Books

Ain't Misbehavin'? — The Problem of Getting Business to Behave (Review Essay)

BUSINESS REGULATION AND AUSTRALIA'S FUTURE
Peter Grabosky and John Braithwaite (eds), Canberra, Australian Institute of Criminology (1993), 275pp, $30.00, ISBN 0642 184534

JOHN GOLDRING*

1. *People and Business: Similarities and Differences*

A major problem facing Australian society — indeed, most societies — today is the problem of getting business to behave in ways that are acceptable to the community. Individuals in their personal life may observe high moral standards, yet in their economic or commercial roles in society may act in ways that have profoundly anti-social effects.

Business Regulation and Australia's Future, edited by Peter Grabosky and John Braithwaite (the leading sociological scholars of the nature and effectiveness of business regulation in Australia) is a collection of conference papers examining the extent of, the need for, and particularly the best and least costly ways of achieving the sort of regulation that Australian society needs.

Brent Fisse's contribution to the collection (ch 18: "Rethinking Criminal Responsibility in a Corporate Society: An Accountability Model") suggests that making corporations comply with legal requirements requires instilling in their managers and controllers a type of responsibility similar to the individual responsibility which is expected of those who take a part in civil society. The types of suasion that will cause an individual to modify her or his behaviour may, indeed usually will, have no effect on a business. The idea that a corporation (most businesses are incorporated) has a totally separate legal personality from those who form or manage it[1] has changed from a convenient legal fiction to an article of faith, so that businesses lack personal morality, even though they may have images and assets. What is more, an increasing proportion of them have no physical presence in any State, so that attempts to find their assets within any given territory may be fruitless: the spirits behind the business are quick to anticipate such threats, and the combination of modern technology and the corporate form makes it easy to move assets rapidly from one country to another (ch 14: Reiss, A J Jr, "Detecting, Investigating & Regulating Business Law Breakers"). Traditional legal and regulatory sanctions have been physical, and require physical presence. They may not be of much value against modern corporations.

* Foundation Dean and Professor of Law, University of Wollongong.

1 Exemplified by the case of *Salomon v A Salomon & Co* [1897] AC 22.

Psychologists know many ways to modify the behaviour of individuals. Some of the more effective methods involve getting those concerned to internalise a set of standards or values, and to become committed to observing them. They are most likely to do this if they feel they have developed the standards themselves. Alternatively, they may act in certain ways because they feel their own interests are best served by so doing, because the behaviour will gain rewards or avoid sanctions. These methods do not involve physical coercion. There are no conclusive empirical studies as to why people in fact observe the law, but it is often asserted that they do so because they hold values which, if not congruent with the values underpinning the law, are close to them. Businesses, as such, do not have moral values, or if they do, they may not be identical with those of the individuals who control them. The controlling factor is profit rather than conscience. For this reason, it may be assumed that businesses often will not behave in the same way as individuals. Different techniques may be required to modify the behaviour of businesses from those which can modify the behaviour of individuals. Several contributions to Business Regulation and Australia's Future suggest that the solution is to bring about a change in attitude and culture in both regulator and regulated.

Influential people might suggest that there is little need for the state to do more than to provide a stable framework within which market forces can operate. Market forces — supply and demand — will then allocate society's resources in the most efficient and just way. There is no reason for the State to intervene. This idealistic model rests on some totally unrealistic assumptions: first, that actors routinely act rationally, and secondly, that markets operate efficiently and effectively. There are, however, always totally unpredictable occasions when humans can be counted upon not to act rationally. Markets, in the short-term real world, are typified almost as often by failure as by efficient allocation of resources, because of the inherent inequality of the operators, and especially of the information available to them.

Economic theory is useful for explaining and understanding a situation. Experience has shown, and continues to show, that it can be dangerous when used as a basis for prescription or legislation. The command economies which used to typify Eastern Europe may have been even more prone to failure than some market economies, but there seems agreement that a mixture of paternalistic intervention and market forces is acceptable and often desirable as the ideal model for an economy in a democratic society. Without State intervention, the powerful operators will do all they can to withhold information from other players in the market, because that information gives them an advantage. Knowledge is power. No market operates effectively without rough equality of information. Many markets would not operate at all unless the state not only provided a legal framework for their operation, but also proved ready and willing to step in to prevent the more extreme adverse consequences of market failure. For this reason, commercial interests which favour maximisation of profits without regard to welfare considerations tend to favour greater emphasis on market forces, while consumer and community groups tend to favour greater intervention. No one, however, favours regulation for its own sake.

As Shearing's contribution (ch 5: "A Constitutive Conception of Regulation") argues most effectively, the nature of market activity entails a need for regulation. Rules are needed in any areas to prevent physical injury: for example, rules about workplace safety, labelling of hazardous substances, protection of the envi-

ronment and prevention of other anti-social behaviour so that people's lives, health and property are not endangered. There is often a disagreement about the limits of such regulation, but they are accepted, generally speaking, as a necessary part of the social framework. Rules are also needed to enhance the functioning of the economy: the rules of contract law are central, but other laws, such as those about business and employee organisations and the payment and working conditions for labour and the raising of capital are also important. Then there are state mechanisms — the defence of territory and the provision of a system of just dispute settlement and compensation for loss or damage caused by another, as well as other infrastructure, such as education and public utilities — which must be established and funded, thus entailing a system of revenue collection.

Many business executives have been conditioned to see a basic conflict between the costs of complying with regulatory rules and corporate profitability. This, they say, impedes Australia's competitiveness in a world economy, especially when our competitors are third-world countries without the standards of occupational health and safety Australians have come to expect. There is a strong note of this in the papers by Martin (ch 12: "Making the Giant Competitive Rather Than Crushing") and Mayer (ch 7: "The Role of Regulatory Enforcement in the Australian Economy"). Undoubtedly high standards of workplace safety, adequate working conditions and wages, of product safety, and of environmental conservation all have costs. These costs are greatly increased by duplication of regulation in a federal system, as Wilkins' paper points out (ch 13: "The Problems of Duplication and Inconsistency of Regulation in a Federal System"). The machinery necessary to establish and maintain the standards also has a cost, and some papers (especially Hartnell, ch 3: "Regulatory Enforcement by the Australian Securities Commission: An Inter-Relationship of Strategies" and Baxt, ch 9: "Thinking about Regulatory Mix") suggest that some aspects of the machinery are under resourced, while others are not cost effective. Businesses are risk averse in that they are unwilling to make decisions as to what standards they should observe. They prefer some standard to be fixed externally, and to observe it in the sure knowledge that if they do so they will not face liability.

2. *Current methods of regulation*

The law has traditionally used two methods to ensure compliance with standards established by legal rules: civil liability, where a person who can establish that he or she suffered loss caused by a breach of the rules may restrain the activity that caused the loss or recover compensation for that loss, and criminal liability, where breach of a standard attracts a criminal penalty. The clearest example of the former is the liability of sellers of goods for breach of the terms implied into contracts for the supply of goods that the goods will be fit for purpose and of merchantable quality. Civil sanctions are not as effective as they may once have been, because it is easy to insure against liability, and the remedies may not be sought because the costs of recovering compensation through a civil claim for many wrongs are usually far greater than the amount which any individual is likely to recover. Still, civil claims for large scale environmental damages may be a distinct possibility, where actual loss can be established.

The typical model for a regulatory structure is for the state to lay down standards or norms of behaviour in legal rules. Any person, natural or legal, who does not comply with the standards commits an offence, and is liable to criminal punishment. In *Business Regulation and Australia's Future,* this system is commonly called the command/control model. The descriptive articles elaborate on the basic idea. The Australian Securities Commission, (described by its former Chairman, Tony Hartnell, in ch 3), the Trade Practices Commission (discussed both by Baxt, ch 9 and Tamblyn, in ch 11: "Progress Towards a More Responsive Trade Practices Regulatory Strategy"), the Cash Transactions Reports Agency, (discussed by Coad and McDonnell, in ch 15: "New Strategies for the Control of Illicit Money Laundering") and the Australian Taxation Office, (discussed by Boucher, in ch 16: "Risk Management on a Market Segmented Basis") all embody the command/control model, though, to varying extents, these agencies are experimenting with other models. Albert Reiss discusses the detection of offenders (ch 14), Commonwealth Director of Public Prosecutions, Michael Rozenes QC, and Graeme Davidson of his office, discuss the prosecution of offenders (ch 17). Because of the serious physical consequences of conviction and punishment of crime, the criminal law properly establishes a series of procedural safeguards — a high standard of proof, certain privileges for defendants, the right to trial by jury in serious cases — which entail significant resources for the law enforcement process. Longo (ch 4: "The Powers of Investigation of the Australian Securities Commission: Balancing the Interests of Persons and Companies Under Investigation with the Interests of the State"), argues that one regulatory agency, the Australian Securities Commission, has powers that go beyond what is necessary for criminal law enforcement, but this argument assumes that corporations, which cannot be subjected to physical punishment, are entitled to the same protection under procedural safeguards as natural persons. This assumption, like the assumption that corporations are entitled to privacy, needs to be questioned very thoroughly.

Contemporary business regulation in Australia appears to focus on ex post investigation, prosecution and punishment of offenders — the control aspect of the command/control model.

By contrast, where business accepts obligations without any formal legal requirement to do so, there is, of course, no need to impose sanctions. Schoer (ch 8: "Self-Regulation and the Australian Stock Exchange"), argues that this is the case with the Australian Stock Exchange (ASX), a relatively stable institution formed for limited purposes, with a restricted membership. Membership of the ASX is, of course, itself a very valuable privilege, and the risk of loss would be a most effective incentive for members to comply with its rules. Norms and standards are internalised and the players have incentives to observe them. The command is not issued authoritatively, but accepted. This is the virtue of self-regulation. However, by definition, market forces work against self-regulation, because competitors in the market must undercut each other in whatever ways they can. They are accused of being anti-competitive if they agree on minimum standards, if refusal to accept those standards leads to restricting the access of others to that market or to the offending competitor being excluded from the market. Self-regulation is, therefore, of limited use in getting businesses to behave when it runs the risk (as is often the case) of offending against laws seeking to enhance competition.

Both civil and criminal sanctions have been part of the law for many years. The effectiveness of civil sanctions is limited because those entitled to invoke them have only limited access to legal remedies. They can rarely obtain legal aid, and the cost of a defended civil action and the risk of liability for the successful defendant's costs usually deters all but the most affluent or determined from pursuing civil remedies. The sanctions, except for dissatisfied consumers of goods who return defective purchases to retailers, go largely unenforced. Criminal sanctions by definition are enforced by agencies of the state, are discretionary, and attract, quite properly, the procedural protections of the criminal law. The consequences may be that the criminal sanctions also remain unenforced. Effective staffing of enforcement agencies (other than the police) ranks low on the priority lists of governments in an era of recession, and when policy seems dominated by the view that the small state is the best state.

Two other factors may work against the effectiveness of criminal sanctions, and thus the command/control model. Crimes are regarded as very serious and morally reprehensible transgressions of legally established standards of acceptable behaviour. Some business behaviour may be regarded properly as being the subject of criminal law when they are carried out consciously and are likely to cause physical injury (for example, failing to fence dangerous machinery in a factory, or allowing toxic products to be sold). Other minor transgressions — such as minor traffic infringements, failure to lodge certain forms required by the corporations law or the customs legislation — are seen as wrong, and sanctionable, but not as criminal. This has led the Australian Law Reform Commission, in recent reports,[2] to suggest a system of administrative penalties, similar to that used for on-the-spot traffic fines, be adopted widely for breach of regulations. Those called upon to pay such fines always have the option of having the matter referred to an ordinary court and defended, with full safeguards. A system of administrative penalties at least avoids the extremes of adversarial attitudes that might arise where fairly routine and uncontroversial business practices, which damage the revenue rather than people or property, run counter to the law.

Where the command/control model depends on a state agency for enforcement, that agency needs not only adequate resources, but it also needs to maintain a balance between an unnecessarily aggressive adversary pose, and becoming captured by the forces it should regulate. Grabosky and Braithwaite have addressed the problem of capture in an earlier book.[3] It is clearly a risk for an agency which lacks adequate resources for proper enforcement.

3. *What are the alternatives?*

Braithwaite has recently published, with an American colleague, Ayres, a detailed treatise called *Responsive Regulation, Transcending the Deregulation Debate* (1992), so it is hardly surprising that Braithwaite's chapter in this collection is called "Responsive Regulation for Australia" and presents a model of how a graduated scheme of different types of regulation could be intro-

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2 Especially, *Administrative Penalties in Customs and Excise*, ALRC 61, 1992; also *Multiculturalism and the Law*, ALRC 57, 1992.

3 *Of Manners Gentle* (1986).

duced in Australia. In some ways this is the most interesting chapter of the book, for it acknowledges that traditional methods of regulation have been only partly effective, but also sees a distinct need for the state to intervene and to direct business behaviour. The model suggests that businesses (or other subjects of regulation) should first be asked to modify their attitudes and behaviour — to comply voluntarily with standards established by the community. If they are unwilling to do so, increasingly severe sanctions are imposed, until ultimately the state may impose commercial capital punishment: the cancellation or withdrawal of a licence to trade. There would be a pyramid of potential disincentives for business not to infringe the required standards.

In favour of the responsive regulation model, it must be said that the idea of a full criminal prosecution as the result of a relatively minor infringement has a chilling effect on the subject, and tends to bring the whole regulatory system into ridicule. In such circumstances it is easier for the more extreme economic rationalists to say that State regulation is invariably a less efficient way of achieving an end than market forces would be.

Another problem that seems inevitably to arise in the context of regulation is "who enforces?" With the command/control model, because the sanctions are almost exclusively penal, the answer is usually that the State must be the sole enforcer. To some extent this is a consequence of the need to observe the procedural safeguards of the criminal law, but it means that a person who wishes to complain about a contravention of a legal standard cannot even implement legal action against the alleged wrongdoer, because the state agency exercises a discretion to prosecute. In Australia, a number of Commonwealth Statutes now follow the pattern of the *Trade Practices Act* 1974 (Cth), ss79-82, which allow a range of enforcement procedures. This has the benefit of ensuring that if the Minister or the regulatory agency chooses not to enforce the provision by commencing criminal proceedings, then any other person may apply for injunctive relief: *Trade Practices Act* 1974, s80. In addition, any person who suffers loss or damage resulting from a contravention of a provision of the Act may recover compensation from the contravener: s82.[4] The *Trade Practices Act* 1974 (Cth), s52, prohibits misleading or deceptive conduct in trade or commerce. It is probably one of the most important statutory provisions to be enacted in Australia for years. Virtually all actions in which a contravention of that section has been alleged have been commenced by business competitors of the alleged contravener, but the consequences have been enhanced consumer protection for the whole community. If the Trade Practices Commission alone had the power to enforce the provision, it is unlikely that the jurisprudence that has developed around this section would ever have occurred. Where the law imposes a standard for business behaviour, it is usually desirable that there be a range of possible enforcement mechanisms.

This, however, is not the major obstacle to enforcement. Even when most businesses in a market agree to act in accordance with established standards, the problem arises with the marginal or non-conforming operator. Faced with cost squeezes or the opportunity for a major profit, a business will act con-

4 The background to these provisions is discussed in Goldring, J, "Public Law, Private Law and Consumers' Remedies" (1978) 50 *Aust Q* 4 at 58. I have also examined them in a different context; "Privatising Regulation" (1990) 49 *Aust J of Public Administration at* 419.

trary to the standards. If persuasion and other extra-judicial sanctions have not worked, in the last resort enforcement through the legal process will be necessary. But what liability will enforcement impose?

As pointed out earlier, civil liability can usually be insured against, and the risk of incurring a major criminal sanction is remote. The prosecution must satisfy the criminal standard of proof: every element of the offence must be established beyond any reasonable doubt. This means that the prosecuting authority will not exercise its discretion to prosecute unless it has available to it convincing evidence. Where the evidence is available, a decision may be made not to prosecute because the agency lacks resources, and this particular prosecution may not fall within a priority area. Even if a prosecution is launched, and succeeds, the conviction may result in no penalty being imposed if the defendant can convince the court that it is contrite and that the offence is relatively trivial, and in any event fines may be set at such an amount that the profit earned from the contravention of the law is far greater. In addition, corporations, by definition, cannot be imprisoned or punished physically. And despite the ability of courts to impose very heavy fines, they rarely do so. Marginal corporations — those whose viability is at risk or who are not interested in a long-term reputation — can and do act with impunity.

Many offences, even those created by statute, require the prosecution to prove beyond reasonable doubt that the defendant had a particular intention before a conviction can be obtained. Because a corporation has no mind, at common law it was difficult to impute intention to it. This problem has, to some extent, been solved by statutory provisions like the *Trade Practices Act* 1974 (Cth), s84, which impute to the corporation the knowledge of directors, officers and employees in certain situations. However such provisions do not assist greatly in enabling a judgment creditor to recover damages from a shell corporation.

Criminal sanctions imposed on a corporation have little effect. There is no physical threat to the corporation, and its principal officers, though technically liable, rarely face stringent penalties for breaches of regulatory offences. Braithwaite suggests that the ultimate sanction is withdrawal of the right to trade. He does not give sufficient attention to lesser sanctions, nor does he contemplate the situation where, because the actors do not require licences to trade, this is not a possibility.

The Australian Law Reform Commission has received a reference to inquire into remedies available under the *Trade Practices Act* 1974 (Cth). That Act is the primary legislative instrument for both maintaining competitive markets and protecting consumers. It does not provide for licensing, but, as we have seen, operates on the command/control model, with the important modification that its provisions can be invoked by others than the State agency. It may be that the Commission will need to consider other sanctions.

One possible way to ensure that businesses comply with legislated standards is to provide that, in appropriate cases, the managers and controllers of a corporation involved in the contravention of a statutory provision personally incur civil joint and several liability with the corporation to compensate persons who suffer loss or damage. Such a provision would be used mainly if the corporation is unable to provide compensation or to reimburse the corporation (or liquidators, receivers or managers of the corporation) for any compensation it might pay. Already the *Corporations Law*, Part 9.4B, imposes as alternatives a measure of both criminal and personal civil liability for a

corporation's debts or damage resulting from the impugned behaviour, upon specified controllers and managers who have contravened specified provisions of the law if the corporation becomes insolvent: see especially s1317HD. Imposing an analogous personal liability on the controllers and managers of corporations that contravene specified statutory standards would discourage abuse of the corporate form and ensure that controllers and managers applied their personal standards of morality to their commercial behaviour. It would almost certainly be against public policy to permit controllers and managers to insure against such liability, but as a precaution, it might also be desirable to legislate specifically to make void any insurance contracts purporting to insure against such liability. The threat of bankruptcy or loss of personal assets might be a far more effective sanction than imposing criminal penalties. The corporate form has played a valuable role in mobilising risk capital and in limiting liability for ordinary debts. However, where the compensation or payment is imposed as much as an incentive to observe standards as to maintain the flow of commerce, it seems contrary to the purpose of the corporate form to allow limited personal liability to the principals of a business. In any event, specific statutory provision would be required to impose such liability.

In the United States, government agencies often have the power to issue orders that persons "cease and desist" from certain conduct pending a hearing. Breach of such an order attracts criminal penalties. These orders in some ways resemble an ex parte injunction, but the agency making or obtaining them is under no obligation to provide undertakings as to damages. The requirements of procedural fairness are satisfied by a speedy hearing within a specified time after the order is made. Such orders are not entirely new in Australia. The *Trade Practices Act* 1974 (Cth), Part V, Div 1A, and corresponding provisions of some State Fair Trading Acts, establish a procedure under which the Minister may make orders banning the sale of specified classes of dangerous products or ordering compulsory recalls of such products. The subjects of the orders are entitled to a hearing after the order has been complied with. Such orders do not, in Australia as yet, extend to other unlawful conduct.[5]

Injunctions and positive orders, such as orders for corrective advertising under the *Trade Practices Act* 1974 (Cth), s80A,[6] may also ensure that businesses observe established legal standards. They fit the command/control model, but relate to specific instances where a business has actually contravened a statutory standard or threatens to do so. The remedial action required is either to cease or to modify behaviour in accordance with the Court's direction. The procedure may be cumbersome, but the experience with private actions seeking injunctions under the *Trade Practices Act* 1974 (Cth), ss52 and 80 has shown just how effective in the hands of a private suitor the injunction may be as an instrument for ensuring that businesses behave.

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5 A more detailed account of these provisions may be found in Goldring, J, Maher, L and McKeough, J, *Consumer Protection Law*, (4th edn, 1993) para [520].

6 Id paras [1078]-[1079]. These provisions have been used rarely.

4. Conclusion

The conference out of which these papers arose appears to follow a view that despite an apparent commitment of certain key bureaucrats and some politicians to deregulation, a measure of regulation of business was necessary because, as several of the contributors argue, market forces alone will not ensure that businesses behave. The descriptions of what has actually happened in Australia show a struggle by inadequately resourced agencies against a business world antipathetic in the extreme to any state activity and able to pay for the best legal and financial advice. Past attempts at regulation in a number of areas (for example, environmental protection, workplace safety and futures trading) had been less than successful, as Neil Gunningham's study (ch 10, "Thinking About Regulatory Mix — Regulating Occupational Health and Safety, Futures Markets and Environmental Law"), demonstrates; but the practising regulators who contribute to this volume do not appear to contemplate different ways of getting business to behave. The articles by the academic contributors, as might be expected, appear to seek alternatives to a problem which will not go away. Contributors like Gunningham, Shearing, Fisse and Braithwaite see a need for regulation, and for regulatory agencies to work in a spirit of cooperation rather than confrontation with the subjects of regulation. However they do not come to grips with the difficulties of actually achieving the attitudinal or cultural change required, or with the need for the state to carry a big stick as a last resort. Universal occupational licensing, even if desirable, would not be possible; criminal sanctions do not work, and both a mix and a shift in attitudes are required.

Attitudinal change is worth striving for, but the difficulties must not be underestimated. In any event, the regulatory mix must have teeth, and those teeth will only bite once it is realised that one of the major obstacles to getting business to behave is the corporate form. Businesses may never behave in the same way as individuals until the corporate form is changed, and those who make business decisions are forced to accept responsibility for them.