

Corporations' civil penalty provisions and penalty privilege: a proposal for reform

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- [1] My question is: should the privilege against exposure to penalties and forfeitures, that we call the “penalty privilege”, be repealed for civil penalty or compensation proceedings for contravention of an officer’s or auditor’s obligations under the *Corporations Act 2001 (Cth)*?
- [2] Both the interim and final reports of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry challenged the low number of civil penalty proceedings brought by ASIC for contravention of the financial services provisions. Between the interim and final reports, ASIC had announced its new “Why not litigate?” policy. In the final report, the question was asked whether radical change was required to the enforcement structure, including the application of penalty privilege, because of the growth in the number of civil penalty provisions.¹ The Commissioner did not recommend any change in structure.
- [3] In 2020, Dr Vicky Comino published an article entitled “Life after the Banking Royal Commission: Is the Royal Commission a ‘game-changer’ for the financial services sector in Australia?”.² She described the Government’s response as one that had overtaken expectations but also made this point:

“... the jurisprudence that has developed from a series of civil penalty cases has undermined the design of the civil penalty regime by causing a range of evidentiary, procedural and enforcement challenges for ASIC in civil penalty proceedings.”³

¹ Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019, p 430.

² (2020) 35 *Australian Journal of Corporate Law* 381.

³ (2020) 35 *Australian Journal of Corporate Law* 381, 392.

- [4] Is that true? Should something be done about it?
- [5] In a civil proceeding against an individual officer, a number of significant consequences arise from the application of the penalty privilege. First, in the pleading phase, the plaintiff obtains no admissions of any of the material facts of the contravention alleged in the statement of claim. As well, it obtains no statement of the grounds of denial or defence, which modern pleading rules require in some places. Second, the plaintiff does not obtain disclosure or discovery of the documents in the possession or power of the defendant which may be relevant in proof of the claim or defence and obtains no answers to interrogatories to assist in that proof. Third, the plaintiff will not have notice of the evidence that might be led in the defence case, either in affidavit, statement or witness summary form, before the plaintiff closes its case.
- [6] Civil penalty provisions were first introduced to the *Corporations Law* in 1993 by adding Part 9.4B.⁴ At the same time, the scope of a director's statutory obligation of care and diligence⁵ was expanded.⁶ These changes were the result of the 1989 report of a Senate Standing Committee commonly known as the Cooney Report.⁷
- [7] From the end of 1999, a number of relevant changes were brought about by CLERP 1 as it is sometimes called.⁸ They included the repeal and replacement of the duties of officers in Chapter 2D,⁹ and the repeal and replacement of Part 9.4B.¹⁰ Thereafter, in 2001, civil penalty provisions were divided into corporation/scheme civil penalty provisions and financial services civil penalty provisions.¹¹
- [8] The academic literature has explored the relevant rationales for why contravention of a director's obligation should be both a criminal offence and punishable by civil penalties, as well as attracting an entitlement to compensation.¹² For my purposes, there are three points to note about the distinction between criminal and civil penalty

⁴ *Corporate Law Reform Act 1992* (Cth).

⁵ *Corporations Law*, s 232(4).

⁶ *Corporate Law Reform Act 1992* (Cth), s 11(a).

⁷ "Company Directors' Duties", Report by Senate Standing Committee on Legal and Constitutional Affairs, November 1989.

⁸ *Corporate Law Economic Reform Program Act 1999* (Cth).

⁹ *Corporations Act 2001* (Cth), ss 180 – 184.

¹⁰ *Corporate Law Economic Reform Program Act 1999* (Cth), s 3(1) and sch 1.

¹¹ *Financial Services Reform Program Act 2001* (Cth), sch 1, pt 2.

¹² For example, see Vicky Comino, *Australia's "Company Law Watchdog": ASIC and Corporate Regulation*, 2015, chs 3, 4 and 5.

proceedings in this context. First, a civil penalty proceeding does not attract the procedural incidents of a criminal proceeding, including that the onus of proof lies on the prosecution to prove all the elements of the offence and to negative possible defences beyond a reasonable doubt. Second, an individual is not exposed to the risk of imprisonment in a civil penalty proceeding.

- [9] Third, and most important for today's purposes, when civil penalty provisions were first introduced in 1993, s 1317FB of the *Corporations Law* provided that “[c]riminal proceedings for an offence constituted by a contravention of a civil penalty provision cannot be begun if a person has already applied for a civil penalty order in relation to the same contravention”. That position was reversed in 1999 by CLERP 1, when s 1317FB was repealed and replaced by s 1317P that provides: “[c]riminal proceedings may be started against a person for conduct that is substantially the same as conduct constituting contravention of a civil penalty provision...”
- [10] The 2020 Final Report of the Australian Law Reform Commission on Corporate Criminal Responsibility¹³ gathered recent data about criminal proceedings and civil penalty proceedings against corporations and associated individuals. It identified the proliferation of criminal offences under the *Corporations Act 2001* (Cth) and analysed them according to different categories or types.¹⁴ It also analysed the range of civil penalty provisions and identified the “dual-track” provisions,¹⁵ where contravention is a basis for a civil penalty order and a criminal offence. As at February 2020, there were 902 criminal offences, 125 civil penalty provisions, and of those 60 were dual-track provisions.
- [11] In 1993, it was hoped that a civil penalties regime would constitute the major part of the overall corporations' enforcement mechanism. How has it operated in a practical sense? In the six years from 1993 to 1999, ASIC started 14 penalty applications relating to 10 corporations.¹⁶ Although the 1999 reforms¹⁷ removed the prior bar to starting a criminal proceeding after a civil penalty proceeding,¹⁸ they also provided

¹³ Australian Law Reform Commission, Final Report Corporate Criminal Responsibility, ALRC Report 136, April 2020 (“Final ALRC Report”).

¹⁴ Final ALRC Report, 3.13 – 3.25.

¹⁵ Final ALRC Report, 3.48 – 3.52.

¹⁶ Vicky Comino, “The enforcement record of ASIC since the introduction of the civil penalty regime” (2007) 20 *Australian Journal of Corporate Law* 183, 184.

¹⁷ *Corporate Law Economic Reform Program Act 1999* (Cth).

¹⁸ *Corporations Law*, s 1317P.

that the evidence given or documents produced in a civil penalty proceeding is not admissible in a criminal proceeding.¹⁹ From then, as at the end of May 2004, ASIC had started 25 civil penalty proceedings.²⁰ The numbers were still not large. As at 2007, ASIC was described as having increasingly issued proceedings, including those against James Hardie and its directors and executives, over events that occurred in 2001, that were tried in 2009 and eventually resolved in the High Court in 2012.²¹

- [12] In 2004, the High Court decided *Rich v ASIC*.²² It held that the penalty privilege applied in a civil penalty proceeding for contravention of a director's duty, so that a defendant was not obliged to give discovery. Later cases applied the privilege to relieve against the requirements to plead a defence in accordance with the civil pleading rules,²³ or to disclose evidence to be relied upon before trial.²⁴ Other cases applied penalty privilege in the same ways in a civil proceeding for compensation. It applies in those proceedings if there is a real and appreciable risk of exposure to a civil penalty.²⁵
- [13] The result is that penalty privilege is often invoked successfully. In the 2019 and 2020 calendar years, there were at least seventeen published judgements in corporations' cases where penalty privilege was considered.²⁶
- [14] A critical plank in the application of penalty privilege to a civil penalty proceeding under the *Corporations Act 2001* (Cth) is that s 1317L expressly provides that the court must apply the rules of evidence and procedure for civil matters when hearing

¹⁹ *Corporations Law*, s 1317Q.

²⁰ Vicky Comino, "The enforcement record of ASIC since the introduction of the civil penalty regime" (2007) 20 *Australian Journal of Corporate Law* 183.

²¹ *ASIC v Hellicar & Ors* (2012) 247 CLR 345.

²² (2004) 220 CLR 129.

²³ *MacDonald v ASIC* (2007) 73 NSWLR 612.

²⁴ *ASIC v Berndale Capital Securities Pty Ltd* [2019] FCA 595; *LM Investment Management Ltd (in liq) v EY & Ors (No 5)* [2020] QSC 264; *Directed Electronics OE Pty Ltd v OE Solutions Pty Ltd (No 3)* [2019] FCA 285; *Directed Electronics OE Pty Ltd v OE Solutions Pty Ltd (No 6)* (2020) 142 ACSR 58; *Spotlight Pty Ltd v Mehta* [2020] FCA 1422; *ASIC v Vella-Arpaci* [2019] FCA 644; *ASIC v Goel* [2020] FCA 1369; *ASIC v Marco (No 3)* (2020) 145 ACSR 265; *Deloitte Touche Tohmatsu (a firm) v Sadie Ville Pty Ltd (as trustee for Sadie Ville Superannuation Fund)* (2020) 144 ACSR 1; *ASIC v Rio Tinto Ltd* [2020] FCA 1721; *Meneses and Anor v Directed Electronics OE Pty Ltd* (2019) 373 ALR 624; *ASIC v Helou* (2019) 139 ACSR 489; *Rossetti v Aus Gold Mining Group Pty Ltd (No 2)* [2019] FCA 1104; *ASIC v Merlin Diamonds Ltd* [2019] FCA 1546; *ASIC v Gallop International Group Pty Ltd (in liq) and Ors* (2019) 138 ACSR 395; *BCEG International (Australia) Pty Ltd v Xiao* [2020] NSWSC 1234; *ASIC v Wilson* (2020) 146 ACSR 149.

²⁵ *Spotlight Pty Ltd v Mehta* [2020] FCA 1422, [25]-[33].

²⁶ See footnote 24.

proceedings for a declaration of contravention or a pecuniary penalty order.²⁷ On the other hand, it is expressly provided that there is no civil penalty privilege against disqualification orders or similar.

- [15] In a proceeding for examination of a person into a corporation's affairs by ASIC or a liquidator or administrator, a person is not excused from answering the question on the ground of penalty privilege.²⁸ Curiously, the answer is admissible in a compensation proceeding against the examinee,²⁹ but not admissible in evidence in a civil penalty proceeding provided the privilege is still claimed before answer. Otherwise, the practical consequence of the availability of penalty privilege depends on the nature of the case. In the usual context of a winding up and insolvency, the company's documents will be in the possession or power of the liquidator and there is no impediment to ASIC obtaining those documents.
- [16] To my mind, this mishmash of protections due to penalty privilege in a civil penalty proceeding and a compensation proceeding is not well thought through. Specifically, I ask two questions: first, more narrowly, why is an answer obtained on examination where penalty privilege cannot be claimed admissible in a civil compensation proceeding but penalty privilege can still be claimed in the same proceeding to relieve against pleading, disclosure or early exchange of evidence? Second, more broadly, why is penalty privilege available in a civil penalty proceeding at all?
- [17] Putting questions of privilege aside, some of the procedural protections penalty privilege gives in a breach of officer's obligations case in 2021 were everyday features of a traditional 19th century common law civil trial. If not before, they were largely swept away in England and Wales by the civil procedural reforms of the *Judicature Acts* of 1873 and 1875 and the *Rules of the Supreme Court* 1883 (Eng) and not long afterwards similar reforms were made in most Australian jurisdictions.
- [18] As well, between the 1970s and now, there has been a tectonic shift in civil procedural laws and the extent to which the parties on both sides are required to disclose their cases to one another in advance of the hearing. One example is that a defendant in a

²⁷ *Rich v ASIC* (2004) 220 CLR 129. The same result might follow from the application of the principle of legality, as it is now called, based on *Potter v Minahan* (1908) 7 CLR 277, 304: see *X7 v Australian Crime Commission* (2013) 248 CLR 92, [86]-[87].

²⁸ *Corporations Act* 2001 (Cth), s 597(12).

²⁹ *Corporations Act* 2001 (Cth), s 597(14).

civil proceeding in Queensland must give a direct explanation in a positive way for the party's belief that a pleaded material fact is untrue,³⁰ and non-admissions are limited to where there is positive uncertainty after reasonable inquiry that the party is unable to admit or deny the alleged fact.³¹ These days, even in a fraud case, a defendant is not necessarily permitted to withhold evidence from pre-trial exchange or disclosure.

- [19] There are complexities, delays and inefficiencies that result from dual-track corporations' provisions, where a contravention can give rise to a criminal proceeding and a civil penalty proceeding and the overlap of those proceedings with a compensation proceeding for the same contravention. Their interrelationship is regulated only to a limited extent. The starting point is that if a person has been convicted of an offence, a declaration of contravention or pecuniary penalty order cannot be made for substantially the same conduct.³² Starting a criminal proceeding for substantially the same conduct stays a proceeding for a declaration of contravention or pecuniary penalty order.³³ Conversely, none of a declaration of contravention, a pecuniary penalty order, a disqualification order or a compensation order prevents a criminal proceeding being started for substantially the same conduct.³⁴
- [20] Where an investigation into conduct may result in either a criminal proceeding or a civil penalty proceeding, there may be a delay in starting a civil penalty proceeding until a decision is made upon the commencement of a criminal proceeding, because of the stay provision if a criminal proceeding is started later. Even if a criminal proceeding is not started, the commencement or possibility of commencement of a civil penalty proceeding may delay the start or continuation of a civil proceeding for compensation because of the availability of penalty privilege.
- [21] How long can this delay be? It is difficult to gauge. It is not difficult to say that the progress of proceedings against directors for alleged contraventions of directors' duties is sometimes remarkable because of the delay in getting to or getting through the court system. I have already mentioned the James Hardie directors' case. And

³⁰ *Uniform Civil Procedure Rules 1999* (Qld), r 166(4).

³¹ *Uniform Civil Procedure Rules 1999* (Qld), r 166(3).

³² *Corporations Act 2001* (Cth), s 1317M.

³³ *Corporations Act 2001* (Cth), s 1317N.

³⁴ *Corporations Act 2001* (Cth), s 1317P.

relatively public recent examples of extreme delay in resolving civil penalty proceedings are not difficult to find in the jurisdictions I am familiar with.³⁵ These delays may be due to many factors. Even so, the courts and the legislature should be thinking about ways to bring them down.

- [22] The uneasy relationship between criminal and civil penalty proceedings for the same contravention, and its contribution to delay, is reinforced by the fact that the power to start a criminal proceeding is vested in the Commonwealth Director of Public Prosecutions (“CDPP”) while the power to start a civil penalty proceeding is vested in ASIC. Since 2006, there has been a Memorandum of Understanding between ASIC and the CDPP about that interaction,³⁶ which requires ASIC to consult with the CDPP before making an application for a civil penalty order.³⁷
- [23] ASIC’s annual report for 2019-2020 identified an increase in enforcement activities in that year as a result of the “Why not litigate?” initiative and increased resources. There was an 11 percent increase in the number of investigations, a 48 percent decrease in the time taken to file civil penalty proceedings and a 100 percent increase in the number of civil penalty proceedings started. The number of civil penalty claims made against individuals increased by 40 percent. And there was a 25 percent increase in matters referred to the CDPP for criminal proceedings.
- [24] Under the present system, the availability of penalty privilege in many proceedings against individuals is an inevitable “system cost” in dealing with increased civil penalty or compensation proceedings. It may be accepted that self-incrimination privilege and penalty privilege should be available to an individual who is exposed to imprisonment for contravening conduct. But is it necessary to extend penalty privilege to an individual who is exposed only to an order to pay money and who is protected by the bankruptcy laws on insolvency, or to a disqualification or a banning order in relation to future activities as an officer?

³⁵ *King v ASIC* (2018) 134 ACSR 105; on appeal from *ASIC v ACN 101 634 146 Pty Ltd (in liq)* (2016) 112 ACSR 138, [856]; *ASIC v Drake (No 2)* (2016) 340 ALR 75, [291].

³⁶ Memorandum of Understanding, Australian Securities and Investments Commission and Commonwealth Director of Public Prosecutions, 1 March 2006.

³⁷ Memorandum of Understanding, Australian Securities and Investments Commission and Commonwealth Director of Public Prosecutions, 1 March 2006, para 4.1.

[25] I suggest a simpler and more efficient litigation enforcement structure against an individual for contravening conduct in relation to penalty privilege could be created as follows:

1. If a criminal proceeding is started, the defendant is protected by the availability of the self-incrimination and penalty privileges.
2. If ASIC starts a civil penalty proceeding, a criminal proceeding may not be started for the same conduct, and the penalty privilege does not apply either in the civil penalty proceeding or in a civil proceeding for compensation for substantially the same conduct.
3. If neither a criminal proceeding, nor a civil penalty proceeding is started, penalty privilege may be relied upon by a defendant in a civil proceeding for compensation.

[26] What are the strengths of such a proposal? First, penalty privilege is preserved in a civil proceeding where an individual remains exposed to a criminal proceeding and imprisonment for substantially the same conduct. Second, provided the risk of exposure to a criminal proceeding and imprisonment for a contravention is removed, both a civil penalty proceeding and a civil proceeding for compensation may be started and continued without the added cost and procedural difficulties associated with the application of penalty privilege.

[27] What are the weaknesses? First, a decision not to start a criminal proceeding for an offence and to start a civil penalty proceeding may prove too favourable to a defendant in the light of information that is obtained after the decision is made. Second, the finality of ASIC's election to start a civil penalty proceeding may lead to delay in the making of such a decision, leaving the penalty privilege available in a civil proceeding for compensation.