



The transformation of corporate ethics into risk management

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🌀 Criminal liability

🌀 Control systems and compliance programs

1 Introduction

Corporate ethics have traditionally been viewed as outside (and sometimes inconsistent with) corporate law principles. Corporate law would have developed very differently if 'good corporate citizenship' — a concept promoted enthusiastically by John Howard — was actually required by law. Instead, shareholder value has been the touchstone of corporate law. Corporate law tolerated 'good corporate citizenship' if it contributed to the company's profitability and promoted shareholder value, but did not require it.

Nonetheless, there is one area of corporate law where some radical developments may ultimately result in corporate ethics being legally required and integrated into corporate behaviour at an operational level. It is not in the area of fiduciary duties, where such a change might be most expected to occur. Rather, the developments are in an area peripheral to most commercial practice — that of corporate crime.

A new regime of criminal liability was introduced in Australia in 1995 under the Criminal Code Act 1995 (Cth) ('the Criminal Code'). This regime has, as yet, received relatively little attention in the corporate law arena, due to the fact that the Act's application was very limited for its first five years of operation, covering only a small number of offences relevant to corporations. In 1999, however, the Criminal Code attached to a new offence, which was of great significance to Australian corporations with overseas operations, namely the offence of bribing a foreign public official. Furthermore, from December 2001 onwards, the provisions of the Criminal Code will have general application and apply to all offences against Commonwealth legislation. Broad application


of the Criminal Code will place far more pressure on corporate management and the board of directors to engage in self-regulation, via the implementation of effective compliance programs, as an aspect of strategic risk management.

BHP's revised 'Guide to Business Conduct' is a good example of this trend towards greater integration of ethical issues into business practice. The BHP 'Guide to Business Conduct' establishes principles and behaviour for employees, which go well beyond technical compliance with the law and merely avoiding the commission of crimes. The guide recognises that community values and expectations are placing new demands on corporate behaviour, and the guide's stated principles include matters such as:

- integrity
- an overriding commitment to safety and environmental responsibility
- support for fundamental human rights of employees, contractors and communities in which the company operates
- respects for traditional rights of indigenous people.

The guide also highlights the existence of BHP's worldwide Business Conduct Helpline, which enables employees to 'question or express concerns about business conduct issues'. The helpline, under which callers can remain anonymous, operates not only as a service to employees seeking assistance on matters of business conduct and ethics, but also an important element of self-regulation and risk management.

A recent example of a direct attempt to make business ethics mandatory is the Corporate Code of Conduct Bill 2000. If passed, the Bill will require Australian companies (and related companies), which employ over 100 employees in a foreign country to observe certain standards (including standards relating to the environment, health and safety, employment and human rights),



irrespective of the laws in the countries in which they operate. According to the Democrat senator who introduced this Bill, one of the justifications for its enactment is 'community demand for corporations to be good corporate citizens'.

The aim of this article is to examine some of the implications for corporations and directors of these developments. It will discuss the following issues:

- the major shift under the Criminal Code in attribution of criminal liability to corporations
- application of the new paradigm of corporate criminal liability to the specific criminal offence of bribing a foreign public official
- risk-shifting techniques for corporations through corporate control systems and compliance programs
- the evolving role of the board in protecting the corporation from criminal liability.

2 When can a company be held criminally liable for an offence committed by one of its employees?

Under traditional legal principles, large Australian public companies were almost never at risk of incurring criminal liability for the commission of an offence by one of their employees. This was as a result of the famous *Tesco*' principle, holding that the corporation would only be criminally liable if the key elements of the offence could be traced to its corporate 'nerve-centre' — to the board of directors, managing director, or someone to whom full managerial powers had been delegated. The *Tesco* test could rarely be satisfied in large public companies with diffuse operations. In these types of companies, offences are typically committed at, or below, the level of middle management. The test could, however, pose far greater dangers to smaller organisations,

with more concentrated operations.

The Criminal Code, which was given assent on 15 March 1995 and commenced limited operation on 1 January 1997, represented a radical and conscious departure from this traditional *Tesco* model of corporate criminal liability. It was based on the idea that corporations should be criminally liable when they are 'organisationally blameworthy', and when the system of incentives within the firm has contributed in some way to the commission of the crime.

This new model of corporate criminal liability is achieved by the following mechanism. Under the Criminal Code, a corporation can be criminally liable if it has 'expressly, tacitly or impliedly authorised or permitted the commission of the offence'. There are a number of methods through which 'authorisation' or 'permission' by the company can be established. The first two methods simply mirror the *Tesco* principle, by attributing liability to the corporation if its board of directors or a high managerial agent has authorised or permitted commission of the offence. The last two methods, however, break new ground. They broaden the circumstances that may trigger corporate criminal liability to include the situation where a 'corporate culture' existed, which either actively encouraged non-compliance or failed to promote compliance.

Under these provisions, 'organisational blameworthiness' is determined by examining the extent to which the corporation's practices and procedures have contributed in some way to the commission of a crime. Theoretically, the company can be criminally liable for an offence committed at any level in its organisational structure.

It is yet to be seen how liberally the courts will interpret these expanded bases for corporate criminal liability under Australian law. One interesting issue is the

extent to which a system of incentives within a company could be regarded as establishing a blameworthy corporate culture. An example would be a company conducting a pizza promotion, which guarantees to deliver pizzas within 30 minutes, or else provide the pizza free of charge. The company tells its delivery people not to speed or run through any red lights, but also states that the cost of any free pizza will be docked from their pay. In spite of the company's express instructions, could it be argued that a blameworthy corporate culture has been created in this scenario? It is worth noting that in a similar factual context in the US, Domino's Pizza dropped its 30 minute delivery guarantee after a jury awarded a plaintiff, who was injured by a delivery person, \$79 million in punitive damages.² Perverse incentives can also sometimes be created by performance-based pay. To what extent could it be argued that these types of incentives create a corporate culture which encourages non-compliance with the law?

It seems clear that the Criminal Code will ultimately put greater pressure on directors and management to establish effective compliance programs within the organisation, to prevent the commission of offences. In the US, where a parallel trend can be observed, the implementation of compliance programs has become a standard mechanism of defensive risk management.

3 Corporate criminal liability in action — The Criminal Code Amendment (Bribery of Foreign Public Officials) Act 1999

The first significant offence, to which the new corporate criminal liability regime applies, is the



Criminal Code Amendment (Bribery of Foreign Public Officials) Act 1999. The Act was passed by Federal Parliament on 3 June 1999, and commenced operation on 18 December 1999. It is highly relevant to any Australian company with off-shore operations.

The introduction of the anti-bribery offence broadens the traditional areas to which corporate criminal liability applies, such as trade practices, occupational health and safety, and environmental protection. In spite of concern by some industry groups that criminalisation of bribery of foreign public officials could disadvantage the ability of Australia to compete overseas, the offence was introduced in Australia as part of a coordinated international initiative under the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

The key provision of the Criminal Code Amendment (Bribery of Foreign Public Officials) Act 1999 is s 70.2, which makes it a criminal offence to provide a benefit, which is not legitimately due, to a foreign public official to achieve certain ends. Some exceptions apply to the offence, including a 'facilitation payment' exception, for minor payments to secure or expedite routine government activities.

The persons responsible for bribing a foreign public official are typically 'on the ground' managers in off-shore locations. Under the traditional test for corporate criminal liability, therefore, companies would almost never be at risk of criminal liability. The application of the Criminal Code to this offence, however, potentially leads to very different consequences. A corporation will itself be criminally liable with respect to bribes paid to a foreign public official by any employee, if it can be demonstrated that the practices and policies, which constituted its 'corporate culture', encouraged, tolerated, or at a

minimum, did not discourage such conduct. In determining whether this is the case, it will be possible for the court to examine the corporation's 'unwritten rules' and employment expectations, if these are at odds with formal documentation. The 'unwritten rules' of an organisation may be difficult to establish, although the existence of intra-corporate emails may prove helpful in this regard to prosecutors.

BHP's 'Guide to Business Conduct' reflects the serious liability consequences of bribery, and stresses the inflexibility of the company's anti-bribery policy. The guide states as follows:

In international business, in particular, employees may sometimes come under pressure to make payments or payments in kind to induce others improperly to grant permits or services to which BHP would not generally be entitled. Never make or agree to such payments. Under no circumstances will BHP approve any irregular payment or payment in kind to win business or to influence a business decision in the Company's favour. Bribes, 'kick-backs', secret commissions and similar payments are strictly prohibited. Moreover, they may expose BHP and relevant employees to criminal prosecution and serious penalties...

4 Recent developments in corporate control systems and compliance programs

Corporations will be protected from incurring criminal liability under the Criminal Code for an offence committed by an employee, provided that the offence was committed without the sanction of management or the board, and the corporation has a culture which does not tolerate the commission of that offence. How does a company prove that it has a culture which does not tolerate the commission of criminal

offences? It will be demonstrated where the corporation has compliance programs, which aim to prevent, or at least punish, the commission of such offences. It therefore provides strong incentives for the corporation to introduce compliance programs, and to self-regulate.

There is increasing interest in internal controls and compliance programs within corporations. In 1999, the Turnbull Committee in the UK released a report on 'Internal control: Guidance for directors on the combined code', which stated that '[a] company's system of internal control has a key role in the management of risks that are significant to the fulfilment of its business objectives. A sound system of internal control contributes to safeguarding the shareholders' investment and the company's assets'.

The Turnbull Committee report, which is supported by the London Stock Exchange, recommended that the company's internal control system should:-

- 'be embedded within its operation and not be treated as a separate exercise
- be able to respond to changing risks within and outside the company
- enable each company to apply it in an appropriate manner related to its key risks'.

The Turnbull Committee report requires companies to evaluate regularly the effectiveness of their internal control systems. According to Nigel Turnbull, Chair of the Internal Control Working Party, it is the responsibility of executive management to manage risks by maintaining an effective system of internal control, and the board as a whole is responsible for monitoring and reporting on the system, as a means of reviewing its effectiveness.

5 The evolving role of the board in corporate control systems and compliance programs

The Turnbull Committee report emphasises that the board of directors is ultimately responsible for the company's internal control systems. The Committee states that the board 'should set appropriate policies on internal control and seek regular assurance that will enable it to satisfy itself that the system is functioning effectively. The board must further ensure that the system of internal control is effective in managing risks in the manner which it has approved'. To aid directors in fulfilling this role, the Appendix to the Turnbull Committee report sets out a range of specific risk/control-related questions, that directors may wish to ask management.

The Turnbull Committee's approach accords with the 1999 OECD Principles of Corporate Governance, which state that a key function of the board of directors is 'ensuring the integrity of the corporation's accounting and financial reporting systems...and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law'. This reflects the growing 'proceduralisation' of corporate law, which is also evident in the new statutory business judgment rule.

Nonetheless, the Turnbull Committee and OECD Principles of

Corporate Governance seem to require a considerably higher level of board oversight than has previously been required at general law. For example, in the high profile AWA litigation,³ Rogers CJ considered that directors are entitled to rely on management to establish proper internal controls and that the board should not expect to be informed of the details concerning management of the corporation. By contrast, the Turnbull Committee considered that it is the role of management to implement board policies on risk and control, and that it is the board's responsibility to assure itself of the effectiveness of the internal control system.

The Criminal Code regime for corporate criminal liability will inevitably place more pressure on directors to adopt an oversight role akin to that envisaged by the Turnbull Committee. Although it is possible in Australia for directors to shift risk by delegating their powers and responsibilities to others, the circumstances where delegation will afford protection from liability are circumscribed under provisions introduced in the Corporate Law Economic Reform Program Act 1999. Neither delegation (nor reliance on a third party's information or advice) will protect a director who simply passes the buck or who relies blindly on a third party's information or advice. Also, directors who fail to adequately monitor the business of the corporation would not receive the protection of the business judgment rule.

6 Conclusion

There is a growing tension in contemporary corporate law. In the area of directors' duties, it is still accepted that the main goal of directors is to make money for their shareholders. Corporate ethics and corporate citizenship are peripheral in this context. On the other hand, corporate ethics are becoming more directly relevant in the area of corporate criminal liability, where there is increasing pressure for them to be integrated in corporate operations, to preclude the argument that a corporation's culture contributed to the commission of a crime. Under the Criminal Code, the quality of a corporation's 'culture' is now a matter of legal, not merely anthropological, significance.

There is also a tension in the role of directors. There is a strong feeling in the business community that it is unrealistic to expect directors of large modern corporations to be involved in anything beyond matters of broad policy. However, a counter trend is emerging, which views directors as ultimately responsible for a company's 'culture' and for its system of internal control. It is this trend, which is forging a new relationship between corporate ethics and risk management.

1. *Tesco Supermarkets Ltd v Natrass* [1972] AC 153.
2. See DeMott, 'Organizational Incentives to Care About the Law' (1997) 60 *Law & Contemporary Problems* 39, 45.
3. *AWA Ltd v Daniels* (1992) 7 ACSR 759 (Rogers CJ); *Daniels v AWA Ltd* (1995) 16 ACSR 607 (Court of Appeal).



Clarification — When can you use an ABN instead of an ACN?

As a number of our readers of our October 2000 edition have noted, early on in the above article an ABRN was inadvertently defined as an Australian Registered Business Number, rather than an Australian Registered Body Number. References

to businesses in the remainder of the article are clearly references to such registrable Australian bodies, foreign companies and Australian Registered Schemes, rather than just registered businesses. The author apologises for the oversight.

Some readers have also queried

the proposition that ABNs may not be used instead of ARBNs and ARSNs, in the same way as ACNs. The author has reconfirmed with the Registration section of the ATO that it is not the practice of the ATO to automatically issue an ABN that incorporates an ARBN or ARSN. However, it is possible for registrable Australian bodies, foreign companies and Australian Registered Schemes to request the ATO to issue an ABN that incorporates their ARBN and ARSN.