HERBERT SMITH FREEHILLS

Inquiry into the performance of the Australian Securities and Investments Commission

Bob Baxt's submission to the Senate Economic References Committee

Inquiry into the performance of the Australian Securities & Investments Commission (ASIC)

I am pleased to assist the committee in this inquiry.

Preliminary comments

May I make some preliminary comments before dealing with each of the topics that have been specifically raised by the Committee. ASIC, together with nearly all of Australia's major business regulators, is asked to perform almost herculean tasks in a time of growing importance.

When ASIC was established some years ago, the problems that were facing our regulators in dealing with corporate law regulation and matters linked to the rules which regulate the operation of the securities markets were already significant. Over time, governments have become more concerned in the way in which our markets operate (or in some cases fail to operate where there is market failure!). More and more responsibility has been thrust on our regulators to find out what has gone wrong, investigate failures quickly and properly, and bring appropriate court or related proceedings.

As is often the case, in searching for the right solutions, shortcuts are contemplated or, usually insisted upon, by the relevant government in the first place. The regulator is faced with the task of having to deliver a result on behalf of the government. This approach is also pursued so that the government is given appropriate credit for achieving success in dealing with these matters. A classic example of this is illustrated by the introduction of the Infringement Notice regime, a form of which is now included not only in the Corporations Act 2001 (the Corporations Act), but has been incorporated into the work of the Australian Competition & Consumer Commission, the Australian Prudential Regulatory Authority and similar organisations.

I had the pleasure and responsibility of serving on the Australian Law Reform Commission (ALRC) inquiry when this particular topic was considered. In its report 'Principled Regulation: Federal Civil and Administrative Penalties in Australia' (ALRC Report 95), the ALRC considered in some detail the request from the then Chairman of ASIC - that a new regime should be introduced to enable the regulator to move quickly in essence, to discipline corporations (and one assumes executives) for breaching the

continuous disclosure regime which had recently been introduced. The apparent difficulty that the regulator had faced in tackling this important area, where Australia in effect had taken a world lead in the rigour and vigour of the regulatory regime in place, suggested that the only sure way for the regulator to act if a breach occurred was to bring appropriate legal proceedings. The ALRC strongly recommended against the introduction of the Infringement Notice regime, which had been campaigned for by David Knott, the Chairman of ASIC. The ALRC was quite clear in its rejection of this proposal in its Report.

The Government decided to ignore that recommendation. It enacted the Infringement Notice regime (found in Part 9.4AA of the Corporations Act) to operate in response to an alleged contravention of the continuous disclosure obligations set out in s674(2) and s675(2) of the Corporations Act. As a representative of the Business Law Section of the Law Council of Australia (LCA), I, together with representatives of other bodies such as the Business Council of Australia, the Australian Institute of Company Directors (AICD) whose law committee I chaired and still chair, and other bodies, met with the Treasurer Peter Costello to try to persuade the government not to go ahead with this initiative. We were promised that there would be a review of the regime within a couple of years. I understand that such a review did take place in early 2007 but no public statement concerning the review was publicised.

The regime has been severely criticised for its lack of transparency, the delay that occurs in dealing with matters in relation to the implementation of the regime, and various other matters (see in particular the article by Aakash Desai and Professor Ian Ramsay 'The use of infringement notices by ASIC for alleged continuous disclosure contraventions: Trends and analysis' (2011) 39 Australian Business Law Review 260).

At my behest, the Business Law Section of the LCA initiated a review of this regime in 2012. A report was prepared by the LCA and this has received support from other organisations. The report has been discussed with ASIC. In my view this Senate Committee should obtain a copy of the relevant report in order to review ASIC's use of this regime. A similar anti-Infringement Notice regime has been adopted by the LCA in discussions with the ACCC.

At the same time as these developments were occurring there was a growing use by all governments of the reversal of onus of proof and strict liability regimes, as highlighted in the report of the Corporations and Markets Advisory Committee (CAMAC) 'Liability for Corporate Fault' in 2006 (over 650 statutes were highlighted in this Report). Together with the infringement notice regime, these regimes create a perception that companies and officers are guilty in relevant circumstances when particular statutes are allegedly breached, in effect they have to establish their innocence when "prosecuted".

Whilst the issue of the notices does not carry with it any assertion that a breach of the law has occurred (or that fault has been agreed to by the company against which it is issued), the impression that follows the publicity surrounding the issue of such a notice, and the usual extraction of the relevant enforceable undertaking, leads to very different conclusions. Class actions may well follow the issue of an Infringement Notice with significant consequences for the corporation.

The increase in this inference that persons were required to establish their innocence when the presumption in the law is that a person is innocent until proven guilty led the Council of Australian Governments (COAG), in considering the CAMAC report referred to earlier, to introduce an agenda for review and reform of the reversal of onus of proof/strict liability regimes. Some States and the Commonwealth have initiated the review. But in my view it has been too slow, and in many respects inadequate. I should note that the AICD has been a champion in requesting that such regimes be abolished or severely modified, especially in the context of commercial legislation.

These matters are matters of some significance, and I am delighted that Senator Brandis, QC, in a debate with Mark Drefyus, QC when he was Attorney-General of the Commonwealth, indicated that if the Liberal/National Party won the election he would refer such matters to the Australian Law Reform Commission. That victory having occurred, we anticipate the referral will be made.

I now turn to deal with the specific questions raised by the Senate Committee for consideration by the Senate Economics References Committee:

(a) ASIC's enabling legislation

Whilst the referral of powers by the States to the Commonwealth has worked satisfactorily for the last few years to overcome the lack of constitutional power on the part of the Commonwealth in the regulation of this area, there is a nagging belief that this is an area that requires a more permanent solution. It is unlikely, however, that such a permanent solution can be satisfactorily reached in Australia because of the almost impossible task of amending the Commonwealth Constitution so as to empower the Commonwealth to deal with all matters relating to corporations law. I believe it would be fanciful to expect that this would ever occur.

To that extent, and because of the necessity for the Commonwealth to refer matters to the States (and Territories in some cases) for consideration from time to time, the spirit of the cooperative approach to legislation and regulation in this

area (in common with the position that exists in relation to our competition statute), has been laudable.

This lack of power means that the Commonwealth can never guarantee that ASIC will be able to act unimpeded by potential State (or in the more extreme case Territory) intervention or opposition. I should note that I cannot point to many situations where this has occurred, but I do understand that from time to time delays may occur in the appointment of Commissioners and other senior officials because of the need to obtain agreement from all the States and Territories involved. This delay hinders a speedy and efficient implementation of the regulatory regime in this area which should operate on a national basis.

(b) The accountability framework to which ASIC is subject …!

ASIC has shown its willingness to fully disclose the various initiatives that it takes in most areas of its administration. It has generally been the subject of criticism when it loses big cases, or where it seems unable to move with the speed that many in the community expect of it, where corporate collapses or similar difficulties arise. The media (and some politicians) are regrettably not well informed on the way in which our regulatory regimes operate. They do not appreciate the tensions and difficulties that face our various business regulators in dealing with very difficult areas of the law which they are required to administer. As a result the level of criticism brought against ASIC by the media, and at times by politicians, is often unbalanced; sometimes it is even hysterical.

Under the current parliamentary system ASIC is required to attend Parliamentary Committee hearings, and is subject to report on matters that are generated by requests from Parliament. Whilst this may cause some frustration and difficulty for the regulator (sometimes the amount of time and effort that the regulator has to put into dealing with these matters is out of proportion with the value that can be generated from such inquiries), I believe the current "system" is operating satisfactorily. If one can exercise a little patience, it is also quite sound in my view. Whilst there may be ways of improving the way in which the system operates, we need to ensure these improvements are made after appropriate consultation.

ASIC is not only “accountable” to the Parliament, but through its association with various organisations such as the AICD and the LCA, and similar bodies, it enables those organisations to consider and comment on its thinking with respect to a number of the difficulties that it faces, and a number of the initiatives it wishes to take. This cooperative spirit has recently been enhanced

insofar as my experience and work with both the LCA and the AICD is concerned. The willingness of ASIC and its officers, for example, to become more involved in the way in which the Corporations Committee of the LCA undertakes various requests that are made of it, is exemplary.

Many requests are made to the LCA by Parliament, different bodies in the community, as well as ASIC. These enquiries are usually aimed at trying to improve the way in which our law should operate. But, sometimes an initiative is taken by the LCA (as was recently illustrated in examination of the operation of the Infringement Notices discussed earlier).**]**

A further matter on which ASIC needs to concentrate is the criticism levelled at it in seeking more robust and appropriate penalties in major cases. I refer in particular to the judgment of the Victorian Court of appeal in *ASIC v Ingleby* [2013] VSCA 49. This decision has been the subject of a recent paper by Appeal Justice Mark Weinberg titled 'Some Recent Developments in Corporate Regulation – ASIC from a Judicial Perspective', which was presented to the Monash University Law School on 16 October 2013.

(c) The workings of ASIC's collaboration and related matters

As noted in paragraph (b), ASIC's collaboration and relationship with other organisations is of the highest order. Rarely will organisations be rebuffed in requesting discussions on matters of importance, or where we feel issues may be addressed in a slightly different form. This does not mean to say that ASIC will agree with the proposals that are put forward by say the LCA or the AICD; but it is willing to listen and to engage in sensible, cooperative and productive discussion.

My main area of practice is not corporate law generally; but I do become involved in matters surrounding corporate governance and related issues. In particular, I work closely with the AICD in that particular context. Whilst I cannot comment on specific issues surrounding the way in which ASIC deals with relevant complaints that it receives from the community and from practitioners, I am persuaded that ASIC is nearly always willing to listen to suggestions. Whether it listens closely enough, or whether it tends to disregard some matters raised by my professional colleagues, is a matter which I think can be discussed and debated in greater detail. So, for example, my colleagues both within our law firm, and elsewhere, are concerned that regulators do not always fully recognise the importance of rule of law principles including the doctrine of professional legal privilege and related matters. These are matters that are

constantly being discussed, not only with ASIC, but with other regulators and also with the Government.

(d) Whistle-blowers

The protection to whistle-blowers is a very critical policy area which needs to be developed in Australia. Both the ACCC and ASIC offer whistle-blowers certain immunity in relation to the provision of information which may lead to prosecution of persons who engage in activities which infringe against relevant legislation. The current US model, adopted by that country's Securities and Exchange Commission, whereby bounties may be paid to whistle-blowers, is a matter that is worthy of consideration. Indeed, in a recent article published in the Australian Business Law Review by Vivian Brand, Sulette Lombard and Geoff Fitzpatrick, entitled 'Bounty hunters, whistle-blowers and a new regulator paradigm', they examine the operation of the bounty system which has been promulgated in the United States. (This issue of the Review has just been published; I will endeavour to send a reference of that journal article shortly.)

The representatives of the ACCC and the Department of Justice in the USA have indicated to me that they are not interested in a similar system being introduced in relation to whistle-blowing incentives being given in the competition law area. The use of monetary rewards in this context are, however, worthy of further consideration.

(e) Related matters

I do believe that there is a need for the way in which our regulators are funded to be reassessed.

In addition to the important question of regulating the operation of the growing use of class actions, and the increased role being played by litigation funders in Australia (a matter the Attorney-General, Senator George Brandis QC has targeted as one for examination), there is a fundamental flaw in the way in which our regulators are funded. Having acted as chairman of the Trade Practices Commission (TPC) (the predecessor for the ACCC), I can say with complete confidence that the level and nature of funding provided to the TPC at the time to conduct its various activities was well below what was needed to properly and adequately undertake its tasks. This was certainly the case in the context of community and media (and some politicians') expectations of the role of the regulator. The apparent unwillingness of the TPC to undertake certain investigations or to pursue certain court actions was often misunderstood,

because the critics did not appreciate the problems that the regulator faced due to its inadequate and restricted use of its funding.

Additionally, and whilst these comments are made primarily from my personal knowledge of the problems faced by the TPC whilst I was Chairman (a position which I understand the ACCC is currently experiencing although it will not say so publicly), there are significantly inadequate resources provided to the regulator to bring appropriate cases in order to challenge the activities of well-funded defendants (which usually enjoy deep pockets and are not burdened by significant restrictions in the way in which they operate in defending the relevant matter).

Rules of court, which now allow class actions to be brought, may change things in the longer term. One other critical matter which continues to face the regulator – ASIC is in no different position, as I understand it, to the ACCC (or the TPC before it) - is that the amount of money the regulator can pay to experts to act on its behalf (barristers, QCs in particular, but also financial and other experts) is limited by strict guidelines. No such guidelines will apply to well-funded defendants. This means that the regulator is often prevented from hiring the best experts possible in order to conduct the relevant litigation.

Were ASIC and the ACCC, for example, better funded with greater flexibility in their funding, both would be able to bring more important cases without fear that by taking on more major cases a year they would be 'blowing their budget', or limiting their ability to bring other pieces of litigation or to pursue other investigations.

Judges have been continually criticising the way in which commercial litigation is run in our community. This is a major issue that needs to be addressed in Australia and has been the subject of a number of interesting recent papers delivered at various seminars. The Chief Justice of New South Wales, Justice Tom Bathurst, has been in the forefront in calling for changes to the rules. The former South Australian Chief Justice, John Doyle AC QC, in a recent paper delivered at the Supreme Court of Victoria Commercial Law conference titled 'Litigation and the adversarial system – time to move on', tackled the question in a proactive and interesting fashion. The commentary delivered by the Honourable Ray Finklestein QC at that conference is also relevant. These commentaries raised questions that need to be addressed quickly by our governments in order to ensure that our legal system is not clogged down by

unnecessary delays and costs, and to ensure the proper administration of justice.

ASIC has recently published its philosophy as to when it will intervene in cases. I welcome this initiative. Its successful intervention in relation to the settlement of the class action involving the collapse of Storm Financial Group is an example of how our regulators can influence the development of appropriate changes in the law. This example was in my view a sensible and speedy intervention has been applauded at a time when the community feels that not enough muscle has been exerted, nor enough actions taken, by regulators to ensure that consumers (investors in the case of ASIC, consumers and others in the case of the ACCC) are properly protected.

Conclusions

Again I thank the Economic References Committee for this opportunity to comment on these important questions. The problems that are currently being faced by ASIC in dealing with the allegations arising in the Leighton Holdings matter (on which I make no specific comment) emphasise the importance of this examination by the Senate Committee into the activities of this important regulator.

I would be pleased to discuss my submission further.

Professor Robert Baxt AO
Emeritus Partner
Herbert Smith Freehills
Chairman Law Committee of the AICD
Member of the Executive of BLS of the Law Council of Australia