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Reverberations after the HIH and other recent Australian corporate collapses: The role of ASIC

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This article focuses on some of the litigation and other developments following the recent spate of corporate collapses in Australia. It gives a basic background to abuses of the 1980s, followed by a short description of some of ASIC's statutory powers. The remaining parts of the article focus on the role ASIC played in instituting actions against the directors of some of the collapsed corporations and in particular what ASIC seeks to achieve with high profile litigation. The article concludes that there is no doubt that in the aftermath of these massive corporate collapses ASIC fulfilled its role as the primary Australian corporate regulator with assiduousness. However, it also draws attention to the fact that the challenges for ASIC now will be to play a far more active role in assuring that signs of corporate collapses are detected at the earliest possible juncture. This will probably mean that ASIC's focus will have to be more and more on monitoring companies, rather than on its role as regulator and enforcer in the strict sense of the word.

1. Introductory remarks

There were several spectacular corporate collapses in Australia over the past three years or so. They include the collapse of HIH, Harris Scarfe, One.Tel, Pasminco, Centaur and Ansett. In itself each one of these collapses was serious, but the combined effect of all of them in a very short period of time caused serious concern for the primary Australian corporate regulator, the Australian Securities and Investments Commission (ASIC).1 This article focuses on the worst corporate collapse in Australia's corporate history, namely the collapse of the insurance company HIH Insurance Ltd.2 The

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2 Although the HIH collapse is often described as the largest corporate collapse in Australia's corporate history, it depends on what criteria are used in making that judgment. F Clarke and G Dean, ‘Corporate Collapses Analyzed’ in Collapse Incorporated: Tales, Safeguards & Responsibilities of Corporate Australia, CCH Australia Ltd, Sydney, 2001, p 81, compare company losses in nominal scaled dimensions and percentage of losses to GDP. On that basis Westpac (1993) tops the list, but it is safe to state that the HIH collapse falls at least within the list of one of the four largest corporate collapses in Australia's corporate history. For some background information on HIH, see ‘The Failure of HIH Royal Commission’, Report of the HIH Royal Commission, Owen Report, Vol I, Department of the Treasury,
corporation went into provisional liquidation on 15 March 2001. On 25 May 2001 the provisional liquidator of HIH Insurance, Tony McGrath, advised the Federal Government that early estimates for the total deficiency of the HIH group of companies would be between $2.7 billion and $4 billion. It is now generally accepted that HIH had debts of $5.3 billion.

HIH was in a terrible financial state when it collapsed. Early investigations revealed that at the time of its provisional liquidation, each of the major insurance license holding companies within the HIH group were clearly insolvent — that is, they were clearly not able to pay their debts in full; the financial position of each of the three main license holding companies was worse than the stated balance sheet position by a very significant margin in each case; the deficiencies reflected previous optimistic valuation of assets and extensive underestimation of liabilities; and the very substantial losses were not restricted to the last nine months of operation.3

The final days of HIH's existence were described in colourful, but strong, language in the Australian press:

It is a tale of scoundrels — crooks even, who jockey and grasp and concoct the most ingenious ways to pocket HIH’s cash while they still can. Well-placed mates help well-placed mates. . . . Mortgages are forgiven, bonuses awarded, dodgy invoices are fast-tracked and cheques are somehow cleared after the banks have closed. But policy-holders get nothing because that is the new policy, and shareholders might as well not exist.4

In an article with the disquieting title, ‘A Cocktail of Greed, Folly, Incompetence and Arrogance’, Trevor Sykes points to the realities of the massive HIH collapse:

Relatively few corporate collapses are the work of one or two white-collar criminals deliberately defrauding the public. Usually business collapses are caused by a cocktail of greed, folly, incompetence and arrogance. HIH is close to the norm, but the fact that the collapse occurred in the insurance industry greatly magnified the loss and, worse, the harm. No corporate collapse in Australia’s history has inflicted so much misery on its people.5

What is particularly fascinating about the HIH case is that it is a real-life example involving almost all aspects of bad corporate governance. It covers breaches of directors’ common law and statutory duties of good faith and care and diligence; conflicts of interest for directors; financial assistance by companies to buy their own shares, share-market manipulation, insider

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trading; insolvent trading, the failure of boards to fulfill its role of managing and directing the business of corporations; executive and non-executive directors not fulfilling their duties; and auditors and audit committees not performing their duties properly.

2. Understanding Australian corporations law — the abuses of the 1980s

John Farrar has noted that:

Each country approaches corporate governance from the background of its own distinctive culture . . . [Australians] . . . are inclined to come down heavily on ‘tall poppies’ and to be excessively penal in [their] approach. The attitude to the excesses of the 1980s and their aftermath reflects this. We also have a tendency to over-legislate and the result is obese and user-unfriendly legislation.6

Having some knowledge of the excesses of the 1980s is indeed essential to understand and explain many of the statutory provisions in the Australian Corporations Act 2001 (Cth). Trevor Sykes’ fascinating account of these abuses in his book, The Bold Riders,7 reveals much of the abuses and is a good starting point to obtain a deeper insight into the current Australian corporations law. Names like Christopher Skase, Alan Bond, John Friedrich and Abe Goldberg are often mentioned in corporate law discussions8 and nowadays, as if these characters have an omnipresence, names like Ray Williams, Rodney Adler, Dominic Fodera, Brad Cooper, Jodee Rich, Brad Keeling and John Greaves are mentioned almost on a daily basis in the financial and other press. One cannot be blamed for asking not whether the abuses will continue in the 2000s, but rather who will be the next group of people to be added to the already impressive list of Australian corporate cowboys.

With the recent corporate collapses in mind, it is certain that it is not the existence of ‘obese . . . legislation’ that prevents corporate collapses and that it was a misconception to rely on Corporate Law Simplification or Corporate Law Economic Reform Programs to provide the answer to the excesses of the 80s.9 There is also very little use in governments constantly acting on an ad hoc basis to deal with specific problems. This makes the law ‘too cumbersome’ and, as Baxt also points out fittingly, ‘make[s] it more and more difficult to discern a clear theme underpinning the legislation, and to provide

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6 J Farrar, Corporate Governance in Australia and New Zealand, Oxford University Press, Melbourne, 2001, p 6 (emphasis added).
7 Allen & Unwin, St Leonards, 1996.
9 See generally Owen Report, Vol I, above n 2, pp xiii–xiv. Clarke and Dean, above n 2, p 72, provide an interesting analysis of legislative changes over several years: ‘Regulatory institutions have been established and progressively given allegedly greater supervisory powers. Accounting and Auditing Standards have burgeoned to govern the financial information low. But the latest batch of failures reinforce the obvious. Corporate regulation and control is virtually no more effective now than it was in the past. Shareholders, creditors and employees are no better informed of likely failure now than they were at the time of the 1960s failure causes célèbres, such as Reid Murray, and Stanhill’ (also see p 89).
a clear message to the courts in deciding cases that are brought before them.\textsuperscript{10} It is true that the breadth and depth of possible remedies in the Corporations Act are impressive and that this legislative net may catch even the smallest fish, but it will be very interesting to compare whether much more will be achieved after the recent corporate collapses by the detailed and bulky Australian Corporations Act in comparison with a core Corporations Act like the ones in New Zealand or Canada.\textsuperscript{11} Other mechanisms are required to detect signs of potential corporate collapses as early as possible in order to minimise the catastrophic consequences of massive corporate collapses.\textsuperscript{12}

In the late 1990s corporate governance was almost considered to be an unnecessary burden upon Australian businesses. Strict corporate governance rules have even been blamed for the under-performance of Australian companies,\textsuperscript{13} but there is now little doubt that corporate governance is once again back on the front pages of newspapers and uppermost in the minds of directors and most regulators in Australia.\textsuperscript{14} The Australian Prudential Regulatory Authority (APRA) has been criticised heavily for not reading the signs of doom for HIH sooner and for not stepping in earlier.\textsuperscript{15} There are some serious allegations that APRA was made aware of financial difficulties in HIH

\textsuperscript{10} R Baxt, ‘The Necessity of Appropriate Reform’ in \textit{Collapse Incorporated}, above n 2, p 329 (see also Baxt’s critical comments of several recent pieces of legislation, pp 329–34).


\textsuperscript{12} For an interesting discussion of so-called ‘distress prediction’, see G Dean and F Clarke, ‘Distressed Businesses — Predicting Failure’ in \textit{Collapse Incorporated}, above n 2, pp 147–83. Also see J Adams and N Jones, ‘Distressed Businesses — Preventing Failure’ in \textit{Collapse Incorporated}, above n 2, pp 185–223.


at least six months before HIH went into provisional liquidation in March 2001.\textsuperscript{16} Although the report of the HIH Royal Commission (Owen Report) did not go so far as making APRA responsible for the HIH collapse or suggesting that it could prevent the collapse, Justice Owen did not hesitate to explain the reasons for APRA’s inaction and mentioned that ‘[i]n many instances — even taking account of the constraints it was under — APRA did not react appropriately’.\textsuperscript{17}

The recent corporate collapses also brought a sudden end to the complacency that prevailed about corporate governance after many years of sustained growth in Australia and Australia’s remarkable survival of the Asian financial crisis.\textsuperscript{18} Solutions to ‘bad corporate governance’ are currently sought along a very broad front, including continuous disclosure; codes of good practice; disqualification of auditors; and the role and functions of the auditor, audit committees, independent directors, and non-executive directors.\textsuperscript{19} Even

\begin{footnotesize}
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\item\textsuperscript{17} Owen Report, Vol I, above n 2, p li. See further D Brearley, T Harris and A White, ‘Williams, Adler, Cooper face jail’, The Australian, 17 April 2003; A White, ‘APRA was Doomed from Start, Says Commissioner’, The Australian, 17 April 2003.
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‘forgotten’ debates are reopened, including the debate on board structures, in particular the two-tier board system versus the unitary board system and it is clear that, as in the ‘old days’, the strong preferences for the one or the other board structure still exist among commentators.20

This article aims at determining how ASIC sees its role after large corporate collapses and to capture the general views on these large corporate collapses among the Australian population by relying on several public addresses by ASIC officials and commentary in the general media.21

3. The Australian corporate regulator: ASIC22

Funding

Before focusing on ASIC’s regulatory and enforcement roles, a few general remarks should be made regarding the funding of ASIC, how it is constituted and some of its statutory powers. ASIC is primarily funded by the Federal Parliament.23 The Federal Government has always been keen for its main corporate regulator not to suffer due to a lack of funding. ASIC’s government funding rose from $122.7m in the 1997–1998 budget to $158.4m in the 2002–2003 budget year. Early last year it was announced that ASIC will be provided with additional funding of $90.8m over four years. The additional $90.8m over this period is specifically earmarked for the implementation of the Financial Services Reforms that were put in place mid-2002. ASIC has


21 The focus of this article is primarily on ASIC’s role after the recent corporate collapses: see T McCann, ‘How ASIC went Missing in Action’, The Weekend Australian, 19–20 April 2003, for some strong criticism of ASIC not picking up the signs of HIH’s distress sooner. ASIC was, however, not given any blame for not fulfilling its regulatory role in the case of the HIH collapse: see Owen Report, Vol I, above n 2, p liv and Vol III, p 473; ASIC, ‘HIH Royal Commission Findings in relation to ASIC’, Press Release, 03/129, 16 April 2003, <http://www.asic.gov.au>.


23 Section 133 of the ASIC Act.
also been provided with additional funding of about $7m in the 2001–2002 and the 2002–2003 budgets to cover the costs associated with the HIH Royal Commission Inquiry.\textsuperscript{24} There is speculation that the government will have to provide further funding to enable ASIC to proceed with the litigation following the HIH Royal Commission Inquiry.\textsuperscript{25}

**Constitution and some statutory powers\textsuperscript{26}**

ASIC is a statutory body corporate, consisting of between three and eight members appointed by the Governor-General on the nomination of the Commonwealth Attorney-General. Of those members, a chair is appointed, however actions of ASIC are done by and in the name of ASIC, not the chair.\textsuperscript{27} The membership and members’ qualifications are contained in s 9 of the Australian Securities and Investments Act (the ASIC Act). The objectives of the ASIC Act are described in general terms in s 1 of the Act. Section 1(2) of the ASIC Act provides inter alia that in performing its functions and exercising its powers, ASIC must take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it.\textsuperscript{28}

Many of the recent litigation instituted by ASIC after the most recent spate of corporate collapses were instituted in response to ASIC’s obligations associated with these responsibilities. In this regard, it was specifically ASIC’s powers under the Corporations Act that became most prominent. It is, therefore, appropriate to deal with some of these powers.

ASIC has standing under s 1317J to apply for a court declaration of contravention of certain, so-called civil penalty provisions contained in s 1317E of the Corporations Act.\textsuperscript{29} The court makes a declaration of contravention if the court is satisfied that any one of the civil penalty provisions mentioned has been contravened. These provisions include the statutory fiduciary duties and duties of care and diligence contained in ss 180–183 of the Corporations Act. Once a court has made such a declaration of contravention, the court may then make several further orders. It could make a pecuniary penalty order (also sometimes referred to as a civil penalty order) under s 1317G; a compensation order under ss 1317H or 1317HA; or disqualification orders under ss 206C–206E of the Corporations Act.

As far as pecuniary penalty orders are concerned, a court can order a person to pay to the Commonwealth, up to $200,000 as a pecuniary penalty or a civil penalty. It should be noted that civil penalty orders have nothing to do with

\textsuperscript{24} D Knott, ‘ASIC Chairman Reviews HIH Collapse in Corporate Governance Address’ (2001) *Australian Bar News* 44 at 45. See also discussion below.


\textsuperscript{26} For an interesting perspective of ASIC’s role as a regulator, see F Assaf, ‘What will Trigger ASIC’s Strategies?’ (2002) May *Law Society Jnl* 60 at 60–1.


\textsuperscript{29} See Gilligan, Bird and Ramsay, ‘Civil Penalties and the Enforcement of Directors’ Duties’, ibid, at 418 and 421–5 for some background on the civil penalty provisions.
orders to cover damages suffered by the company because of a breach of the civil penalty provisions. Civil penalties are statutory penalties paid to the Commonwealth simply for a breach of what are considered to be some of the most important provisions of the Corporations Act, namely the civil penalty provisions mentioned in s 1317E of the Corporations Act. The main aim of these so-called pecuniary penalty or civil penalty provisions is to highlight some of the core provisions relating to directors’ duties in the Corporations Act and to serve as a serious warning to all directors and officers not to contravene these provisions. This was explained as follows in ASIC v Adler:

It is well established that the principal purpose of a pecuniary penalty is to act as a personal deterrent and a deterrent to the general public against a repetition of like conduct (ASC v Donovan (supra); Trade Practices Commission v CSR Ltd [1991] ATPR 52-135).30

ASIC has wide powers either to disqualify directors for shorter periods without even applying for a court order31 or to apply to the court for longer periods of disqualification.32 Whereas the court can only disqualify a director for a maximum period of 10 years under s 206D, the court can disqualify a director ‘for [any] period the court considers appropriate’ under ss 206C and 206E of the Corporations Act.33

4. Initial steps by ASIC after the HIH collapse

ASIC’s first step, after news broke that HIH went into provisional liquidation, was to apply for court orders to freeze all former HIH directors’ personal assets.34 ASIC also obtained court undertakings from Ray Williams, Rodney Adler and Dominic Fodera along the following lines: that they would not deal with any of their interests in personal or household assets (exceeding $50,000), real property, securities or superannuation without first giving ASIC 30 days notice of their intention to do so; that they would not transfer monies or assets outside Australia without first giving ASIC 30 days prior notice; and that they would not have any real or personal property that is otherwise not subject to the court undertaking with a value greater than $50,000.35

Prior to ASIC’s court application, Ray Williams voluntarily surrendered his passport to ASIC, but in the case of Fodera, ASIC obtained a court undertaking that if he desires to travel outside Australia he would provide ASIC with seven days notice, a detailed itinerary and a photocopy of his return airline ticket. ASIC was clearly determined to prevent a repeat of Christopher Skase, who left Australia and never faced prosecution in Australia. Skase died on the Spanish resort island of Majorca in August 2001.36

31 Section 206F of the Corporations Act.
33 See discussion below.
34 See Assaf, above n 26, at 62 for some comments on ASIC’s powers in the case of asset freezing orders.
36 Skase was 52 when he died and had personal debts of $172. His name is closely associated
5. Actions instituted by ASIC against directors after the HIH collapse

Actions by ASIC

ASIC took immediate steps to institute actions against the HIH directors after it became known that the company collapsed.\textsuperscript{37} HIH went into provisional liquidation on 15 March 2001 and the first reported judgment associated with the collapse was already handed down on 14 March 2002 — \textit{ASIC v Adler}.\textsuperscript{38} In this case, ASIC sought declarations of contraventions of the following civil penalty provisions: related party transactions;\textsuperscript{39} financial assistance to buy own shares;\textsuperscript{40} breach of the duty of care and diligence;\textsuperscript{41} breach of the duty of good faith;\textsuperscript{42} misuse of position to gain advantage for oneself or another or to cause detriment to the corporation;\textsuperscript{43} and improper use of information.\textsuperscript{44} The court made orders of contravention of all these civil penalty provisions.

In the decision of 30 May 2002, \textit{ASIC v Adler},\textsuperscript{45} the court was asked to make pecuniary penalty orders, compensation orders and disqualification orders following on the contravention orders made in the decision of 14 March 2002. ASIC was successful in obtaining all the orders sought.

Court orders

Santow J ordered that Rodney Adler should be disqualified for a period of 20 years and that he and Adler Corporation should pay pecuniary penalties of $450,000 each (totalling $900,000). Ray Williams was disqualified for a period of 10 years and was ordered to pay pecuniary penalties of $250,000. Dominic Fodera was not disqualified, but ordered to pay pecuniary penalties of $5000. In addition, Rodney Adler and Ray Williams and Adler Corporation were ordered to pay aggregate compensation of $7,958,112 to HIH Casualty and General Insurance Ltd (subject to verification of the calculation of interest).\textsuperscript{46}

\textsuperscript{37} R Baxt, ‘The HIH Litigation’ (2002) 30 \textit{Aust Bus L Rev} 145 describes the case as ‘a remarkable decision . . . because in an area of law where there is continuous demand for tougher laws, the judge, only four months after hearing the case, handed down a judgment which is nearly 200 pages long’.
\textsuperscript{39} Chapter 2E ss 208, 209 and s 1317E(1)(b) of the Corporations Act.
\textsuperscript{40} Part 2F.3 ss 260A, 260D and 1317E(1)(c) of the Corporations Act.
\textsuperscript{41} Sections 180 and 1317E(1)(a) of the Corporations Act.
\textsuperscript{42} Sections 181 and 1317E(1)(a) of the Corporations Act.
\textsuperscript{43} Sections 182 and 1317E(1)(a) of the Corporations Act.
\textsuperscript{44} Sections 83 and 1317E(1)(a) of the Corporations Act.
\textsuperscript{45} (2002) 42 ACSR 80.
Some considerations regarding the period of disqualification

If the court exercises its discretion to disqualify a director from managing corporations, the court also has to determine the appropriate period of disqualification based on the particular facts of the case. In ASIC v Adler,\(^{47}\) Santow J considered a number of cases where directors were disqualified. From these cases, he extracted several factors the courts took into consideration in determining the appropriate period of disqualification. He then concluded that by using these factors, three broad periods of disqualification could be ascertained: the longest periods of disqualification (that is disqualification of 25 years or more); periods of disqualification ranging from 7–12 years; and disqualification periods for up to three years.

The period of disqualification and the factors a court should take into consideration to determine the appropriate period of disqualification was again considered in ASIC v Rich.\(^{48}\) In this case, dealing with the disqualification of the former co-managing director of One.Tel (Brad Keeling), Bryson J was considerably more hesitant to use the periods of disqualification determined in previous cases as guidelines for determining the appropriate period of disqualification for the particular case under consideration. He observed as follows:

The guidance I can obtain from other decisions is limited, as each decision is closely related to its own facts, the facts in such cases tend to be highly complex and the circumstances of each person under consideration are special to that person.\(^{49}\) . . . There is in my view not much to be gained from considering or attempting to classify periods of disqualification which have been imposed in other cases.\(^{50}\)

Bryson J also made two further important points. First, he referred to the statement by Santow J in ASIC v Adler that the purpose with disqualification is personal deterrence rather than punitive, but he strongly disagreed with this approach. He was of the opinion that it was not only difficult to distinguish between motives of deterrence and a punitive motive with disqualification, but also that it was impossible to sustain such a distinction in practical terms. He suggested that the punitive nature of disqualifying somebody from managing corporations should be recognised and that courts will in any case apply these measures with care to ensure that ‘[n]o-one [is] sacrificed to the public interest’ by applying these punitive measures (disqualification orders) without care or excessively. This will probably become the norm in future cases and it is to be expected that the long-established practice of not seeing disqualification orders as punitive in nature will probably be viewed far more carefully by judges in future.

The second important point that Bryson J made was that the period of disqualification is entirely in the court’s discretion. It was particularly important to stress this point in the case of Brad Keeling, as the period of disqualification suggested by ASIC was part of an application by ASIC for

\(^{47}\) (2002) 42 ACSR 80.
\(^{48}\) (2003) 44 ACSR 682.
\(^{49}\) Ibid, at [26].
\(^{50}\) Ibid, at [30].
agreed declarations and orders effectively disposing of the proceedings as
between ASIC and Keeling.\textsuperscript{51} Part of the arrangement between ASIC and
Keeling was that he would pay compensation in the amount of $92m to
OneTel.\textsuperscript{52} Bryson J made it clear that even in the case of an agreed form of
consent orders, the court will have to give genuine consideration to all factors
relevant to determine the appropriate period of disqualification. It is clear from
the relevant statutory provisions\textsuperscript{53} that the period of disqualification is
exclusively in the court’s discretion and that this power cannot be delegated
to any other party, for instance ASIC.\textsuperscript{54} It is submitted that this is a correct
interpretation of the relevant disqualification powers. By accepting the
suggested disqualification period of 10 years, the court was strongly
influenced by the fact that ASIC joined in the proceedings. Bryson J made it
clear that he respected the suggestions of ASIC as ‘a guardian of the public
interest’.\textsuperscript{55} It should be noted that ASIC’s views on the appropriate period of
disqualification would also influence the court’s discretion in the case of
contested hearings.\textsuperscript{56}

Criminal prosecutions

Under s 1315(1), ASIC may lay charges or make complaints regarding any
criminal offences committed in terms of the Corporations Act, but ASIC will
not bring the criminal proceedings itself. That role is reserved for the
Commonwealth Director of Public Prosecutions. ASIC will normally conduct
investigations into criminal breaches to enable the Commonwealth DPP to
prosecute.\textsuperscript{57} This does, however, not exclude the possibility that any action
could be instituted by the DPP without ASIC’s involvement.\textsuperscript{58}

Rodney Adler already faced criminal charges for several illegal share
transactions on 3 December 2002. The offences he is charged with carry the
potential of up to 25 years of imprisonment for Adler. Adler is also facing five
further possible criminal and civil charges associated with the HIH collapse.\textsuperscript{59}
Other HIH officers like Ray Williams, Brad Cooper and Dominic Fodera are
all implicated as having being involved in criminal offences and they all run
the risk of criminal prosecution over the next few months.\textsuperscript{60}

On 31 January 2003, the Chief Operating Officer of the collapsed Harris
Scarfe company, Daniel McLaughlin, was also charged with 17 charges
arising from ASIC’s investigation into the collapse of the Harris Scarfe group.

\textsuperscript{51} See ibid, at [1].
\textsuperscript{52} See ibid, at [12] and [21].
\textsuperscript{53} Sections 206C and 206E.
\textsuperscript{54} (2003) 44 ACSR 682 at [27].
\textsuperscript{55} Ibid, at [30]. See also at [21].
\textsuperscript{56} See Australian Securities Commission (ASC) v Roussi (1999) 32 ACSR 568 at [13].
\textsuperscript{57} Ministerial Orders, ‘Serious Corporate Wrongdoing — Direction Relating to Investigation
and Enforcement’, [MO30], issued 30 September 1992; B Collier, ‘The Role of ASIC in
Corporate Governance’, Corporate Governance Summit 2002, 27 November 2002,
\textsuperscript{58} Section 1315(3) of the Corporations Act.
\textsuperscript{59} Brearley, Harris and White, above n 17; T Harris, ‘Bellevue Hill Battler Adler Hits a Tough
\textsuperscript{60} Brearley, Harris and White, above n 17; D Brearley, ‘Moral Hazard’, The Weekend
These charges include seven counts of failing to act honestly in the exercise of his powers and the discharge of his duties as an officer of Harris Scarfe and 10 counts of being reckless as an officer of Harris Scarfe Ltd and failing to exercise his powers and discharge his duties in good faith and in the interest of the company.\footnote{ASIC, ‘Former Harris Scarfe Chief Operating Officer Committed for Trial’, Press Release 03/033, 31 January 2003, <http://www.asic.gov.au>. See also J Segal, ‘Corporate Governance: Substance over Form’ (2002) 25 UNSW Law Jnl 320 at 329.}

As will be pointed out below, it is expected that several further criminal prosecutions will now follow based on recommendations contained in the Owen Report. More than 40 people, allegedly involved in roughly 1000 possible breaches, were mentioned by name in the closing submission of counsel for the Royal Commission, Wayne Martin QC.\footnote{S Hughes and B Frith, ‘HIH Counts could Sentence Adler to Jail’, The Australian, 4 December 2002. See also D Elias, ‘HIH Report Expected to Recommend Criminal Prosecutions’, The Age, 31 March 2003.} It was, however, always clear that Owen J would make up his own mind, based on the facts he gathered throughout the whole hearing, as to who would be named in the final Royal Commission Report and which breaches and contraventions of the law will require further prosecutions.\footnote{Some were disappointed that not more people were implicated in the final; see D Brearley, ‘Cowboys in Suits Escape Harsh Penalties’, The Australian, 17 April 2003; M Westfield, ‘But Others to get off Lightly’, The Australian, 17 April 2003.}

6. Aim with high profile prosecutions\footnote{Gilligan, Bird and Ramsay, ‘Civil Penalties and the Enforcement of Directors’ Duties’, above n 28, at 440–7 and Assaf, above n 26, at 60 provide interesting perspectives on what type of consideration will trigger actions by ASIC.}

There is little doubt that ASIC is taking its regulatory and enforcement roles very seriously. It accepted full responsibility to act swiftly and used the considerable powers it has to send out a stark warning signal to other directors of the dire consequences that may visit them personally if companies collapsed and they are to blame for that. David Knott, Chair of ASIC, is reported to say that the orders against the three HIH directors served as a warning to company directors and ‘highlighted the serious consequences that could flow from the failure of good corporate governance’.\footnote{The Australian, 31 May 2002.} Berna Collier observed that ‘it is important to note that all [the recent] enforcement action [by ASIC] does more than target individuals who breached the law. It has an education and market confidence impact.’\footnote{B Collier, ‘The Role of ASIC in Corporate Governance’, Corporate Governance Summit 2002, 27 November 2002, <http://www.asic.gov.au/asic/asic_pub.nsf> (speeches) at 6.} Or, as Assaf puts it, ‘the above matters [civil proceeding against HIH and OneTel directors] sent out a strong signal to directors of public companies — comply with your statutory obligations or else[!]’.\footnote{Assaf, above n 26, at 63.}

How scared some greedy corporate cowboys will be is an open question, but it is at least comforting to know that there are other strategies in place to control the financial markets as well. The Financial Services Reform Act 2001 (Cth) and the other reforms in the Insurance Industry should be seen as part
of a broader strategy to ensure good corporate governance and to act proactively in the battle to prevent spectacular corporate collapses. The words ‘spectacular corporate collapses’ are used specifically, as it is impossible for any regulator, legislature or the market to prevent corporate collapses completely. It has also been ASIC’s view that there will always be company failure because of the simple reality of competitiveness and economic forces. The role of the law and the regulators is rather to manage the problem and to ensure, as diligently as possible, that signs of financial difficulties are detected as soon as possible and where there is still hope, to take struggling companies by the hand through voluntary or external administration or similar supportive arrangements.

7. The role of ASIC in corporate governance

ASIC has clearly accepted that it should play an important role in corporate governance in Australia. Berna Collier outlined the role of ASIC in corporate governance as follows:

So what exactly is our role in corporate governance? What do we do on a daily basis to improve corporate governance in Australia? Essentially, ASIC’s role in corporate governance is threefold:

1. ASIC monitors, enforces and administers compliance with the broad range of corporate governance provisions in the Corporations Act;
2. ASIC has a public education or advocacy role; and
3. ASIC contributes to law reform in relation to corporate governance.

It was the first of these roles, and in particular enforcing compliance, that was prominent in ASIC’s dealings with the corporate collapses in Australia in 2001 and 2002. It is to be hoped that the monitoring role of ASIC will become more and more prominent in future as a way of detecting the signs of potential huge corporate collapses as soon as possible rather than cleaning up after such collapses. That is a sensible approach and, as part of that approach, the education and advocacy roles of ASIC will surely also become quite prominent in future. But, as Jillian Segal points out, it will definitely require

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69 See Adams and Jones, above n 12, pp 210–16.


71 See generally regarding the role of governments in risk minimisation: Sarre, above n 13, pp 319-21.
a willingness and commitment from the private business sector as well to ensure the success of this approach.\textsuperscript{72}

It only requires a quick glance over public speeches and media releases by ASIC to realise that ASIC is committed to play a key role in regulating and enforcing corporations law and the law relating to financial services.\textsuperscript{73} There is little doubt that ASIC is living up to this challenge.

8. Other developments following the HIH collapse

General

So far the focus was on ASIC’s active role in initiating actions against certain of the HIH directors. The HIH collapse was, however, of such a magnitude that it sparked off several other developments. Two of these developments are of particular importance, namely, new legislation for the insurance industry and the appointment of the HIH Royal Commission.

Insurance legislation fast-tracked and huge legislative reforms implemented

As a direct consequence of the HIH collapse, the whole process of insurance legislation was fast-tracked\textsuperscript{74} and huge changes were introduced in a very short period of time. Implementing these changes has been described by ASIC as ‘the largest single logistical exercise that [they] have been called upon to implement’.\textsuperscript{75}

\textsuperscript{72} J Segal, ‘Corporate Governance: Substance over Form’ (2002) 25 UNSW Law Jnl 320 at 345.


HIH Royal Commission

The HIH collapse was so huge that the government realised, under considerable political pressure,\textsuperscript{76} that it should do something to prevent similar collapses and to protect the public. On 18 June 2001 the Prime Minister, John Howard, announced that a Royal Commission (chaired by a Supreme Court judge, Justice Neville Owen) would be appointed to investigate the HIH collapse. The original intention was to have a report completed by 30 June 2002, but that date was extended to 28 February 2003 and earlier this year to 4 April 2003. The commission only finished its investigation at the end of January 2003.

The terms of reference for the Royal Commission were particularly wide, but focused specifically on how the actions of officers (directors, employees, auditors, advisors and agents) ‘contributed to the failure of HIH’ or ‘involved undesirable corporate governance practices, including any failure to make desirable disclosures regarding the financial position of HIH’.\textsuperscript{77} The inquiry was a massive undertaking, stretching over 15 months (commencing on 3 December 2001), 220 sitting days and calling 125 witnesses. The proceedings recorded in more than 19,500 pages of transcript. The closing submissions comprise about 10,000 pages.\textsuperscript{78}

In a public address David Knott indicated that the appointment of a Royal Commission would ‘raise complex issues’ regarding the overlap between the Royal Commission’s investigation and ASIC’s own statutory powers to proceed against directors and officers.\textsuperscript{79} This issue was eventually resolved by establishing a protocol between ASIC and the HIH Royal Commission on 6 November 2001.\textsuperscript{80} The primary aim of the protocol was to prevent unnecessary duplication and to ensure that ASIC would provide the Royal Commission with ‘documents and information’ obtained by ASIC under its extensive investigative powers under Divs 2 and 3 of Pt 3 of the ASIC Act and ‘which could be relevant to the commission’s inquiry’. This protocol also recognised the inevitability of some overlap. It was also agreed that the Royal Commission would provide ASIC with relevant information and evidence to assist ASIC with its actions against HIH directors.

The Owen Report, released on 16 April 2003, indicated that there are 56 matters of breach of the Corporations Act and the Crimes Act 1900 (NSW)

\textsuperscript{76} D Elias, ‘The Report that HIH’s Players Fear Begins to Take Shape’, The Age, 3 February 2003. See generally Baxt, above n 10, pp 329–35 and 352 for the dangers of ad hoc legislative reforms purely based on ‘political pressure’.

\textsuperscript{77} See generally McCarthy, above n 15, at 110.

\textsuperscript{78} Some commentators break the sheer volume of reading down differently: see D Elias, ‘The Report that HIH’s Players Fear Begins to Take Shape’, The Age, 3 February 2003: ‘[A] million pages of documents and 10 million words of transcript . . . and . . . 4200 pages of submissions from counsel assisting to consider and nearly as many pages from those who have accused.’

\textsuperscript{79} See also McCarthy, above n 15, at 111.

that should be referred to ASIC to examine further and to prepare briefs for possible proceedings. None of these matters overlap with any of the proceedings already initiated by ASIC or the DPP. The scale of these possible actions and prosecutions is of such a magnitude that the Treasurer, Peter Costello, announced that a taskforce will be established immediately within ASIC to assist with these proceedings.\textsuperscript{81} There is considerable public expectation that some of the HIH directors should go to jail and the politicians and policy makers are surely aware of this expectation of the Australian voters.\textsuperscript{82} The Treasurer is already reported to ‘pledge to the public that where there is admissible evidence and where there has been a breach of law, that will be put into a court to deal with those people’.\textsuperscript{83} These popular views of persecuting everybody remotely involved in the HIH collapse prompted Owen J to make it clear in his final report that he hopes that ‘readers of the report will not be preoccupied with blame’.\textsuperscript{84} The Owen Report also contains extensive recommendation in Chs 6 and 7 regarding corporate governance and financial reporting. These proposals are generally consistent with the CLERP 9 proposals and it is clear that the government is keen to get legislation prepared to reflect these recommendations within a very short period of time, possibly even before the end of this year.\textsuperscript{85}

9. Is there still a place for private party (shareholders, directors and other officers) litigation?

There is an array of actions available for private parties to institute actions against directors or to enforce their rights internally.\textsuperscript{86} One of the most recent additions to the Corporations Act was the so-called statutory derivative action, giving several parties like members, former members, directors and former directors standing to institute actions on behalf of the company.ASIC is specifically excluded from bringing such an action, because, as it was stated in the Explanatory Memorandum:

the basic policy objective of derivative proceedings is to provide an effective remedy for investors and to overcome the difficulties in Foss v Harbottle — there is no proper role for the ASC to bring such proceedings. In particular, the statutory action is not intended to be regulatory in nature . . . In this regard, a statutory derivative

\textsuperscript{83} Brearley, Harris and White, above n 17.
\textsuperscript{84} Owen Report, Vol I, above n 2, p lxii.
\textsuperscript{85} The Treasurer, above n 81.
action has the potential to remove some of the regulatory burden from the ASIC by making it easier for investors to protect the interests of the company.\textsuperscript{87}

The irony is, however, that ASIC is playing such an active part in this field that one could well ask: what role there is left for investors if the primary corporate regulator is so dominant in this arena? It should be noted that in \textit{ASIC v Adler}\textsuperscript{88} several of the actions brought by ASIC were specifically for a breach of the directors' duties towards the company. ASIC's aim was obviously to establish a breach of civil penalty provision listed in s 1317E, which enabled them to apply for long periods of disqualification, but ASIC did not stop there. It was successful in obtaining not only very long periods of disqualification against Rodney Adler and Ray Williams, but it succeeded in pecuniary penalty orders amounting to $1,155,000 against the three directors (Adler — $900,000; Williams — $250,000; and Fodera — $5000). It will also be remembered that ASIC obtained a compensation order (under s 1317H) in the amount of $7,958,112 against Adler, Fodera, Williams and Adler Corporation.

Another interesting aspect that will certainly become an issue over the next few years is the extent to which the company or minority shareholders can 'free ride' on the actions instituted by ASIC. In other words, if ASIC was successful in obtaining a court declaration of contravention under s 1317J for a breach of the director's duty of care and diligence under s 180 of the Corporations Law, would the shareholders be able to tap in on the court proceedings of ASIC to prove a similar breach of duty towards the company and claim the damages suffered by the company because of such a breach? Or, on the same basis, would the company or shareholders be able to rely on facts already proven in the separate ASIC's civil penalty proceeding against directors for a breach of a statutory (eg, s 182 — duty to prevent a conflict of interest and not to gain an advantage for themselves) or common law fiduciary duty and claim any profits the directors made from such a breach? It is to be expected that already in the HIH litigation, challenging questions will arise regarding the litigation instituted by ASIC and any future private party litigation.\textsuperscript{89}

It is now an open question where the lines are to be drawn in bringing these actions. Is there a public duty on ASIC to bring these actions? Should ASIC bring these actions in all cases or only in high profile cases where the corporate collapses are considered to be huge? Is there not a duty on ASIC to assist litigants in smaller corporations where they may have fewer resources available to bring these actions? To what extent will ASIC's actions tap the funds of the corporate culprits, leaving virtually nothing to make it worth its while for the 'investors' (primarily shareholders and creditors) to institute action, including class actions, against the corporate culprits? Some of these questions already prompted ASIC to make public statements about its involvement in high profile matters.

\textsuperscript{87} \textit{Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998}, para 6.30. See also Duffy, ibid, at 55.
\textsuperscript{88} (2002) 42 ACSR 80.
Bernie Collier pointed out that ASIC is not only involved in high profile cases, but also acted in several other matters in 2001–2002. During this period:

- ASIC investigations resulted in 19 criminals being jailed and 23 convicted from briefs prosecuted by the DPP. 11 of those jailed were company directors;
- ASIC took 81 civil proceedings, resulting in orders against 140 people or companies, $65 million in recoveries and compensation orders and $45 million in frozen assets;
- 20 people were banned from managing corporations as a result of ASIC enforcement action; and
- 10 company auditors and liquidators were disciplined for misconduct as a result of ASIC enforcement action.90

This might be true, but it is just natural to expect that there will necessarily be some sort of prioritisation in deciding when to take action and that will necessarily deprive some needy shareholders and creditors of the supportive role ASIC played in high profile cases.91 Assaf, a former solicitor for ASIC, points out that it is obviously impossible for ASIC, as a statutory authority with limited resources, to get involved in every single case of a contravention of the Corporations Act. He explains that ASIC normally balances the following issues in its decision to get involved: regulatory impact; chances of success; cost; significance of the contravention; and the individual or individuals involved.92

A successful compensation order of approximately $8m against Rodney Adler, Ray Williams and Adler Corporation seems impressive, but the scale of collapses should be considered as well.93 HIH’s debts were approximately $5000m and ASIC was successful in compensation orders amounting to roughly $8m. The question is whether ASIC will also fulfill its enforcement role in a case where the collapse is a hundred times less spectacular, say a debt of $50m with a potential of a successful compensation order of $8000?

The statistics of ASIC’s involvement in civil, criminal and disqualification cases seem quite impressive. Also here, however, the scale of things should be considered. There are approximately 700094 corporate collapses in Australia

91 For a useful summary of ASIC’s actions in recent high profile cases, see J Segal, ‘Corporate Governance: Substance over Form’ (2002) 25 UNSW Law Jnl 320 at 327–31.
92 Assaf, above n 26, at 61. See also Gilligan, Bird and Ramsay, ‘Civil Penalties and the Enforcement of Directors’ Duties’, above n 28, at 440–7.
93 For an interesting analysis of the scale of several large corporate collapses in Australia, see Clarke and Dean, above n 2, pp 80–2.
each year. A large percentage of these collapses would be because of competitiveness and economic forces. It will, however, be quite interesting to investigate in what percentage of the corporate collapses that were directly or indirectly ascribed to bad management and breaches of the corporations law ASIC actually intervened. It will also be interesting to determine what the total losses suffered by shareholders and creditors were in these cases and to determine the success rate of ASIC expressed as a percentage of the total losses suffered by shareholders and creditors in these cases. These comments are not made as criticism of ASIC. They are posed to stimulate debate and research on some very interesting issues. Proper research into these questions may well reveal that ASIC’s involvement is truly over the whole spectrum of corporate collapses, from the most spectacular to the least spectacular. It falls outside the scope of this article to deal with these interesting questions.

10. Limits of ASIC’s powers and responsibilities?

Fundamental questions about the scope of ASIC’s prudential supervision, powers and responsibilities are nowadays asked. There are definitely some differences in opinion, even in ASIC, as to how far the powers of a regulator should be extended. David Knott touched on some of these issues in one of his recent public addresses:

Is the traditional approach leaving responsibility for corporate governance and compliance with boards, shareholders and auditors still valid? Or should we be thinking about extending the scope of prudential supervision more pervasively throughout the business community? Should the corporate regulator, for example, have rights to enter, inspect and even seize records without cause? Should the regulator have powers to prescribe and enforce governance standards? These would be radical notions for a corporate regulator and would represent a major shift in managing governance responsibilities. I am not necessarily advocating such change, merely making the point that if you are not in control of governance, you cannot prevent failure.

95 Assaf, above n 26, at 60, refers to some of the high profile cases and then observes as follows: ‘Consequently, one could be forgiven for thinking that ASIC is focused solely on achieving as much media attention as possible. Indeed, to many practitioners and industry participants, ASIC’s enforcement efforts may seem unpredictable or even haphazard. Nothing, however, is further from the truth — every enforcement action that ASIC pursues is designed to achieve maximum regulatory impact. In other words, each enforcement outcome ASIC achieves is designed to send out an appropriate signal to the marketplace’. Although ASIC’s enforcement efforts may not be ‘unpredictable or even haphazard’, there could be little doubt that ASIC is indeed trying ‘to achieve as much media attention as possible’. If this is not the case, how would ASIC ‘achieve maximum regulatory impact’ and ‘send out an appropriate signal to the marketplace’? That is surely achieved by focusing on high profile prosecutions that will get the media’s attention and help ASIC to warn the marketplace of the dire consequences that may flow from breaching the corporations law.

96 In other words, cases where the collapses are not ascribed to usual market forces like competitiveness, over supply, wrong line of business etc.


98 D Knott, ‘Corporate Governance — Principles, Promotion and Practice’, Inaugural Lecture — Monash Governance Research Unit, 16 July 2002,
One could be forgiven for detecting from this a hint that ‘failure’ may well be ‘prevented’ if ASIC’s powers are extended along the line David Knott alludes to. That notion may nowadays find favour among the general public,99 who suffered greatly from the recent corporate collapses, and among politicians, who will surely see the political gain in ‘protecting’ and ‘coming to the rescue’ of the voters. There are, however, also views that such drastic powers are unwarranted if one considers the success of the regulators in the Australian courts in recent times100 and that further regulation may just stifle corporate initiative.101 It is interesting to note that the adult population of Australians owning shares is one of the highest in the world, with approximately 53.7% (approximately 7.4 million people), of the Australian population owing shares.102 Many of these shareholders, the thousands of creditors and those who lost their insurance cover in the HIH collapse, will surely support any suggestion of extending ASIC’s powers that may prevent future spectacular corporate failures.

11. Concluding remarks

The spate of corporate collapses over the past few years did not only impact on the Australian economy generally and the lives of millions of Australians, but their reverberations were felt much wider. Politicians, legislatures and regulators were possibly closest to the shockwave caused by these collapses and that resulted in remarkable reforms in the financial markets and in the corporations law over a very short period of time. Several new pieces of legislation were rushed through parliament, regulators pursued their roles with renewed vigour and the debates on corporate governance, in all its manifestations, attracted renewed and invigorating interest.

The primary Australian corporate regulator, ASIC, played a dominant role in the aftermath of these huge corporate collapses. It used its statutory powers


101 Baxt, above n 10, p 326.

extensively to act swiftly to institute action against the directors of most of the
collapsed corporations and was remarkably successful in this quest. Several
directors were disqualified for long periods of time; huge pecuniary penalty
orders were obtained; and it was also successful in obtaining huge
compensation orders against directors and related corporations. Several
criminal actions against directors are pending and it is certain that more will
follow. There is little doubt that the swift and efficient way ASIC dealt with
these cases was aimed at maximum public impact and to deter similar
unacceptable conduct by directors. At the same time, ASIC also ensured that
its role as regulator, enforcer and educator was highlighted.

There is not the slightest doubt that in the aftermath of these massive
corporate collapses ASIC fulfilled its role as the primary Australian corporate
regulator with assiduousness and for that the commission should be highly
commended. The challenges for ASIC now will be to play a far more active
role, not in assuring that corporate collapses do not occur in future, but to
ensure that signs of corporate collapses are detected at the earliest possible
time. This will probably mean that ASIC’s focus will have to be more and
more on monitoring companies, rather than on its role as regulator and
enforcer in the strict sense. It will probably be a far greater challenge to fulfill
this role than one of picking up some of the leftovers on behalf of affected
corporations and individuals after the corporate cowboys and bold riders have
left financially ruined corporations. Only time can tell whether ASIC will take
up this challenge and live up to public expectations in this regard.