsay, above n 51, 425–33. The purpose this article is not to critique 'strategic' or 'responsive' regulation and the 'pyramid of enforcement' model. There is already a rich critical literature on this model: see, eg, Neil Gunningham, Darren Sinclair and Peter Grabosky, *Smart Regulation: Designing Environmental Policy* (Clarendon Press, 1998); Richard Johnstone, 'Putting the Regulated Back into Regulation' (1999) 26 *Journal of Law and Society* 378; Robert Baldwin and Julia Black, 'Really Responsive Regulation' (2008) 71 *The Modern Law Review* 59, 62–3. This article simply recognises that the pyramid model was articulated as the foundation of the civil penalty regime: see above n 56. Indeed, there is judicial recognition that this model underpins our current approach to corporate regulation: see, eg, *ASIC v HLP Financial Planning (Aust) Pty Ltd* (2007) 164 FCR 487, 501–2 [50] (Finkelstein J). However, ASIC does not rely exclusively on this model. Other regulatory models that have made advances in regulatory theory, most notably 'risk-based' regulation and the 'regulatory craft' approach developed by Harvard University academic, Malcolm Sparrow, *The Regulatory Craft: Controlling Risks, Solving Problems and Managing Compliance* (Brookings Institution Press, 2000), have been influential in providing ASIC with further guides to its strategies and practice: see, eg, Jeremy Cooper, 'The Integration of Financial Regulatory Authorities – The Australian Experience' (Paper presented at the 30th Anniversary Conference of the Securities Exchange Commission of Brazil, Assessing the Present, Conceiving the Future, Rio de Janeiro, 4–5 September 2006) 3 <[http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/integration-financial-regulatory-authorities.pdf/\\$file/integration-financial-regulatory-authorities.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/integration-financial-regulatory-authorities.pdf/$file/integration-financial-regulatory-authorities.pdf)>.

60 The consequences of breaching a civil penalty provision included the court being able to prohibit the person from managing a corporation for a specified period of time and/or impose a pecuniary penalty of up to \$200 000 upon that person under the *Corporations Law* ss 1317EA(3)(a)–(b). The available civil penalty orders continue to be disqualification orders and pecuniary penalties under *Corporations Act* ss 206C and 1317G respectively. These are in addition to a declaration of contravention: s 1317E, and/or a compensation order: s 1317H.

61 See *Corporations Act* s 1317L, discussed above n 23.

62 See *Cooney Report*, above n 18, 191. But see in particular discussion above nn 5–14 and accompanying text. See also below Part IV(B)(5).

63 See, eg, Middleton, *ASIC Corporate Investigations and Hearings*, above n 40. In this regard, ASIC's regulatory objective in s 1(2)(g) of the *ASIC Act* to strive to enforce the corporations legislation effectively and with a minimum of procedural requirements should be noted.

III DEVELOPING PROBLEMS WITH CIVIL PENALTY PROCEEDINGS

In the early years – from 1993 to 1999 – ASIC brought very few civil penalty proceedings.⁶⁴ In recent years, however, ASIC has made greater use of civil penalty litigation and, since 2000, has had success in using part 9.4B, especially in obtaining civil penalties against directors in some high profile cases.⁶⁵ These cases include those against the directors of HIH Insurance Ltd ('HIH'), Water Wheel Holdings Limited ('Water Wheel') and to a lesser extent, One.Tel,⁶⁶ as well as more recently, in such matters as Centro Properties,⁶⁷ Australian Wheat Board ('AWB')⁶⁸ and James Hardie, where contraventions of the duty of care in section

64 See Gilligan, Bird and Ramsay, above n 51, 417, 437. In this period, ASIC commenced only 14 civil penalty actions. See also Bird, above n 51, 405, 420–7.

65 An examination of ASIC's enforcement record since 2000 suggests that the *CLERP Act* reforms are largely responsible for this success. The reforms were intended to remedy shortcomings in the original regime. For a discussion of how the *CLERP Act* overcame structural weaknesses from the perspective of strategic regulation theory so that the current enforcement pyramid is a more cohesive structure: see, eg, Vicky Comino, 'The Enforcement Record of ASIC Since the Introduction of the Civil Penalty Regime' (2007) 20 *Australian Journal of Corporate Law* 183, 190–3.

66 For a detailed discussion of these cases, see *ibid* 195–207. Concerning HIH, ASIC subsequently brought successful criminal proceedings against the directors: see, eg, *R v Adler* (2005) 53 ACSR 471 (Dunford J). ASIC had only limited success in the case against the four One.Tel directors: Rich, Silbermann, Bradley Keeling and John Greaves, and suffered a major loss in *ASIC v Rich* (2009) 236 FLR 1 (Austin J).

67 On 27 June 2011, ASIC was successful in the civil penalty proceedings it brought against eight former Centro directors and executives when the Federal Court found that they breached their duties in approving the property company's faulty 2007 accounts. The accounts failed to reveal that the shopping centre giant had approximately \$2 billion in current liabilities and another \$1.75 billion in guarantees: *ASIC v Healey* (2011) 196 FCR 291 (Middleton J). But in *Healey [No 2]* (2011) 196 FCR 430 (Middleton J), low penalties were imposed on only two of the eight defendants. Former Centro CEO Andrew Scott received a \$30 000 penalty and no ban and CFO Romano Nenna received a two year ban but no penalty while all of the non-executive directors escaped any penalties or bans. Justice Middleton said that the publicity given to the directors' breaches of duty made the need to impose disqualification orders or pecuniary penalties for reasons of deterrence 'much less than it would otherwise be': at [177]. His Honour concluded that the declarations of contravention, the refusal to relieve the directors from liability and the reputational damage inflicted on them were 'sufficient to serve the objective of general deterrence': at [190]. The author disagrees: see above nn 11–14 and accompanying text.

68 In December 2007, ASIC commenced civil penalty proceedings against six former directors and officers of AWB, alleging breaches of their duties under *Corporations Act* ss 180(1) and 181. These alleged breaches arose in connection with secret payments of \$290 million (purportedly inland transportation fees) made to the Iraqi government under contracts for the sale of wheat in violation of the United Nations Oil-for-Food Programme. To date, only the proceedings against Andrew Lindberg, former Managing Director, and Paul Ingleby, former CFO, have been finalised. In *ASIC v Lindberg* (2012) 91 ACSR 640 (Robson J) ('*Lindberg*'), Lindberg was ordered to pay a pecuniary penalty of \$100 000 and disqualified from management for two years for his contraventions of s 180(1). But in *Ingleby* (2013) 275 FLR 171, Ingleby, who was also found to have contravened s 180(1), was penalised \$40 000 and disqualified for 15 months.

180(1) of the *Corporations Act* figure prominently.⁶⁹ Yet, despite this, since the majority of the High Court in the *Rich* case held that the penalty privilege is available in civil penalty proceedings,⁷⁰ I have consistently argued that ASIC's ability to use part 9.4B effectively has been reduced and that ASIC would continue to challenge its 'enemies' with one hand tied behind its back.⁷¹ This is due to the significant evidential, procedural and enforcement problems created by this decision in cases where ASIC has sought to rely on civil penalty provisions.⁷² These problems and others that have emerged in the case law on civil penalties since 2000 are the result of the courts' tendency to treat civil penalties as *quasi-criminal* offences notwithstanding Parliament's designation of the civil penalty provisions as *civil*.⁷³

IV JAMES HARDIE

A Background to the James Hardie Litigation

This article will now canvass some of the problems that have arisen with civil penalty proceedings, beginning with a discussion of the James Hardie matter. Few companies in Australia have generated as much negative publicity or been subjected to as much public vilification as James Hardie, once Australia's main asbestos miner and asbestos products manufacturer and distributor.⁷⁴ Contrary to statements made to the Australian Stock Exchange ('ASX') in 2001 that the MRCF

69 ASIC can now only commence civil penalty proceedings for a breach of the duty of care. There is no criminal liability for contravention of s 180(1). This is because the 'fault elements' that must be established for a criminal offence under s 184 do not include 'negligence'. Breaches by directors of the duty to act with care was decriminalised because it was thought that 'mere negligence' was incompatible with criminality: see Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998 (Cth) [6.76]; Middleton, *ASIC Corporate Investigations and Hearings*, above n 40, [8.3360]. See also M Welsh, 'Civil Penalties and Responsive Regulation: The Gap between Theory and Practice' (2009) 33 *Melbourne University Law Review* 908, 932, who makes the same point that as a consequence of breaches of the duty of care not attracting any criminal liability, ASIC has been better able to cope with enforcement in cases where it believes that no criminality is involved.

70 But see *Corporations Act* s 1349, discussed in detail below nn 167–8.

71 See Vicky Comino, 'High Court Relegates Strategic Regulation Theory and Pyramidal Enforcement to Insignificance' (2005) 18 *Australian Journal of Corporate Law* 48, 48; Vicky Comino, 'Civil or Criminal Penalties for Corporate Misconduct: Which Way Ahead?' (2006) 34 *Australian Business Law Review* 428, 437; Comino, 'The Enforcement Record of ASIC', above n 65, 207–8; Comino, 'The Civil Penalty Problem', above n 26, 814.

72 See below Part VI(A).

73 See *Corporations Act* s 1317L, discussed above n 23.

74 There have been many changes in the identity and names of the James Hardie companies over the years, but it was mainly three companies that were involved in the manufacture and distribution of asbestos products (which finally ceased in 1987). Those companies were: JHIL (until 1937); and its subsidiaries, Amaca Pty Ltd ('Amaca') and Amaba Pty Ltd ('Amaba') (thereafter until 1987). It is principally these subsidiaries that gave rise to 'long-tail' liabilities to asbestos victims.

set up by JHIL⁷⁵ to meet the claims of asbestos victims had ‘sufficient funds to meet all legitimate compensation claims’,⁷⁶ it was ‘massively under-funded’.⁷⁷

As one commentator aptly puts it, the events leading to the relevant legal issues raised in the James Hardie litigation ‘attracted great and legitimate public interest following the company’s manifest intention at the outset to create a limited fund to compensate asbestos victims and thereafter to divest itself of future liabilities upon depletion of the fund.’⁷⁸ In addition to giving rise to the Jackson Inquiry,⁷⁹ those events prompted ASIC to allege, in the civil penalty proceedings it launched in February 2007, that JHINV (based in the Netherlands),⁸⁰ JHIL and its officers and

75 JHIL is the former Australian listed entity.

76 These statements were contained in a press release: ASX, ‘James Hardie Resolves Its Asbestos Liability for Claimants and Shareholders’ (Media Release, 228763, 16 February 2001) (emphasis added).

77 D F Jackson, ‘Report on the Special Commission of Inquiry into the Medical Research and Compensation Foundation’ (Report, New South Wales Department of Premier and Cabinet, September 2004) vol 1, 356 (‘*Jackson Report*’). In February 2004, amid mounting concerns that James Hardie had underestimated its liability to asbestos claims and that asbestos sufferers would be unable to recover compensation, the New South Wales government established a Special Commission of Inquiry, headed by David Jackson QC. When he reported in September 2004, his report made some dire findings. The most significant was that James Hardie had greatly underfunded the MRCF (as at 30 June 2004, the estimated liabilities of the MRCF were \$1.5 billion – this was compared to the total value of assets it acquired of \$293 million) and the ‘bombshell’ that the compensation funds were rapidly being depleted by current claims and would be exhausted by 2007: see at 7–8.

78 Anil Hargovan, ‘*Australian Securities and Investments Commission v MacDonald [No 11]*: Corporate Governance Lessons from James Hardie’ (2009) 33 *Melbourne University Law Review* 984, 986. See also New South Wales Department of Premier and Cabinet, above n 77, 3. When the James Hardie Group restructured in 2001, the liability-ridden subsidiaries (Amaba and Amaca) were cut adrift from the parent company and the Group and a special purpose fund, known as the MRCF, was established to manage payment of asbestos-related claims against the subsidiaries. The MRCF was set up as a separate entity not related in any way to the companies in the James Hardie Group. The structure, therefore, took advantage of the benefits of the doctrine of separate legal personality and limited liability: see generally *Salomon v Salomon & Co Pty Ltd* [1897] AC 22; *Walker v Wimborne* (1976) 137 CLR 1, 6–7 (Mason J), establishing that these concepts apply to corporate groups.

79 See above n 77.

80 Part of the controversial 2001 corporate reconstruction involved the James Hardie Group entering into a complex scheme of arrangement to move control from Australia to the Netherlands and set up as a Dutch company, JHINV. The reasons given for the move to the Netherlands (which does not recognise Australian court decisions thus preventing any liability imposed in Australia being enforced in the Netherlands) included being in the ‘best interests of the shareholders as a whole’ because of higher after-tax returns to shareholders and the possibility of further international growth: see *Jackson Report*, above n 77, 32–3. However, it also took with it \$1.9 billion in assets from the Group: John H Farrar, *Corporate Governance: Theories, Principles, and Practice* (Oxford University Press, 3rd ed, 2008) 511. This was achieved by the cancellation of partly paid shares held by JHINV and the setting up of a new foundation in March 2003, the effect of which was to completely separate JHIL from the operating arms of the James Hardie Group. The profitable non-asbestos tainted parts of the Group’s business were now outside Australia separate from the future liabilities of its former asbestos-ridden entities that remained in Australia. Perhaps not surprisingly, these steps were not made public at the time, just as the earlier entry of JHIL, Amaba and Amaca into a Deed of Covenant and Indemnity in the early hours of the morning of 16 February 2001 prior to the public announcement of the separation that day had not been disclosed at that time. For an interesting discussion of how the actions of the James Hardie Group outlined above might be viewed as exhibiting either the worst or the best of corporate social responsibility: see Paul von Nessen and Abe Herzberg, ‘James Hardie’s Asbestos Liability Legacy in Australia: Disclosure, Corporate Social Responsibility and the Power of Persuasion’ (2010) 26 *Australian Journal of Corporate Law* 56, 64.

directors committed multiple contraventions of the corporations legislation between February 2001 and July 2003.⁸¹ However, it is events surrounding the board meeting on 15 February 2001 and the announcement made to the ASX on 16 February 2001 that gave rise to what emerged as key legal issues in the proceedings. ASIC's major allegation was that the 10 member board of JHIL breached its statutory duty of care and diligence under section 180(1) of the *Corporations Act* when it approved the draft announcement for sending to the ASX.

B James Hardie Civil Penalty Proceedings

1 *Macdonald [No 11]*

In *Macdonald [No 11]*, while Gzell J did not uphold all of ASIC's allegations,⁸² his Honour held that the entire board of JHIL – (including its seven non-executive directors) – breached its statutory duty of care under section 180(1).⁸³ The judge accepted that, at the board meeting on 15 February 2001, the directors approved the false or misleading and deceptive draft ASX announcement, released to the public on the following day, to the effect that JHIL had provided for a foundation (the MRCF) which had sufficient funds to meet all future legitimate asbestos-related claims.⁸⁴ Even though all of the directors denied any recollection of this document being considered at the relevant meeting, despite it being referred to in the minutes,⁸⁵ Gzell J did 'not accept the chorus of denial of recollection to be genuine.'⁸⁶

81 See Hargovan, above n 78, 993–4, for a good summary of these alleged contraventions.

82 ASIC alleged that the central role played by Peter Macdonald, eg, in disseminating false and misleading information on the adequacy of funding for asbestos victims in the separation plan also evidenced a failure to act in good faith in the best interests of the company and for a proper purpose as required by s 181 of the *Corporations Act*. However, Gzell J rejected ASIC's allegation that the defendant had breached this duty in any of these circumstances. For instance, his Honour refused to hold that Macdonald breached s 181 through deliberate and repeated use of the phrase 'fully-funded' in press conference statements to justify and influence acceptance of the separation plan: *Macdonald [No 11]* (2009) 256 ALR 199, 360.

83 Ibid 260–3 (Gzell J). For a more comprehensive analysis of this case, especially from the viewpoint of corporate governance: see, eg, Hargovan, above n 78.

84 *Macdonald [No 11]* (2009) 256 ALR 199, 260–2.

85 At trial, ASIC tendered the minutes of the February board meeting which recorded the tabling and approval of the Draft ASX Announcement Resolution. Those minutes had been adopted and signed as a correct record at the next board meeting in April 2001. The special evidentiary status of the minutes given by s 251A(6) of the *Corporations Act* could not be relied upon. This was because the company had failed to comply with the strict formalities requiring the entry of minutes within one month of the meeting: see *Macdonald [No 11]* (2009) 256 ALR 199, 218. The central issue at trial, therefore, was whether the directors had assented to the substance of the resolution by informal means.

86 *Macdonald [No 11]* (2009) 256 ALR 199, 377.

2 *Macdonald [No 12]*

In Justice Gzell's subsequent judgment in *Macdonald [No 12]*,⁸⁷ his Honour adopted a strict approach to the statutory duty of care and dismissed the defendants' applications for relief from liability.⁸⁸ This was despite Gzell J acknowledging that the critical board meeting on 15 February 2001 was a busy meeting and that approval of this announcement by the non-executive directors, who had long and accomplished careers of service on other boards, was an isolated act.⁸⁹ In refusing the defendants relief, Gzell J concluded:

This was a serious breach of duty and a flagrant one. The non-executive directors were endorsing JHIL's announcement to the market in emphatic terms that the Foundation had sufficient funds to pay all legitimate present and future asbestos claims, when they had no sufficient support for that statement and they knew, or ought to have known, that the announcement would influence the market.⁹⁰

Accordingly, Gzell J made the following disqualification orders under section 206C of the *Corporations Act* and imposed the following pecuniary penalties under section 1317G:

1. Macdonald (former director and CEO of JHIL and JHINV) was banned from management for a period of fifteen years and made liable to pay a penalty of \$350 000;
2. Shafron (former Company Secretary and General Counsel of JHIL) was banned from management for a period of seven years and made liable to pay a pecuniary penalty of \$75 000;
3. Morley (former CFO of JHIL) was banned from management for a period of five years and made liable to pay a pecuniary penalty of \$35 000;
4. All of the seven former non-executive directors of JHIL were banned from management for a period of five years and made liable to pay a pecuniary penalty of \$30 000 each; and
5. JHINV only was liable to pay a pecuniary penalty of \$80 000.⁹¹

Macdonald [No 11] with its focus on the conduct of management during decision-making was heralded by ASIC 'as a landmark decision in Australia on corporate governance.'⁹² ASIC's victory in this matter was also lauded in the

⁸⁷ (2009) 259 ALR 116. For a more comprehensive analysis of this case: see, eg, Hargovan, above n 78, 1006–8.

⁸⁸ *Corporations Act* ss 1317S, 1318 confer judicial discretion to grant relief from liability where the court is satisfied that a person acted 'honestly' and, in the circumstances, 'ought fairly to be excused' for the contravention. The courts have said that these provisions 'do not exonerate' the applicant by removing the breach or contravention but operate as a 'dispensing power' to excuse the applicant: *Deputy Commissioner of Taxation v Dick* (2007) 226 FLR 388, [78] cited in *Healey [No 2]* (2011) 196 FCR 430, [86].

⁸⁹ *Macdonald [No 12]* (2009) 259 ALR 116, 130.

⁹⁰ *Ibid* 133–4.

⁹¹ *Ibid* 201–2. The original company, JHIL, was exempted under a special Act of Parliament, *James Hardie (Civil Liability) Act 2005* (NSW).

⁹² ASIC, 'James Hardie Proceedings' (Media Release, 09–69, 23 April 2009).

press.⁹³ *Macdonald [No 12]* was argued to have ‘large potential to improve the deterrence calculus’⁹⁴ as shown by the disqualification orders made in that case, although the low level of pecuniary penalties imposed⁹⁵ appear to have only ever been viewed as a ‘slap on the wrist’.⁹⁶ Nevertheless, all of the defendants (except *Macdonald*) appealed to the New South Wales Court of Appeal.

3 *Morley and ASIC’s Obligation to Act Fairly*

Notwithstanding the findings of both the *Jackson Report*⁹⁷ and Gzell J that the draft announcement had been brought to the board meeting on 15 February 2001 and, that the directors had passed the Draft ASX Announcement Resolution at the meeting,⁹⁸ the New South Wales Court of Appeal in *Morley* upheld the appeal by the non-executive directors.⁹⁹ The Court ruled that the draft ASX announcement had been brought to the relevant board meeting.¹⁰⁰ However, the Court was ‘not satisfied that the non-executive director appellants voted in favour of the Draft ASX Announcement Resolution.’¹⁰¹

The main reason for this finding of fact was that ASIC did not call all material witnesses, most notably, David Robb (a former partner of Allens Arthur Robinson), a key legal adviser, who attended the relevant meeting and who, therefore, potentially could have given evidence about what happened at that critical meeting. While the Court said that ASIC did not have a duty akin to that of a criminal prosecutor (as the directors argued on appeal),¹⁰² it held that the failure by ASIC to call material witnesses can constitute a breach of the obligation of fairness it owes to defendants in civil penalty proceedings.¹⁰³ It was this aspect of the case that created problems and led ASIC to appeal to the High Court.¹⁰⁴

Prior to *Morley* and, indeed well before *Morley*, it was well recognised that ASIC has a special duty of fairness. ASIC’s duty to conduct proceedings fairly is based on the ‘model litigant’ rules, which are derived partly from the common

93 Front page headlines appearing in the press in April 2009 included: ‘Judge Slams Deception by Hardie Board’, ‘Judge Lashes Hardie’s Lies’ and ‘ASIC Bags Big Game in Corporate Jungle’, quoted in Patrick Durkin, ‘ASIC Under Fire For String of Failures’, *The Weekend Australian Financial Review* (Sydney), 18–19 December 2010, 28.

94 See Hargovan, above n 78, 1020.

95 In particular, on the non-executive directors and former CFO, *Morley*: see above n 91 and accompanying text.

96 See, eg, Low, above n 9, 9.

97 See *Jackson Report*, above n 77, 351.

98 *Macdonald [No 11]* (2009) 256 ALR 199, 260–3, 377.

99 *Morley* (2010) 274 ALR 205, 206–8. As far as the executive directors were concerned, the Court allowed the appeal and the cross-appeal in part against Shafron, and dismissed the appeal and cross-appeal by *Morley*.

100 *Ibid* 349 [789].

101 *Ibid* 349 [796].

102 *Ibid* 333 [699]. See also below n 111.

103 *Ibid* 329 [673]–[678], 339 [728], 339 [731]–[732], 341 [741]–[742], 344 [756], 347 [775]–[777].

104 See below Part IV(B)(4).

law,¹⁰⁵ and partly from formal governmental statements.¹⁰⁶ However, until *Morley*, it was generally believed that this duty did not extend to the requirement to call all material witnesses in civil penalty proceedings.¹⁰⁷ As Austin J in *ASIC v Rich* pointed out, the requirement to make available all material witnesses is the exclusive domain of the criminal law¹⁰⁸ and, therefore, has no place in a civil penalty regime.¹⁰⁹

Why then did the Court of Appeal in *Morley* decide to expand the scope of ASIC's duty of fairness by importing requirements that belong to the criminal law (to call all material witnesses) into the civil arena? It was common ground that ASIC was not pursuing criminal proceedings. The Court also accepted the inappropriateness of adopting rules that have developed in the criminal law context and applying them to civil penalties because of section 1317L of the *Corporations Act*,¹¹⁰ which had resulted in it rejecting the appellants' argument (by analogy with criminal procedure) that ASIC owed a prosecutorial duty to call material witnesses in civil penalty proceedings.¹¹¹ This is demonstrated in the following statement that the Court in *Morley* relied on, which had been made by Santow J in *Adler v ASIC*¹¹² when that Court rejected a similar submission with respect to a suggested duty of prosecutorial fairness, including the duty to call material witnesses:

The concepts have developed in the particular circumstances of criminal proceedings. By declaring that these proceedings are to be conducted as civil proceedings, the legislature has plainly declined to pick up the concepts ... Once it is recognised not only that the proceedings are not criminal proceedings, but also that they are by prescription civil proceedings, the basis for some analogous rules is hard to see.¹¹³

Being mindful that Parliament has designated the civil penalty provisions as *civil*, the Court in *Morley* thus made it plain that:

105 See *Melbourne Steamship Co Ltd v Moorehead* (1912) 15 CLR 333 (Griffith CJ), where his Honour discussed an 'old-fashioned traditional, and almost instinctive, standard of fair play to be observed by the Crown in dealing with subjects': at 342.

106 See Australian Government, *Legal Services Directions*, 1 October 2012, sch 1 app B 'The Commonwealth's Obligation to Act as a Model Litigant'.

107 See also Einstein and Sheldon, above n 28, 114.

108 In criminal proceedings, this requirement is well established: see, eg, *Whitehorn v R* (1983) 152 CLR 657, 663 (Deane J), 674 (Dawson J). In civil proceedings, however, it has long been the position that it is the right of counsel alone to decide which witnesses to call: see, eg, *Bond v Australian Broadcasting Tribunal [No 2]* (1988) 19 FCR 494, 514.

109 *ASIC v Rich* (2009) 236 FLR 1, 122 [556].

110 As noted above n 23, *Corporations Act* s 1317L directs courts to apply the rules of evidence and procedure applicable to civil matters in civil penalty proceedings.

111 The appellants had invoked analogy from criminal procedure that a prosecutor should call material witnesses, rather than direct application of the principle, in recognition of s 1317L.

112 (2003) 179 FLR 1, 151 [678].

113 *Morley* (2010) 274 ALR 205, 330 [685].

The focus of this court's attention, by reason of s 1317L [of the *Corporations Act*] should not be on whether the principles of criminal procedure apply ... The focus should be to identify the particular content of the principles of civil procedure that apply.¹¹⁴

Nonetheless, in seeking to determine the content of the *civil* evidential and procedural rules that apply in civil penalty cases, here the principles of a fair trial, the Court in *Morley* ultimately defaulted to criminal, instead of civil, process values at the expense of the overarching regulatory rationale of part 9.4B and direction contained in section 1317L. This occurred because the Court was heavily influenced by the fact that a public authority like ASIC, charged with enforcement of the corporations legislation,¹¹⁵ has considerable powers¹¹⁶ so that it 'cannot be regarded as an ordinary civil litigant when it institutes proceedings',¹¹⁷ particularly in the context of the civil penalty regime. In addition, it was the important public interest dimension of ASIC's special role as regulator,¹¹⁸ that led the Court to hold ASIC to a higher standard of fairness than that owed by other civil litigants. In concluding that Robb should have been called, the Court declared:

A body in the position of ASIC, owing the obligation of fairness to which it was subject, was obliged to call a witness of such central significance to critical issues that had arisen in the proceedings. The scope of its powers and the public interest dimensions of its functions ... was such that resolution of the civil penalty proceedings required it to call ... a witness of such potential importance.¹¹⁹

The Court had also said:

The failure to call Mr Robb means more than a disinclination to draw inferences favourable to ASIC's case. Failure of a party with the onus of proof to call an available and important witness, the more so if the failure is in breach of the obligation of fairness, counts against satisfaction on the balance of probabilities.¹²⁰

4 *Hellicar*

The High Court in *Hellicar*¹²¹ was scathing in its rejection of the proposition put forward in *Morley* that to discharge its duty of fairness in civil penalty

114 Ibid 332 [696].

115 See *ASIC Act* s 1(2).

116 See *Morley* (2010) 274 ALR 205, 337–9 [723]–[727], where the Court lists the powers conferred on ASIC to enable it to fulfil its special enforcement role under the legislative scheme. Those powers include examination of persons, production of documents, and the power to require a person to give all reasonable assistance to ASIC in an application for a declaration of contravention or a pecuniary penalty order.

117 Ibid 339 [728]. While ASIC has some powers 'equivalent to a civil litigant seeking compensation', the Court concluded that 'the full range of ASIC's enforcement powers goes well beyond anything available to a civil litigant': at 337 [724].

118 Ibid 336 [719]–[721]. The Court highlighted that 'ASIC was created to administer the laws of the Commonwealth [relevantly with respect to the corporations legislation] ... it is conduct which, by reason of the significance of corporations in Australian commercial life, is of a broader public interest.'

119 Ibid 347 [775].

120 Ibid 350 [794]–[795] (citations omitted).

121 (2012) 247 CLR 345, 406 [147] (French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ), 434 [237] (Heydon J).

proceedings, ASIC was obliged to call all witnesses of material significance. In relation to the consequences that the Court of Appeal attributed to the failure to call Robb, it stated:

If there was such a duty [to call Robb] ... it would be expected that the remedy for breach of the duty would lie either in concluding that the primary judge could prevent the unfairness by directing ASIC to call the witness or staying proceedings until ASIC agreed to do so or, if the trial went to verdict, in concluding that the appellate court should consider whether there was a miscarriage of justice that necessitated a retrial. But no solution to the hypothesised unfairness could be found by requiring that the primary judge or an appellate court apply some indeterminate discount to the cogency of whatever evidence was called in proof of ASIC's case. This would seem to be no more than an attempt to 'punish' a regulatory authority by denying it the relief it seeks.¹²²

In a separate but concurring judgment,¹²³ Heydon J was also scathing in his rejection of the respondents' case that the minute recording, tabling and approval of the draft announcement was false and that the minutes were demonstrably wrong in other respects:

This suggests a further unreality in the respondents' case. If there had been no resolution approving an ASX announcement, that fact would have been known to all persons present. The respondents' case assumes that management and Mr Robb, after seeking to comply with the ASX Listing Rules by issuing the Final ASX Announcement, realised that the board had not approved it. Management, on that case, then fabricated a minute recording a resolution, in the sense of adopting the resolution stated in the pre-meeting draft documents, which had no basis in fact. That was an extremely risky fabrication, for it assumed that no-one on the board would read the minutes before approving them, or that all directors would forget that they had not approved *one of the most important announcements in the company's history*.¹²⁴

The *Hellicar* decision thus vindicates the position ASIC took all along in the James Hardie matter. To quote former Supreme Court judge and Minter Ellison consultant, Robert Austin, the *Hellicar* decision also 'removes the discouragement that ASIC would have felt about civil penalty proceedings'¹²⁵ if it had to call all material witnesses to discharge its duty of fairness which *Morley* had imposed on it. This duty was higher than that imposed on any ordinary civil litigant.

5 *Gillfillan*

However, *Hellicar* was not the end of the story. The High Court referred the matter of penalties back to the New South Wales Court of Appeal. Unfortunately, the Court of Appeal in *Gillfillan* reduced the original penalties on the Hardie directors.¹²⁶ As a result, it is arguable that not only have civil penalties failed to secure an effective enforcement outcome in the Hardie matter, but the imposition

122 Ibid 408 [155] (French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ).

123 Ibid 459 [303].

124 Ibid (emphasis added).

125 Hannah Low and Alex Boxsell, 'Hardie Ruling Raises Bar for Directors', *The Australian Financial Review* (Sydney), 4 May 2012, 1, 14.

126 As noted above n 7.

of modest or no penalties by the courts in serious cases, as has occurred recently in some other high profile matters,¹²⁷ raises concerns about the future use of civil penalties as a credible enforcement response. In the wake of the recent scandal that unfolded in October 2013 concerning construction firm Leighton Holdings – one of Australia's largest companies – over claims of paying kickbacks to Iraqi officials in return for lucrative contracts from the Iraqi regime and the obvious comparisons drawn between it and AWB, it is interesting that these comments have been made about the deterrence value, or rather the lack thereof, of the AWB case:

It was a bit of a deterrent, but if you think about it, the only financial losses that were suffered were a couple of directors of AWB, the former chief executive [Lindberg] and the former chief finance officer [Ingleby], who suffered penalties of \$100 000 and \$40 000 respectively, which in the general scheme of corporate salaries is not ... a [big] deterrent.¹²⁸

The courts must also, therefore, on finding a contravention be prepared to not only impose civil penalties, but impose them at an appropriate level so that they will have deterrent value and deliver moral approbation.¹²⁹ Another issue deserving attention is the need for more consistency.¹³⁰ It is acknowledged that ultimately, the imposition of civil penalties and the level of its severity are matters of judicial discretion and are based on the facts of each case. Yet, it is puzzling, for instance, that Vizard was penalised \$390 000 (\$130 000 for each breach of director's duty),¹³¹ when JHINV was only penalised \$80 000 for conduct that 'demonstrated a significant disregard for honesty and transparency and a subjective willingness to interpret its statutory obligations to suit its own corporate purposes.'¹³²

127 See, eg, *Healey [No 2]* (2011) 196 FCR 430 (Middleton J); *Lindberg* (2012) 91 ACSR 640 (Robson J); *Ingleby* [2013] VSCA 49 (Weinberg and Harper JJA, Hargrave AJA), discussed above n 67–8.

128 ABC Television, 'Leighton Insider Reveals New Evidence in Corruption Claims', *The 7.30 Report*, 3 October 2013 (Stephen Bartos). Bartos is an expert in corporate governance with economic consultancy ACIL Tasman and a former secretary in the Finance Department. He also went on to opine that ASIC should have launched criminal prosecutions against those responsible for the AWB bribery. However, this is a separate issue, which is beyond the scope of this article. But see above n 22.

129 Although the decision not to institute criminal proceedings and to bring only civil penalty proceedings against celebrity businessman Stephen Vizard for contraventions of s 232(5) of the *Corporations Law* (now *Corporations Act* s 183) when he was a director of Telstra Corporation has been criticised: see, eg, Golding and Steinke, above n 39, 27; these considerations were pivotal to Justice Finkelstein's decision in *Vizard* (2005) 145 FCR 57, 67–9 to impose a 10 year disqualification order on him and an order to pay \$390 000 in pecuniary penalties.

130 This is notwithstanding that the courts have developed guidelines for determining civil penalties: see, eg, *Re HIH Insurance Ltd (in prov liq)*; *ASIC v Adler* (2002) 42 ACSR 80, 97–9 (Santow J) regarding disqualification orders.

131 As noted above n 129. Vizard was found to have improperly used secret boardroom information to trade in three listed companies in which Telstra Corporation had an interest. Even though he did not actually make a profit as a result of his insider trading activities, the Court considered that his conduct was 'both dishonest and a gross breach of trust': see *Vizard* (2005) 145 FCR 57, 67–8 (Finkelstein J).

132 See *James Hardie Industries NV v ASIC* (2010) 274 ALR 85, 204 [575] (Spigelman CJ, Beazley and Giles JJA). The New South Wales Court of Appeal in this case not only dismissed the appeal JHINV had made against liability, but also criticised ASIC for not having appealed against what it said was a 'light' penalty for such conduct: see at 204 [577].

Hellicar, of course, is also not sufficient to secure the proper role of civil penalties in the regulatory process. The reason for this is that, while *Hellicar* has removed one obstacle, all of the other evidential and procedural hurdles that have developed in the case law remain. These problems are due to the courts providing heightened procedural protections for defendants in spite of section 1317 of the *Corporations Act* (to apply the rules of evidence and procedure applicable to civil matters in civil penalty proceedings).¹³³ The courts' difficulty with applying civil evidence and procedure rules in such proceedings appears to be attributable to two related factors regarding the nature of civil penalties.¹³⁴

V THE NATURE OF CIVIL PENALTIES

A A Statutory Remedy: A Product of Regulatory Law

The first factor is that, unlike actions in civil and criminal law,¹³⁵ civil penalties in part 9.4B of the *Corporations Act* are a statutory remedy, a product of regulatory law, which were developed as part of a 'pyramid of enforcement' model focused on compliance.¹³⁶ As such, arguably civil penalties do not mesh easily with the older principles of civil and criminal law.¹³⁷

The courts have recognised that civil penalties are a product of regulatory legislation,¹³⁸ including the Court of Appeal in *Morley* (which cited the author's work) when it examined the legislative history of part 9.4B and the reasons for enacting a civil penalty regime.¹³⁹ It explained that the provisions of part 9.4B

were based expressly on the need to establish an enforcement mechanism of intermediate severity between civil proceedings for compensation and criminal proceedings that could lead to criminal sanctions. This approach, referred to as 'strategic regulation theory', is often expressed in terms of the visual metaphor of a 'pyramid' of enforcement sanctions, namely, that sanctions escalate as contraventions become more serious.¹⁴⁰

¹³³ See *Corporations Act* s 1317L, discussed above n 23.

¹³⁴ This is a point the author has made in some earlier work: see, eg, Comino, 'The Civil Penalty Problem', above n 26, 810. What follows builds on and updates it.

¹³⁵ See Mann, above n 49, 1799. After noting that civil and criminal law are the two basic paradigms that constitute the doctrinal foundation for the whole field of sanctioning law, Mann explains:

within this paradigmatic framework the criminal law is distinguished by its punitive purposes, its high procedural barriers to conviction, its concern with the blameworthiness of the defendant, and its particularly harsh sanctions. In contrast, the civil law is defined as a compensatory scheme, focussing on damage rather than on blameworthiness, and providing less severe sanctions and lower procedural safeguards than the criminal law.

¹³⁶ See discussion above nn 56–9.

¹³⁷ See Comino, 'The Civil Penalty Problem', above n 26, 811, agreeing with Spender, above n 40, 250, 258. See also Mann, above n 49, 1813.

¹³⁸ See, eg, *Rich v ASIC* (2003) 203 ALR 671, 688 [100] (Spigelman CJ, Ipp and McColl JJA).

¹³⁹ (2010) 274 ALR 205, 331–2 [692]–[694]. The Court referred to Comino, 'Civil or Criminal Penalties for Corporate Misconduct', above n 71, 428; Comino, 'The Challenge of Corporate Law Enforcement', above n 22, 233.

¹⁴⁰ *Morley* (2010) 274 ALR 205, 331 [692].

However, with Spigelman CJ in *Morley* proceeding to apparently find the ‘enforcement pyramid’ an unhelpful metaphor as opposed to a deliberate legislative policy,¹⁴¹ it seems that when resolving disputes about procedure in civil penalty proceedings, judges are not always willing to ensure that approaches based on older ideas of criminal and civil law should give way to regulatory innovation. This is in contrast to the way that Kirby J in his dissent in *Rich*¹⁴² reasoned when he refused to extend the operation of the common law penalty privilege. Justice Kirby said that the majority of the High Court’s ruling¹⁴³ that the penalty privilege is available in civil penalty proceedings¹⁴⁴ was ‘out of harmony with the introduction of a “pyramid” of statutory responses’¹⁴⁵ and warned that the Court ‘should avoid superimposing on the graduated pyramid of sanctions and remedies any over-simplification inherent in past common law and equitable principles.’¹⁴⁶

B Civil Penalties: A ‘Hybrid’ between the Civil and Criminal Law

The second factor that has contributed to the courts’ difficulty with applying the rules of evidence and civil procedure applicable in civil penalty proceedings pertains to the ‘hybrid’ nature of civil penalties, which have been described as ‘punitive civil sanctions’.¹⁴⁷ From his research on civil penalties in the US, Mann comments that:

With more punishment meted out in civil proceedings, the features distinguishing civil from criminal law become less clear. As civil law becomes more punitive, serious doubt arises about whether conventional civil procedure is suited for an unconventional civil law.¹⁴⁸

Middleton has made similar observations about civil penalty proceedings under Australian corporations legislation. He states that with civil penalty proceedings for pecuniary penalty orders (under section 1317G of the *Corporations Act*) and disqualification orders (under section 206C of the *Corporations Act*) being punitive in nature,¹⁴⁹ the distinction between the purpose of civil penalty proceedings and criminal proceedings is ‘not an easy one to make.’¹⁵⁰ He also notes the following similarities between civil penalty and criminal proceedings:

141 See *ibid* 332 [693], where his Honour noted that the judiciary has cautioned against using metaphors like ‘pyramid’ and that ‘[m]etaphors in law are to be narrowly watched, for starting as devices to liberate thought, they often end by enslaving it’ (citations omitted).

142 *Rich* (2004) 220 CLR 129, 172.

143 *Ibid* 147–8 (Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ), 157 (McHugh J).

144 But see *Corporations Act* s 1349 discussed in detail below nn 167–8.

145 *Rich* (2004) 220 CLR 129, 172.

146 *Ibid*.

147 See especially Mann, above n 49, 1798. See also John C Coffee Jr, ‘Paradigms Lost: The Blurring of the Criminal and Civil Law Models – and What Can Be Done about It’ (1992) 101 *Yale Law Journal* 1875.

148 Mann, above n 49, 1798.

149 See discussion below n 167.

150 Middleton, *ASIC Corporate Investigations and Hearings*, above n 40, [8.1380].

both are concerned with alleged contraventions of public law, the protagonists (ASIC and the Commonwealth DPP) are Commonwealth agencies, and the defendants are subjects of the Crown. ASIC (in the context of civil penalty proceedings), like the Commonwealth DPP, is the guardian of the public interest with an obligation to ensure that justice is done. In addition, ASIC and the Commonwealth DPP both have vast resources in comparison to the defendants.¹⁵¹

The author does not agree that ASIC has vast resources, especially in civil penalty cases against powerful and well-resourced defendants (large corporations and their directors and officers), where, if anything, the resources of ASIC are likely to be more constrained.¹⁵² However, the point is that, due to the special role of ASIC as regulator and ‘model litigant’, coupled with the fact that a civil penalty case is a civil action that may result in the imposition of penalties on the defendant, it is not difficult to appreciate why courts have resolved issues about proper procedures in civil penalty proceedings by reference to criminal, rather than civil, procedural frameworks, as happened in *Morley*.¹⁵³ Courts have been particularly concerned about deprivations of due process in such cases. According to Spender, it is ‘endemic to the judicial power and function to be zealous about fair procedure.’¹⁵⁴ She goes on to argue that, ‘[z]ealousness about fair procedure has led to the development of a gold standard [in civil penalty proceedings] which belongs to the criminal law rather than the negotiated standard which is characteristic of civil proceedings.’¹⁵⁵

VI OTHER PROBLEMS WITH CIVIL PENALTY PROCEEDINGS

A The *Rich* Case and the Penalty Privilege

Certainly, this approach is evident in the way that the majority of the High Court in the *Rich* case dealt with the penalty privilege issue. As a consequence of the Court refusing, *in limine*, to order discovery on the ground of the penalty

151 Ibid. Middleton also refers to *ASIC v Rich* (2009) 236 FLR 1, 117 [533].

152 As with all public authorities, ASIC operates in a limited resource environment, which means that it faces the challenge of balancing its statutory objectives as corporate regulator in s 1(2) of the *ASIC Act* with its limited resources. Taking action ‘to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it’ is only one of the six objectives listed: *ASIC Act* s 1(2)(g). It is also interesting that the Government in recent years has seen the need to provide ASIC with additional funding to enable it to cope better with corporate wrongdoers whose access to financial resources is such that ASIC has found it difficult to deal with them in an effective way. In the May 2003 Budget, for example, substantial funds were provided for enforcement in the HIH matter to take forward the work arising from the HIH Royal Commission: see ASIC, *Annual Report 2002–03* (2003) 47. See also Roman Tomasic, ‘The Challenge of Corporate Law Enforcement: Future Directions for Corporate Law in Australia’ (2006) 10 *University of Western Sydney Law Review* 1, 5.

153 See especially above nn 116–19 and accompanying text.

154 Spender, above n 40, 249.

155 Ibid.

privilege,¹⁵⁶ ASIC's task in its proceedings against former One.Tel directors, Rich and Silbermann, had become more difficult than originally envisaged. Evidence of this is the protracted nature of the proceedings, which were characterised by delays and were the subject of multiple procedural challenges.¹⁵⁷ A further two years then elapsed before Austin J handed down his judgment.¹⁵⁸ Unsurprisingly, ASIC suffered a humiliating loss in 2009 when Austin J in *ASIC v Rich* dismissed the proceedings against Rich and Silbermann. In his judgment, Austin J recognised the problems that the ruling in *Rich* on the penalty privilege had caused not only for ASIC in the presentation of its case at the trial, but also the court's management of the trial, and preparation of his judgment, as well as, it having added significantly to the length of the hearing and to the length of some periods of adjournment.¹⁵⁹

According to Austin J, those problems included 'that although the court and ASIC had the defendants' Defences, they did not have anything that would indicate the nature or content of the defendants' evidentiary case,'¹⁶⁰ which meant, for instance, that 'ASIC had been unable to prepare evidence to meet the defendants' evidence before the trial.'¹⁶¹ Additionally, '[w]hen there were glimpses of what the defendants' evidentiary case might be, revealed during the course of cross-examination of ASIC's witnesses, ASIC had to consider whether its evidence was adequate to meet what was likely to come from the defendants.'¹⁶² The penalty privilege also led to some substantial gaps in the hearing timetable, which Austin J said occurred, for example, when the defendants relied on the privilege and did not indicate whether they would give evidence until after ASIC closed its case in chief. They then sought, and were granted, 'a substantial adjournment for the purpose of preparing their evidence.'¹⁶³ His Honour discussed another gap of around four months, which occurred between when ASIC closed its case on 9 February 2006 and the commencement of the oral hearing of the defendants' case on 13 June 2006. This is in contrast to '[t]he more usual practice in the Equity Division, in a case where

156 (2004) 220 CLR 129, 147–8 (Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ), 157 (McHugh J). The penalty privilege is a procedural rule that requires a plaintiff to prove their case without the assistance of the defendant: *The Daniels Corporation International Pty Ltd v ACCC* (2002) 213 CLR 543, 559 (Gleeson CJ, Gaudron, Gummow and Hayne JJ). For a fuller discussion of this privilege and the argument that judgments concerning the penalty privilege often confuse it with the privilege against self-incrimination, which unlike the penalty privilege is a 'substantive rule of law': *Reid v Howard* (1995) 184 CLR 1, 11; see especially Spender, above n 40, 249, 252–3.

157 Following the appeal by Rich and Silbermann to the High Court in *Rich*, the trial before Austin J in the New South Wales Supreme Court resumed in September 2004. However, the hearing of the substantive issue against these defendants took until August 2007 before it was completed. This was because Austin J was required to make over 60 separate rulings on procedural points: see *ASIC v Rich* (2009) 236 FLR 1, 22, 29 (Austin J).

158 See *ibid* 29–30.

159 (2009) 236 FLR 1, 26–8.

160 *Ibid* 26.

161 *Ibid*.

162 *Ibid* 26–7.

163 *Ibid* 27.

there is no penalty privilege and affidavits are exchanged before the hearing.¹⁶⁴ There, ‘the defendants go into evidence immediately after the plaintiff’s case is closed, or perhaps after a short break,’¹⁶⁵ which led Austin J to conclude that ‘it seems to me that this substantial gap was very much tied up with the penalty privilege.’¹⁶⁶

Since the *Rich* case, Parliament has introduced section 1349 of the *Corporations Act* to remove the penalty privilege in relation to proceedings involving disqualification.¹⁶⁷ This restores the position for ASIC that existed prior to *Rich* by abrogating both the penalty privilege and resulting ‘use’ evidential immunity in proceedings when it is applying for a disqualification order.¹⁶⁸ However, the evidential and procedural problems resulting from the penalty privilege remain for ASIC in proceedings when ASIC is seeking other civil penalty sanctions, most notably proceedings for a pecuniary penalty.¹⁶⁹ This is because proceedings for pecuniary penalties under section 1317G of the

164 Ibid 28.

165 Ibid.

166 Ibid.

167 Prior to the *Rich* case, disqualification proceedings were classified as ‘protective’, rather than ‘penal’ in nature. As such, disqualification proceedings did not fall within ‘proceedings for the imposition of a penalty’ under s 68(3)(b) of the *ASIC Act* or attract ‘use’ evidential immunity in ss 68(3) and 76(1)(a) where the penalty privilege was claimed (in accordance with the requirements of s 68(2) of that *Act*). Section 1349 of the *Corporations Act* was introduced to address the specific problem that, as a result of *Rich*, disqualification proceedings were then classified as ‘proceedings for the imposition of a penalty’ in terms of s 68(3) of the *ASIC Act*. This meant that ‘use’ evidential immunity under ss 68(3) and 76(1)(a) could operate in such proceedings provided the requirements of s 68(2) were complied with. See further Tom Middleton, ‘The High Court’s Decision in *Rich v ASIC* [2004] HCA 42 and Its Potential Impact upon ASIC’s Disqualification Orders, Banning Orders and Oral Examination’ (2005) 23 *Company and Securities Law Journal* 248.

168 As Tom Middleton, ‘The Privilege against Self-incrimination, the Penalty Privilege and Legal Professional Privilege under the Laws Governing ASIC, APRA, the ACC and the ATO – Suggested Reforms’ (2008) 30 *Australian Bar Review* 282, 315–16, has noted:

Section 1349(1) and (3) [of the *Corporations Act*] provide that a person is not entitled to refuse to comply with a requirement to answer a question, or give information, or to produce a book or any other thing, or to do any act whatever, on the ground that those requirements might tend to make that person liable to a penalty by way of a disqualification order or a banning order or a specified range of other cancellation or suspension orders. Section 1349 applies to all requirements to provide information made in the context of civil or criminal proceedings and to administrative proceedings before a tribunal (including ASIC) that arise out of the *ASIC Act* or *Corporations Act*. Section 1349 applies to all requirements to provide information in the context of ASIC’s investigative powers ... Section s 1349(4) of the *Corporations Act* makes it clear that the ‘use’ evidential immunity afforded by s 68(3)(b) of the *ASIC Act* does not apply where ASIC is seeking a disqualification order from the court or where ASIC is seeking to impose an administrative disqualification order or banning order. Accordingly, [even] where examinees claim the penalty privilege before they make self-incriminating statements that may expose them to a penalty (by way of a judicial or administrative disqualification order or an administrative banning order) at an ASIC oral examination, those statements are admissible against them in any subsequent proceedings for such orders.

169 According to Middleton, defendants may also be able to claim the penalty privilege in non-punitive civil penalty proceedings for a statutory compensation order in situations where there is a real risk that they may give evidence in those proceedings that could expose them to a penalty in subsequent punitive civil penalty proceedings or criminal proceedings: Middleton, *ASIC Corporate Investigations and Hearings*, above n 40, [8.1520], [8.1800], citing *One.Tel (in liq) v Rich* (2005) 190 FLR 443, 464 [77].

Corporations Act have always been treated by the courts as penal in nature and have always been proceedings ‘for the imposition of a penalty’ in terms of section 68(3)(b) of the *ASIC Act* and thereby attracted the penalty privilege and ‘use’ evidential immunity.¹⁷⁰ It is incongruous that disqualification orders and pecuniary penalty orders (both being penal in nature) are given differential treatment under the legislation referred to above in terms of the operation of the penalty privilege and ‘use’ evidential immunity. For this reason, if Parliament fails to heed the call to enact legislation that will settle the procedures to be adopted in civil penalty proceedings,¹⁷¹ it should at least make reforms that standardise the operation of the penalty privilege. It is suggested that those reforms should not permit the penalty privilege to be raised where ASIC is pursuing a civil penalty – either a pecuniary penalty or disqualification – but preclude ASIC from taking criminal action against these defendants.¹⁷²

In any event, law reform is crucial, because defendants being able to claim the penalty privilege can cause significant problems which can occur at different stages of case management, including pre-trial discovery and filing of evidence before ASIC closes its case,¹⁷³ as evidenced in ASIC’s ill-fated case against Rich and Silberman, and recognised by Austin J in *ASIC v Rich*. Indeed, much of the case law on civil penalties that has developed since 2000 concerns disputes regarding the operation of the penalty privilege.

Such cases include *Macdonald*,¹⁷⁴ *ASIC v Mining Projects Group Ltd*¹⁷⁵ and more recently, the Queensland Court of Appeal decision in *Anderson*.¹⁷⁶ These cases deal with procedural disputes about the proper scope of disclosure in a defence to a civil penalty action. They arose at the interlocutory stage of the proceedings and arguably demonstrate the adoption of the criminal, rather than civil, procedure model of disclosure and the resulting complication of ASIC’s case.¹⁷⁷ Unlike civil procedure, where modern court rules require disclosure of case strategy and evidence through pleadings based on the ‘policy of the

170 See Middleton, *ASIC Corporate Investigations and Hearings*, above n 40, [14.1900], [14.1950].

171 See above n 47 and accompanying text.

172 But see Middleton, ‘The Privilege against Self-incrimination’, above n 168, 296, for a different view of suggested reforms to standardise the law in this area. If this course was followed, Parliament would also have to enact individual reforms to the relevant regulatory legislation governing civil penalty proceedings initiated by other regulators who have the power to bring such proceedings.

173 The consequence of defendants not being required to file witness statements prior to trial on the ground of the penalty privilege is well recognised: see, eg, *ACCC v Amcor Printing Papers Group Ltd* (1999) 163 ALR 465; *ASIC v Plymin* (2002) 4 VR 168; *ACCC v FFE Building Services Ltd* (2003) 130 FCR 37.

174 (2007) 73 NSWLR 612 (Spigelman CJ, Mason P and Giles JA). As noted earlier, the defendant, Macdonald, was the former Hardie CEO.

175 (2007) 164 FCR 32 (Finkelstein J) (*‘Mining Projects’*).

176 [2013] 2 Qd R 401 (Holmes and White JJA and McMurdo J).

177 See Comino, ‘The Civil Penalty Problem’, above n 26, 821; Spender, above n 40, 258, who make this argument about the earlier cases *Macdonald* and *Mining Projects*.

prevention of surprise',¹⁷⁸ criminal procedure is founded on 'the accused's right to silence' so that 'disclosure is either non-existent or minimal'.¹⁷⁹

This difficulty is well illustrated by an analysis of the *Anderson* case, since McMurdo J, who delivered the lead judgment (and with whom Holmes and White JJA agreed), considered the *Macdonald* and *Mining Projects* cases.¹⁸⁰ In *Anderson*, the Court allowed the appeal from the decision of the trial judge (*ASIC v Managed Investments Ltd [No 3]*)¹⁸¹ and relieved the appellants/defendants from a number of the pleading rules in the *Uniform Civil Procedure Rules 1999* (Qld) ('UCPR') to ensure that their privileges against exposure to penalty and self-incrimination were not compromised.¹⁸²

The appeal in *Anderson* arose in this way. After ASIC commenced civil penalty proceedings in 2009 seeking relief against three corporations and five individual defendants, including the imposition of pecuniary penalties for contraventions of the *Corporations Act*,¹⁸³ ASIC made an application for orders striking out various paragraphs of the defences of the individual defendants. This raised the question of the extent to which the requirements of the UCPR for the pleading of a defence must be varied in proceedings that attract the penalty privilege and privilege against self-incrimination.¹⁸⁴

The trial judge, Fryberg J, had found that the operation of the pleading rules was qualified to permit a proper claim for either privilege.¹⁸⁵ However, his Honour recognised very limited qualifications and ordered that the defendants had to file defences which complied with the rules subject only to those qualifications.¹⁸⁶ His Honour accepted that where the UCPR would require the admission of a fact alleged in the statement of claim, because the defendant believed it to be true, the defendants should be allowed to claim the privilege concerning the allegation instead of admitting it and ruled that such a claim would override any deemed admission under rule 166(1).¹⁸⁷

Justice Fryberg recognised another possible qualification to the rules, where there was a denial or non-admission pleaded in a defence. Rule 166(4) requires a denial or non-admission to be accompanied by an explanation for the defendants'

178 Spender, above n 40, 250, citing Tom Middleton, 'The Difficulties of Applying Civil Evidence and Procedure Rules in ASIC's Civil Penalty Litigation' (2003) 21 *Company and Securities Law Journal* 507, 511.

179 Ibid.

180 See also Comino, 'The Civil Penalty Problem', above n 26, 821–7, for a more detailed discussion of these cases.

181 (2012) 88 ACSR 139 (Fryberg J) ('*Managed Investments Ltd [No 3]*').

182 *Anderson* [2013] 2 Qd R 401, 407 [20]–[21].

183 ASIC alleged that the corporations had breached s 601FC(5) of the *Corporations Act* by applying funds for the benefit of related parties rather than for the purposes of a managed investment scheme. It also alleged that the individual defendants (David Anderson, Craig White, Michael King, Marilyn Watts and Guy Hutchins) had been directors or officers of the corporations or other relevant entities at the time of the contraventions and that they breached ss 209(2), 601FC and 601FD: ibid 403 [6]–[7].

184 Ibid 403 [15].

185 *Managed Investments Ltd [No 3]* (2012) 88 ACSR 139, 143 [15]–[16].

186 Ibid.

187 Ibid 145 [21].

belief that the allegation is untrue or cannot be admitted. Otherwise, the allegation is deemed to be admitted: rule 166(5). Even though a claim for privilege in relation to the provision of such an explanation had not been pleaded, his Honour recognised the theoretical possibility that having to provide the explanation for a non-admission or denial could infringe the penalty privilege or privilege against self-incrimination.¹⁸⁸

The individual defendants appealed to the Court of Appeal, arguing that the outcome would compromise the benefit of each privilege. They submitted that a pleading in line with the orders made by Fryberg J would reveal a defendant's belief as to the truth or falsity of each allegation in ASIC's case, or (in the case of non-admissions) a defendant's uncertainty as to its truth. The operation of the privileges would be prejudiced by this disclosure of their states of mind. In particular, it was said that ASIC would gain an unfair forensic advantage by knowing which parts of its case would ultimately not be seriously challenged. Further, it was argued that a defendant making a non-admission would reveal their unawareness of a fact, where that lack of knowledge might be relied upon by ASIC to advance its case, by it saying that the defendant should have been aware of the fact at the time of the relevant events.¹⁸⁹

After McMurdo J set out the content and the relevant legal principles governing the operation of the penalty privilege and privilege against self-incrimination,¹⁹⁰ his Honour stated that '[t]he tension between these privileges and modern procedural rules for civil proceedings, more specifically the *UCPR*, is immediately apparent'.¹⁹¹ Special attention was paid to the purpose of the rules in rule 5 (to facilitate the just and expeditious resolution of the real issues in civil proceedings at minimum expense and that a party impliedly undertakes to the court and to the other parties to proceed in an expeditious way)¹⁹² and the requirements for the pleading of a defence: rules 165 (answering pleadings), 166 (denials and non-admissions) and 167 (unreasonable denials and non-admissions).¹⁹³

Justice McMurdo then went on to discuss the potential ways in which his Honour regarded that the operation of the privilege could be affected by the orders made by Fryberg J. In the first place, there is the use which might be made

188 Ibid 148 [37].

189 As noted by McMurdo J: *Anderson* [2013] 2 Qd R 401, 409 [25].

190 Ibid 405–8 [15]–[22]. Even though McMurdo J recognised that the two privileges are distinct, his Honour said they are similar. As such, the author agrees with the argument noted above n 156, that 'the penalty privilege has not been properly conceptualised in the case law,' where it has often been regarded as 'a weak form' of the privilege against self-incrimination, thus inviting courts 'to interpolate the penalty privilege into the ... framework of the criminal rather than the civil law.': Spender, above n 40, 252.

191 Ibid 408 [23].

192 Ibid. Justice McMurdo continued that:

The 'real issues' in this sense are those for which there could be a genuine dispute and the rules for pleading operate to confine a case to them. They prevent a defendant from contesting an allegation which the defendant believes to be true. They require a defendant to make reasonable inquiries about the truth of an allegation if it is not to be admitted.

193 Ibid 408–9 [24].

of a defendant's response to an allegation by claiming the privilege. Justice McMurdo said that the response could found an inference, as against the defendant, that the allegation was true, at least if the alleged fact was something of which the defendant had direct knowledge. This was because the privilege could be claimed only where the defendant would otherwise have to admit the allegation.¹⁹⁴

Noting that the issue of whether a claim for privilege could be tendered as an admission was not fully argued,¹⁹⁵ McMurdo J preferred not to express a firm view on this point. However, his Honour said that the claim for privilege could arguably provide assistance in the ultimate proof of ASIC's case. For instance, if a defendant gave evidence which was inconsistent with the allegation for which the claim of privilege was made, the pleaded claim could be used to discredit the defendant in cross-examination so that in that way, a defendant might be compelled to provide a pleading which ultimately helped ASIC to prove its case.¹⁹⁶

Justice McMurdo also considered that there were potential consequences when a defendant pleaded a non-admission. His Honour noted that under rules 166(3)(a)–(b), a defendant may plead a non-admission only if the defendant has made inquiries which are reasonable inquiries having regard to the time limited for a defence. Further, under rule 166(6), a party making a non-admission is obliged to make any further inquiries that may become reasonable and to amend the pleading appropriately. If a party fails to comply with these obligations, the non-admission is susceptible to being struck out. In that event, the allegation made by the plaintiff is taken to be admitted: rule 166(1).¹⁹⁷ While McMurdo J said that these conditions upon the ability to contest an allegation are 'entirely appropriate in modern civil procedural rules', which are aimed at limiting the litigation to what rule 5 refers to as the 'real issues',¹⁹⁸ they were hard to reconcile with the relevant privileges, which in the case of the penalty privilege means that a plaintiff should prove its case without the assistance of the defendant.¹⁹⁹ His Honour pointed out that:

A defendant might fail to make the required inquiry by choice, by inadvertence or perhaps, because of a lack of means. Where there is a failure to inquire for any of these reasons, the consequence is that part of the plaintiff's case is established by the defendant's own conduct, rather than by evidence adduced by the plaintiff. Should that occur here, the defendant by his or her omission to inquire would assist in the proof of ASIC's case.²⁰⁰

194 Ibid 409–10[27].

195 Ibid 410–11 [30].

196 Ibid 411 [30]–[31].

197 Ibid 411 [32].

198 Ibid. See also as noted above n 192.

199 Ibid. See also above n 156.

200 Ibid.

Having identified a number of other pleading rules that could be potentially relevant, but which did not appear to have been considered by the trial judge,²⁰¹ McMurdo J also thought that compliance with these rules by the defendants could provide information that could lead ASIC to other evidence which could be used to prove the case against them.²⁰² His Honour was, therefore, prepared to make a specific order to the effect that a defendant was excused from compliance with these rules if to do so would expose the defendant to a civil penalty or tend to incriminate him or her.²⁰³

On the important issue of whether these privileges might be prejudiced by requiring any form of ‘positive’ defence to be pleaded,²⁰⁴ McMurdo J noted the different approaches taken in *Mining Projects* and *Macdonald*. Justice Finkelstein in *Mining Projects* said that:

There is a potential problem if ... a defendant wishes to run a positive case. Ordinarily a positive case must be raised in the defence. Whether it must be raised in a defence in a civil action to recover a penalty is by no means clear. The view I favour is that there is no such requirement as it would be inconsistent with the privilege. On the other hand, if a defendant who wishes to run a positive case is required to plead his case that can be accommodated while maintaining the privilege. What should occur is that the defendant should be entitled to rely on the privilege until the plaintiff’s case is concluded. If at that point the defendant decides to run a positive case he can deliver an amended defence ... In an exceptional case the judge may grant a short adjournment to allow the plaintiff time to prepare, if he is taken by surprise. In most cases that will not be necessary. By the time the plaintiff has closed his case the nature of the defence will usually be apparent.²⁰⁵

However, Mason P (with whom Giles JA agreed) in *Macdonald* considered that not every form of positive defence might detract from the penalty privilege and that there was nothing wrong with a pleading in the following form:

If, which is denied, the matters alleged in para X [of the Statement of Claim] constitute a contravention of s Y of the *Corporations Law*, the defendant says that the matters alleged by ASIC also establish that the plaintiff relied upon

201 Those rules were *UCPR* r 149(1)(b) which requires a pleading to contain a statement of all the material facts on which the party relies; r 149(1)(c) which requires a pleading to state any matter that, if not stated specifically, may take another party by surprise; r 150(4)(c) which imposes the same obligation upon the pleader of a defence; r 150(1)(k) which requires to be pleaded any motive, intention or other condition of mind, including knowledge or notice; r 150(2) which requires that any fact from which a matter in sub-r (1) is to be inferred should also be specifically pleaded; r 157 which requires a party to include in a pleading such particulars as are necessary to define the issues and to prevent surprise at the trial and to support a matter specifically pleaded under r 150.

201 [2013] 2 Qd R 401.

202 Ibid 412 [34].

203 Ibid [35].

204 This includes the business judgment rule in s 180(2) of the *Corporations Act* and the defence of reasonable reliance in s 189, as well as an application for relief from liability made pursuant to ss 1317S and 1318.

205 (2007) 164 FCR 32, 37–8. The author has previously made the point that she does not share Justice Finkelstein’s confidence that in most cases, ASIC will not require an adjournment, given the difficulties ASIC faced in dealing with Rich and Silbermann in the One.Tel matter. See also Comino, ‘The Civil Penalty Problem’, above n 26, 823.

information or professional or expert advice (etc)/acted honestly (etc). The defendant reserves the right to advance in his case additional material in support of his defence, the details whereof will be disclosed by amending this paragraph after the close of ASIC's case.²⁰⁶

Of these approaches, McMurdo J preferred that of Mason P requiring a defendant to give the court and the plaintiff notice of an intention to rely upon a positive defence, without requiring the defendant to plead the facts of that defence which are not already pleaded within the statement of claim.²⁰⁷ In this way, trials can be properly prepared and conducted, while still preserving the penalty privilege.

Justice McMurdo was also concerned that under the trial judge's orders, there was potential for the operation of rule 165(2)²⁰⁸ which could not have been intended. In that regard, a defendant who believed an allegation to be true at the time of pleading and who made a claim for privilege could contradict the fact by evidence in the defendant's case. However, where the defendant was simply uncertain, rule 165(2) would prevent the defendant from doing so.²⁰⁹

Even though McMurdo J acknowledged that the procedural rules have some differences between jurisdictions, his Honour considered *Macdonald* to be 'particularly instructive'.²¹⁰ In that case, the defendant (Macdonald) was relieved from the requirements of the rules which would have required him to reveal his belief in the truth or otherwise of the facts alleged by ASIC, as discussed above. He was also relieved from the equivalent rules of rules 149(1)(b)–(c), 150(1) and 150(4). According to McMurdo J, this outcome was 'far different' from that put in place by the trial judge.²¹¹

Accordingly, his Honour found that the regime established by Fryberg J was not sufficient to prevent the pleading rules affecting the privileges and so it was necessary to provide the appellants with a further dispensation from the requirements of the pleading rules in the *UCPR*, consistent with the approach in *Macdonald*.²¹² This was when the appellants would also be permitted to file a

206 (2007) 73 NSWLR 612, [72].

207 *Anderson* [2013] 2 Qd R 401, 413 [37].

208 *UCPR* r 165(2) provides that a party who pleads a non-admission may not give or call evidence in respect of a fact not admitted (unless the evidence relates to another part of the party's pleading). Yet, there would be no similar barrier to a defendant in relation to a fact for which the defendant had a claim for privilege.

209 *Anderson* [2013] 2 Qd R 401, 413 [38].

210 *Ibid* 413 [39].

211 *Ibid*.

212 *Ibid* 414 [40]–[42]. As to the manner in which the pleading rules were to be varied to allow reliance on the privileges, the Court ordered at 414 [44]:

A defence filed and served by an appellant must at a minimum:

(a) state with respect to each allegation of fact in the statement of claim whether the allegation is admitted, not admitted or denied;

(b) give notice of any intention by the defendant to rely upon any relevant statutory defence or ground of dispensation

but is not otherwise required to comply with rr 149(1)(b),(c), 150, 157, 165 and 166 of the *UCPR*.

further amended defence after ASIC closed its case, as was regarded appropriate in both *Macdonald* and *Mining Projects*.²¹³

B Standard of Proof

Problems have also developed with the standard of proof required by ASIC when making out its allegations in civil penalty cases. This is notwithstanding that the standard of proof in civil penalty proceedings under the *Corporations Act* is the lower civil standard (on the balance of probabilities),²¹⁴ not the criminal standard (beyond a reasonable doubt).²¹⁵ Difficulties have arisen because the courts have consistently adopted a flexible and variable civil standard of proof: the common law *Briginshaw*²¹⁶ standard of ‘reasonable satisfaction’.²¹⁷ This means that the rigour of the courts’ application of the civil standard varies depending on factors, such as the seriousness of the allegations and the gravity of the consequences upon finding that a contravention has occurred.²¹⁸ The result has been that the standard of proof required in (serious) civil penalty cases may be very close to the criminal standard.²¹⁹ In *ASIC v Vines*,²²⁰ Austin J went so far as to require an ‘exactness of proof’ for ASIC to make out its case.²²¹

C Flexibility in Civil Penalty Cases Leading to Uncertainty and Lack of Consistency

Although the flexibility allowed in civil penalty proceedings is meant to enable the courts to adapt civil procedures so that justice is afforded to defendants in individual cases, this approach has caused other difficulties. Significantly, it has produced uncertainty in the law and a lack of consistency in the way various cases are treated by different courts and judges.²²² *Forrest* is a case on point. The decision of the High Court in October 2012 in this high profile matter provides fresh evidence that ASIC’s major enforcement work is being hampered. In *Forrest*, the Court held that ASIC failed to prove that Fortescue had contravened *Corporations Act*, section 1041H (dealing with misleading and deceptive conduct), or section 674 (the continuous disclosure requirements), or that Forrest had breached his duties in section 180(1) in respect of the statements

213 Ibid 414 [43].

214 As noted above n 23: see s 1332 of the *Corporations Act*.

215 As noted above n 23: see s 13.2 of the *Criminal Code Act 1995* (Cth).

216 *Briginshaw v Briginshaw* (1938) 60 CLR 336, 361–3 (Dixon J).

217 See, eg, *Neat Holdings Pty Ltd v Karajan Holdings Pty Ltd* (1992) 110 ALR 449, 449–50 (Mason CJ, Brennan, Deane and Gaudron JJ).

218 See Middleton, *ASIC Corporate Investigations and Hearings*, above n 40, [8.1520], citing, eg, *ASIC v Cochrane* [1999] NSWCA 814; *Commonwealth Bank of Australia v Saleh* [2007] NSWCA 903, [2.80].

219 See also Gilligan, Bird and Ramsay, above n 51, 445.

220 (2003) 21 ACLC 159.

221 Ibid 163 (Austin J).

222 Sections 1337B and 1337E of the *Corporations Act* provide that ASIC may bring civil penalty proceedings in the various states’ courts or the Federal Court, which have different rules of evidence and procedure, thus exacerbating this problem: see Middleton, *ASIC Investigations and Hearings*, above n 40, [8.15200].

Fortescue had made to the market about certain framework agreements with Chinese state-owned entities being ‘binding contracts’.²²³ The Court admonished ASIC on its case, which involved allegations of both fraudulent and negligent misrepresentations. It said that ASIC’s statement of claim was ‘confusing’,²²⁴ where there were ‘hundreds, if not thousands, of alternative and cumulative combinations of allegations’,²²⁵ so as to declare:

This is no pleader’s quibble. It is a point that reflects the fundamental requirements for the fair trial of allegations of contravention of law. It is for the party making those allegations (in this case ASIC) to identify the case which it seeks to make and to do that clearly and distinctly. The statement of claim in these matters did not do that.²²⁶

The Court considered that the confusion in ASIC’s statement of claim, of allegations of fraudulent misrepresentations with allegations of negligent misrepresentations, had its

origins in ASIC’s combination of two allegations: first, that the relevant statements conveyed to their intended audience that Fortescue had made binding contracts; and second, that those statements also conveyed to the audience that Fortescue ‘had a genuine and reasonable basis for making’ the relevant statement.²²⁷

In so doing, the Court found that the ‘second allegation served only to distract attention from two questions’²²⁸ which were critical to the case of misleading and deceptive conduct which ASIC had set out to make: ‘first, what ASIC alleged that the impugned statements conveyed to their intended audience; and second, whether what was conveyed was misleading or deceptive or likely to mislead or deceive.’²²⁹

As a result of the High Court’s criticism of ASIC’s decision to plead its case against Fortescue and Forrest by making these alternative allegations, ASIC is arguably now in an even more difficult position than it was in previously when it was thought that doing pleadings in the alternative was the appropriate course in civil penalty cases since, as Gibson commented, ASIC usually does not know what defences will be raised by defendants until it has closed its case.²³⁰ It is also ironic in light of the High Court’s criticism of the complexity of ASIC’s case, that ASIC changed both its approach in this matter and its pleadings midstream. In 2007, ASIC switched from the Australian Government Solicitor (who had launched the case in 2006) to a top-tier firm, Mallesons Stephen Jacques (now King & Wood Mallesons), and a team of silks, no doubt to match up against Forrest’s team of Gadens, who briefed leading silk Allan Myers QC; and Fortescue’s Clayton Utz, which briefed John Karkar QC and David Jackson

223 (2012) 247 CLR 486, 496 [8].

224 Ibid 502 [23].

225 Ibid 503 [27].

226 Ibid 502 [25].

227 Ibid 502 [23].

228 Ibid.

229 Ibid.

230 See above n 44 and accompanying text.

QC.²³¹ At trial, ASIC's pleadings simply made allegations of fraud (that Fortescue, its board of directors and Forrest had been dishonest in making the impugned statements).²³² However, on appeal to the Full Court of the Federal Court,²³³ and again on appeal to the High Court, ASIC changed the whole basis upon which it advanced its case that the impugned statements should be found to be misleading or deceptive. In other words, whereas the focus of the case, at trial, was on 'the honesty of Fortescue, its board and Mr Forrest,'²³⁴ the focus of ASIC's case in the appeals was on 'what it was that the impugned statements would have conveyed to their intended audience.'²³⁵

The High Court's reasons for ultimately determining that these statements, made about 'binding contracts' with Chinese state-owned entities to build and finance Fortescue's massive Pilbara Iron Ore and Infrastructure Project, were neither false nor misleading are also quite imaginative to say the least. The four sitting judges in their joint judgment said that disclosure was not made to the public at large, but to investors (both present and future) and, perhaps to some wider section of the commercial or business community, who were sufficiently sophisticated and wise to the games played in commercial negotiations such that it would be 'extreme or fanciful'²³⁶ for them to believe that contracts agreed in a foreign jurisdiction, such as China, could ever be legally enforceable in Australia.²³⁷ In his separate judgment, Heydon J, went further by claiming that investors were 'sufficiently tough, shrewd and sceptical'²³⁸ to know the truth.

The Court thus made huge assumptions about the investment audience and its commercial understanding. Yet, if one was to take this approach to its logical conclusion, it is arguable that: *if* business people know what 'framework agreements' are, then why weren't the agreements with the Chinese referred to as such by Fortescue? At the same time, the Court found that Fortescue had properly represented these agreements as 'binding contracts' because it believed them to be.²³⁹ This has prompted one commentator to sum up the position in this way: '[i]n other words, it was right for Fortescue to believe but silly for investors to follow suit!'²⁴⁰ *Forrest* was also a missed opportunity. Instead of giving important rulings and much needed direction about continuous disclosure

231 See Durkin, Boxsell and Barrett, above n 42, 50.

232 *ASIC v Fortescue Metals Group Ltd [No 5]* (2009) 264 ALR 201 (Gilmour J). Justice Gilmour dismissed ASIC's claims.

233 *ASIC v Fortescue Metals Group Ltd* (2011) 190 FCR 364 (Keane CJ, Emmett and Finkelstein JJ). The Court allowed ASIC's appeal and declarations of contravention were made.

234 See *Forrest* (2012) 247 CLR 486, 503 [28].

235 Ibid.

236 Ibid 509 [47].

237 Ibid 506 [36], 509 [48], 510 [50], 511 [56], 512 [58]–[59] (French CJ, Gummow, Hayne and Kiefel JJ).

238 Ibid 526 [105]. Justice Heydon was referring to the Chinese group described in the ASX announcement as China's largest construction group – China Railway Engineering Corporation, which is a Chinese state-owned enterprise.

239 See *Forrest* (2012) 247 CLR 486, 523 [98].

240 Matthew Stevens, 'Lack of Clarity Damns ASIC', *The Australian Financial Review* (Sydney), 3 October 2012, 40.

obligations under the *Corporations Act* and directors' duties concerning public announcements, the High Court, regrettably, only chose to focus on a narrow set of issues surrounding the contracts entered into by Fortescue and ASIC's interpretation of how the market interpreted the announcement of those contracts.²⁴¹ Consequently, the litigation strategy that ASIC should adopt in future cases and the law concerning continuous disclosure requirements are more unclear than they have ever been.²⁴² The *Forrest* case has inevitably also led to growing concerns about ASIC's ability to effectively enforce corporate law.²⁴³

VII CONSEQUENCES AND SOLUTION

From the foregoing, it is apparent that our present approach of leaving it up to the courts to negotiate an effective process for civil penalties has been and remains problematic and risks 'lead[ing] to indeterminacy or default to criminal procedure.'²⁴⁴ It is hardly surprising then, that procedural challenges and appeals have been a feature of many civil penalty cases brought by ASIC – James Hardie, One.Tel, Centro Properties, AWB and Forrest. As a result, part 9.4B of the *Corporations Act* has not turned out to be the 'boon to effective law enforcement'²⁴⁵ that it was originally thought to be because of ASIC having the advantage of civil rules of evidence and procedure rather than the limitations of criminal rules of evidence and procedure in civil penalty cases. Nor have civil penalty proceedings been the cheap and timely enforcement response initially anticipated.

If there is a continuing public policy interest in maintaining a civil penalty process, the ideal solution is for Parliament to pass appropriate legislation to provide greater clarity and consistency relating to the procedures to be adopted in civil penalty proceedings.²⁴⁶

241 See also Tony Boyd, 'Chanticleer, Four Lessons from Judgment', *The Australian Financial Review* (Sydney), 3 October 2012, 56.

242 See ASIC, 'Decision in High Court Appeal by Fortescue Metals Group and Andrew Forrest' (Media Release 12–244, 2 October 2012). See also, eg, Peter Durkin, Hannah Low and Ayesha De Kretser, 'High Court: Don't Believe China Hype', *The Australian Financial Review* (Sydney), 3 October 2012, 6, where Bob Austin was reported as saying that ASIC might now be tempted to rely on other enforcement options, most notably infringement notices and enforceable undertakings rather than risk bringing more big cases. This seems to be the approach of the current chairman of ASIC, Greg Medcraft, who has tended to favour the use of enforceable undertakings when dealing with the issue of continuous disclosure. However, entering into enforceable undertakings with ASIC under ss 93A and 93AA of the *Corporations Act* is not an appropriate enforcement response where the person has engaged in serious breaches of statutory duty: *Franke v ASIC* [2008] AATA 83, [26]; *Jungstedt v ASIC* (2003) 73 ALD 105, 148 [337].

243 See, eg, Stevens, above n 240, 40.

244 See above n 50 and accompanying text.

245 Spender, above n 40, 249.

246 See discussion above n 47 and accompanying text.

In some previous work, the author has made some suggestions about what law reform in this area might entail.²⁴⁷ In contrast to our current approach where the courts, through case law, are seeking to develop a 'third way' or 'middleground' for civil penalties, which involves a balance of civil and criminal procedure, the author has agreed with Spender's proposal that a 'paradigm shift is required which reconsiders the bifurcation of criminal and civil procedure to effectively accommodate regulatory law and statutory remedies.'²⁴⁸ Importantly, this proposal recognises that civil penalties are a product of regulatory law that fit uneasily within the traditional civil-criminal procedural divide.²⁴⁹

In this regard, the work of Issachar Rosen-Zvi and Talia Fisher in particular is significant. These scholars argue that the existing procedural division along civil-criminal lines should be superseded by a procedural model that runs along two axes, which are more conducive to the actual goals of our justice system.²⁵⁰ They are the severity of the sanctions or remedies and the balance of power between the parties (the more controversial axis). Rosen-Zvi and Fisher contend that the civil regime does not always respond in an effective way to the imbalance of power between the regulator and the defendant since it is based on the assumption of equality in the power and resources of the parties. This is reflected in the 'supposed neutrality of civil procedure, including its preponderance of the evidence standard of proof, which favours neither defendant nor plaintiff'.²⁵¹ They suggest that there may be cases where powerful and well-resourced defendants take advantage of the procedural safeguards in the civil field and that those safeguards could 'tilt the scales of justice in their favour' with the result that they could be 'left off the hook',²⁵² with all that this implies in terms of not promoting regulatory objectives, such as optimal deterrence and retribution.

The model advanced by Rosen-Zvi and Fisher requires reducing the power of the party presently enjoying a built-in advantage in litigation.²⁵³ Although the adoption of this model would present Parliament with a number of practical

247 See Comino, 'The Civil Penalty Problem', above n 26, 829–32.

248 Ibid 830, citing Spender, above n 40, 257.

249 As noted above nn 135–7.

250 See Issachar Rosen-Zvi and Talia Fisher, 'Overcoming Procedural Boundaries' (2008) 94 *Virginia Law Review* 79, 84, 133–55. Their work is discussed in Comino, 'The Civil Penalty Problem', above n 26, 830–2.

251 Rosen-Zvi and Fisher, above n 250, 135.

252 Ibid 136. Rosen-Zvi and Fisher make the same argument about powerful defendants in criminal cases, where the enhanced criminal procedural safeguards, including the beyond a reasonable doubt standard of proof, are designed to restore the balance of power between the parties and to place them on equal footing. The pro-defendant bias inherent in the rules of criminal procedure is intended to remedy the system's assumption about the imbalance of power in favour of the prosecution, 'which stems from the government's greater access to resources, its ability to gather evidence even before the suspect knows that an investigation is under way, and its sophisticated investigative and prosecutorial apparatuses.': above n 250, 135.

253 Ibid 136.

challenges, the author agrees that it provides a good starting point for the paradigm shift proposed by Spender, which may be necessary before law reform in this area can be achieved.²⁵⁴ Those challenges include how to measure the relative power of each party, with the author arguing for the adoption of a scale of procedural protections according to the power of defendants so that those (usually) large corporations and their directors and officers who can afford a stronger legal team would have fewer protections available to them.²⁵⁵

VIII CONCLUSION

Since 2000, ASIC has made increasing use of civil penalties and had some success against directors in high profile cases. But, as this article has demonstrated by its discussion of the James Hardie litigation and other case law on civil penalties, ASIC's ability to use part 9.4B effectively has been reduced. This is because of the courts' treatment of civil penalties as *quasi-criminal* offences by affording defendants enhanced procedural protections. Law reform – at a minimum, to standardise the operation of the penalty privilege, or ideally, to devise a set of civil penalty procedure rules to resolve the evidential and procedural difficulties facing the use of civil penalties – is the answer. If this occurred, ASIC would be better positioned to use civil penalties, which are an important element of the enforcement pyramid under the corporations legislation to deal effectively with corporate misconduct. Additionally, the courts must be prepared to impose civil penalties at a high enough level, failing which doubts must be had about the deterrence value and general credibility of the law. Arguably, the need for this law reform and for the courts to impose appropriate penalties has been made more compelling at this time when ASIC's performance is under increasing public scrutiny, especially with the current Senate inquiry into its performance.²⁵⁶

254 See Spender, above n 40, 258.

255 See Comino, 'The Civil Penalty Problem', above n 26, 832.

256 The Senate referred this inquiry into ASIC's performance to its Economics References Committee on 20 June 2013 for report by 30 May 2014: see Senate Standing Committees on Economics, Parliament of Australia, *The performance of the Australian Securities and Investments Commission* (2014) <http://www.apf.gov.au/Parliamentary_Business/Committees/Senate/Economics>.