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Corporate crime & investigations  
in focus briefing

## The ALRC's proposed “system of conduct” offence

How repeat civil  
contraventions may  
have criminal bite

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# A proposed new “system of conduct” offence

## Key takeaways

Earlier this year we published a report on the implications of the ALRC’s Final Report on Corporate Criminal Responsibility.<sup>1</sup>

In the Final Report, the ALRC made a number of recommendations for reform, including to address what it identified as an over-proliferation of offences applicable to corporations and to ensure that criminal sanctions are reserved for the most egregious corporate misconduct.<sup>2</sup>

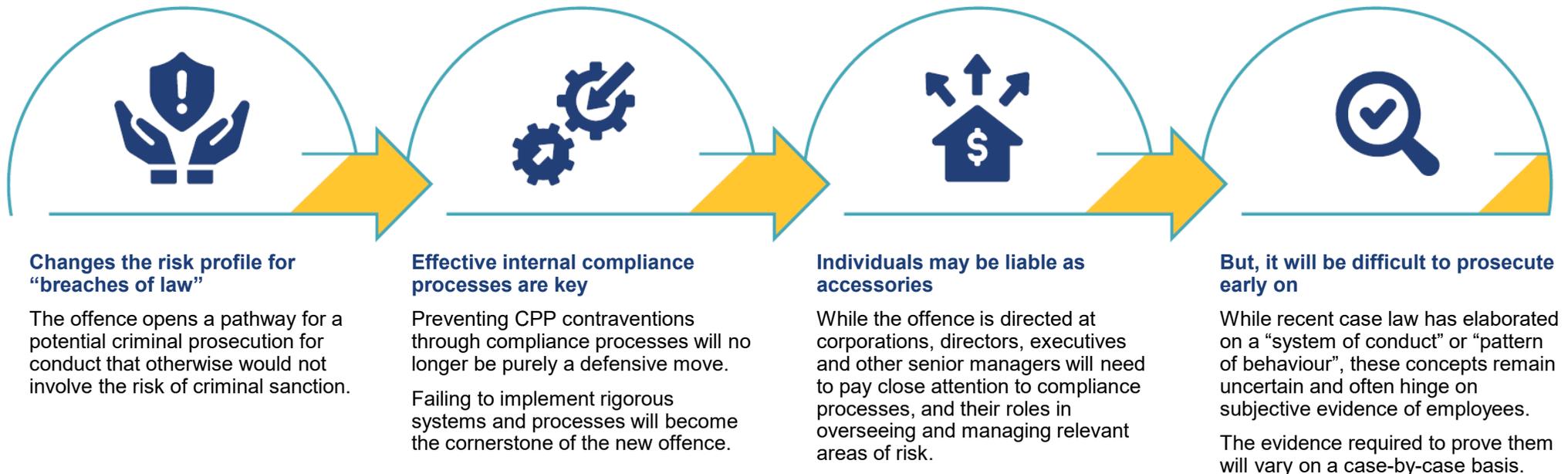
One of the more novel recommendations made by the ALRC concerned the introduction of a new offence for engaging in conduct that constitutes a “**system of conduct**” or “**pattern of behaviour**” that would lead to **repeated civil penalty provision (CPP) contraventions**.

This recommendation reflects a view that organisational fault is closely tied to an organisation’s systems, “group think”, collective behaviours and decision making at an organisational level.

It also seeks to deter misconduct that might otherwise be viewed by contravening corporations as a “cost of doing business” by signalling that repeated or systemic breaches of CPPs should be treated more seriously – criminally – to ensure that they are addressed early and/or avoided.

In this briefing we provide a breakdown of what a new “system of conduct” offence could involve and our initial views on implications for corporations in Australia.

**Much of the detail will need to be developed if there is government support for the recommendation. If the offence is implemented in the broad way articulated by the ALRC, some of the implications will be:**



1. See our report [here](#).

2. [Australian Law Reform Commission, Corporate Criminal Responsibility \(Report No 136, April 2020\)](#).

# The proposed new offence

## Elements of the offence

The ALRC has proposed a “model” statutory provision to institute the new “system of conduct” offence. The elements of the offence appear below.

The implementation of any “system of conduct” offence remains dependent on how fault is attributed to a corporation. The ALRC’s broader recommendations dealt with this issue (see our briefing on the ALRC’s final report [here](#) for more information).

### Limb 1 – the corporation intentionally or recklessly engaged in particular conduct

#### Physical element

The corporation engaged in particular conduct (whether by act or omission).

#### What does this mean?

The company has engaged in the conduct underlying the prescribed CPPs (by acts or omissions) e.g. by charging fees for no services.

#### Fault element

Intention or recklessness.

#### What is recklessness?

A person is reckless if they are aware of a substantial risk that the circumstance exists or will exist and it is unjustifiable to take that risk in the circumstances.

### Limb 2 – the conduct objectively constituted a system of conduct or pattern of behaviour

#### Physical element

The conduct engaged in constitutes a system of conduct or pattern of behaviour.

#### What does this mean?

The evidence shows that the conduct is more than just many of the same instances. Rather, it points to internal issues with the company’s systems or repeated instances that are more than just anomalies.

#### Fault element

Absolute liability.

#### What is absolute liability?

Proof of fault is not required and no defences are available for this limb.

### Limb 3 – the corporation was reckless as to whether the system of conduct or pattern of behaviour would result in the relevant repeated contraventions

#### Physical element

The system of conduct or pattern of behaviour would result in two or more contraventions of the same prescribed civil penalty provision OR a prescribed civil penalty provision with similar characteristics.

#### What does this mean?

There is no requirement to establish actual contraventions or for proceedings to have been brought – only that the system or pattern would result in the repeated contraventions.

#### Fault element

Recklessness.

# Nature of the proposed offence

## How is a “system of conduct” or “pattern of behaviour” established?

The existence of a “system of conduct” or “pattern of behaviour” is key to the offence. This requires proof of more than a significant volume or repetition of similar breaches.

There is an emerging body of law around what constitutes a “system of conduct” or “pattern of behaviour” and the kind of evidence required to establish this. While the concepts are distinct (and only one of them would need to be shown), they may also overlap. For example, a “system of conduct” might give rise to “pattern of behaviour”.

These concepts appear in existing statutory frameworks, for instance, unconscionable conduct under section 21 of the Australian Consumer Law and s 12CB of the ASIC Act.

Cases considering these provisions indicate that a “**system of conduct**” focuses on the internal structure of a company. A “**pattern of behaviour**” might be demonstrated by proving repeated instances of the same or similar conduct and that each of the instances is not an anomaly or a distinct event. The following recent decision illustrates the type of evidence led.

### *Australian Securities and Investments Commission v AGM Markets Pty Ltd (in liq) (No 3) [2020] FCA 208*

ASIC alleged multiple contraventions of the Corporations Act and the ASIC Act by three entities (**the Defendants**) in relation to financial advice provided by account managers (**AMs**) engaged on behalf of the Defendants.

#### What kind of evidence was successfully relied on to prove a “system of conduct”?

ASIC successfully led evidence that highlighted the commonality of business structures and practices of the three Defendants. This was supported by evidence from affected investors. ASIC’s evidence included:



#### Training and guidelines

AMs engaged by the Defendants received similar training and guidelines and adopted a consistent approach to engaging with clients.



#### Conduct in relation to trading accounts

A purpose of the AMs (applied consistently across clients) was to increase amounts deposited by clients into their trading accounts, exposing them to an increased risk of loss.



#### Use of software

The use of software enabling remote view access was designed to allow AMs to entice clients to deposit more money into their accounts.



#### Interactions between AMs and investors

The scripted tactics (which originated from the same source) used by the AMs were designed to gain investors’ trust and encourage them to make larger deposits.



#### Employee testimony

Employees were actively encouraged by management to receive deposits and trades without regard to the clients’ circumstances.



#### Commissions and incentives

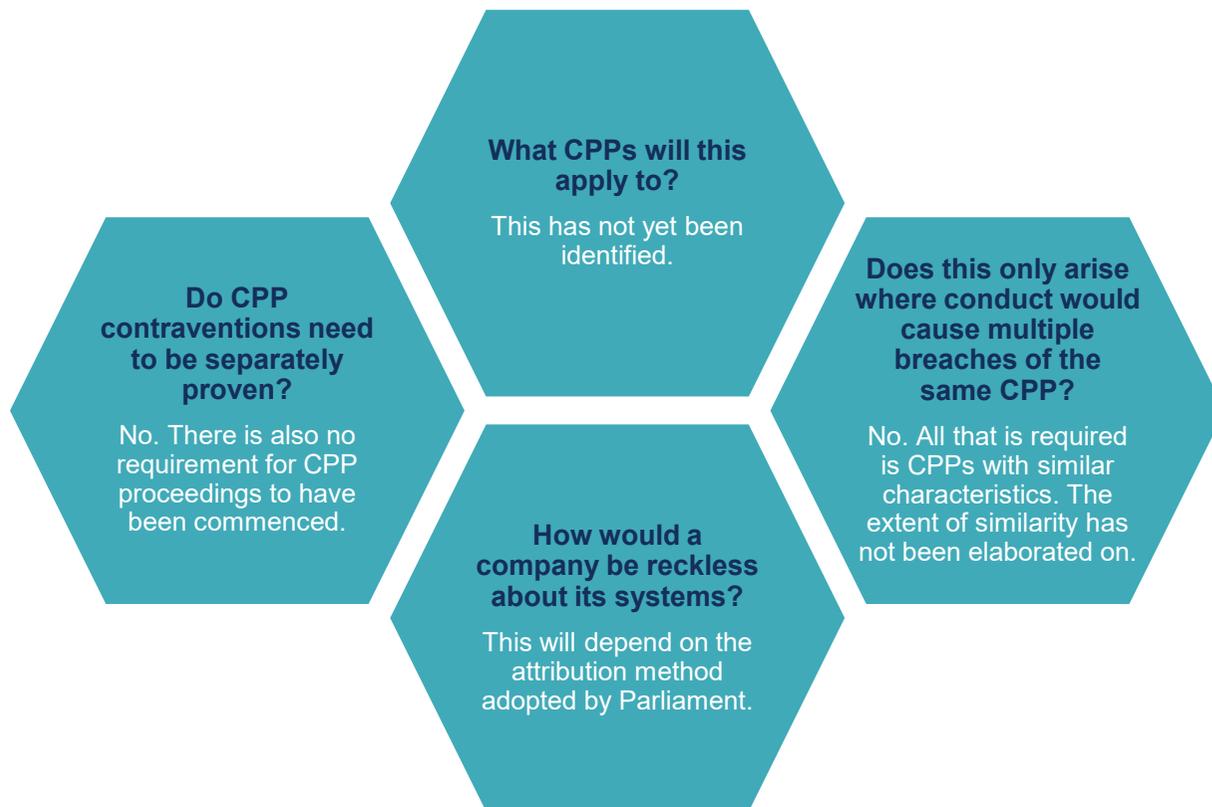
The structure of commissions paid to AMs placed them in a position of conflict with their clients’ best interests.

#### What does this show?

While cases concerning “system of conduct” type contraventions deal with other specific (civil) statutory regimes, they highlight that a “system of conduct” is context-specific and will require a range of supporting evidence (including evidence from employees).

# Nature of the proposed offence

What further guidance has the ALRC provided about the operation of the offence?



## What does “similar characteristics” mean?

The ALRC has suggested that it will be enough if the “system” or “pattern” would result in repeated contraventions of prescribed CPPs with “*similar* characteristics” (as opposed to the same CPPs).

This would provide prosecutors with the flexibility to string together a number of related or similar contraventions (given that there may be a range of CPPs applicable to the underlying conduct and scales of non-compliance) to establish the physical element of this limb, while also maintaining the need for a sufficient link between different contraventions.

The ALRC has said that the concept of “similarity” could be identified in statute or develop at common law. It has not proposed a draft definition.

This definition would necessarily need to balance the flexibility that it is intended to achieve with the certainty required by corporations to enable effective compliance.

# International perspectives

## Other jurisdictions are examining parallel reforms to corporate criminal liability regimes

### Germany

The German Parliament is currently considering the *Verbandssanktionengesetz* legislation (**Draft Corporate Sanctions Act**). While the proposed German legislation is not yet law, it looms large as a potential game changer as it would heighten the consequences for egregious corporate misconduct. The draft legislation is a response to the inadequacy of current laws to properly disincentivise misconduct that may otherwise be viewed as a “cost of doing business” (similar to the issues the ALRC’s “system of conduct” offence are directed towards).

The Draft Corporate Sanctions Act:

- provides the prosecutor and courts sharper and more flexible sanctioning instruments
- expands extra-territoriality of current criminal laws for corporations
- significantly increases fines. The current maximum is 10 million Euros per offence and would increase to 10% of the corporate group’s worldwide annual turnover.

The reforms also affect the investigation and prosecution of corporate crime. The decision whether to initiate a corporate prosecution would no longer be at the discretion of the prosecutor. Instead, the Draft Corporate Sanctions Act would introduce an obligation on prosecutors to investigate *all* corporations reasonably suspected of having committed an offence. The practicality of this proposal is a matter for debate.

The Draft Corporate Sanctions Act also aims to promote compliance, including by providing incentives for companies to conduct internal investigations and to cooperate with regulators. Measures have been proposed that would allow a court to reduce the fine applicable for co-operation.

### England

The UK has seen political appetite for and momentum toward significant reforms to the law on corporate criminal liability. Most recently, a Law Commission review has been initiated focusing on corporate liability for economic crime.

Currently, the “default” doctrine for attributing corporate fault for criminal conduct requires that the “directing mind and will” of the corporation held the requisite state of mind applicable to each physical element of the offence. This has been construed quite narrowly. There are widespread concerns about the effectiveness of the current law of corporate attribution in holding corporations to account when economic crimes are committed by them or on their behalf. Recent “mixed success” in high-profile prosecutions in England has fuelled calls for reform by investigating and prosecuting bodies, most notably the Serious Fraud Office.

The Law Commission review follows the UK Government’s response on 3 November 2020 to a Ministry of Justice “call for evidence” in 2017, which related to potential law reform in relation to corporate liability for economic crimes (the **Call for Evidence**). The response concluded that there was no clear consensus among the submissions as to what, if any, reform should be made to this area. A majority agreed that there were deficiencies in the law.

The focus of proposed reform to date has tended toward making corporate economic crime easier to prosecute, including, for example, the proposal to introduce a further “strict liability” offence where a corporate fails to prevent economic crime being commissioned on its behalf. The idea of a “system of conduct” offence was not considered in the Call for Evidence and has not featured as a proposed route to reform previously.

Like the ALRC, the Law Commission is poised to review the purpose and scope of corporate criminal responsibility and the principal distinctions between it and civil regulation. This will include the consideration of “approaches to criminal liability taken in relevant overseas jurisdictions” as well as the “relationship between criminal and civil law on corporate liability”. The Law Commission may therefore consider an offence like the system of conduct offence and the ALRC’s rationale. An Options Paper is due to be published by the Law Commission in late 2021.

# What to expect

## Prospects for reform

### Early stages of development

The ALRC's proposed new "system of conduct" offence is still in the early stages of consideration. Much will turn on the Government's response to the ALRC's Final Report, which is expected in 2021.

### Political attitudes will be telling

The Australian Government's attitude toward corporate regulation more generally, especially following the ALRC's Final Report, will be telling as to whether there is a shift away from "over-criminalisation" in federal statutes. The attitude towards the criminal regulation of corporations will determine the level of scrutiny that will be applied to the introduction of a novel offence like the "system of conduct" one.

### The form of the offence is uncertain

Translating the proposal into legislation is likely to involve further detailed evaluation and compromise. Unlike other aspects of the ALRC's Final Report which were the subject of more extensive submissions, this proposal is more likely to require further consultation and deliberation.

### Is it conceptually acceptable?

The ALRC received significant resistance to reforms escalating *civil* contraventions to the level of criminal wrongdoing. The Australian Parliament will need to consider whether:

- the moral condemnation and reputational impact of the criminal law is appropriate in relation to the proposed offence
- the deviation from the standard civil enforcement mechanisms because of the presence of a "pattern" or "system" is justified

### Practical for regulators?

One key question that remains is whether the offence would be attractive to regulators as an enforcement tool, and how the offence will sit within a coherent enforcement pyramid. The proposed new offence would create a new pathway for enforcement action, but one where the prospect of a criminal sanction may have a different perception (and impact) to the current alternative of alleging many multiple civil penalty contraventions.

Regulators have shown, through a number of recent notable cases, that significant penalties can be imposed where multiple civil penalty breaches are established.

This highlights the need for regulators to be clear about the role for any new "system of conduct" offence, and the criminal law generally, within the enforcement pyramid. If a "system of conduct" offence is enacted, it needs to support, rather than hinder, the objectives underpinning much of the ALRC's Final Report.

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