Equity fines for corporate crime: why they should be back on the legislative agenda

Around 213 workers are killed at work in Australia on average every year.[1] Hazardous waste production grows by around 9% per year, with an increasing vulnerability to illegal dumping and disposal.[2] Predatory lending, theft and money-laundering abound within major financial institutions, with one even conducting the banking for terrorist organisations.[3] Yet when corporations are held to account for such crime, they are mostly met with monetary fines – a frequently inadequate punishment due to a paradox in the sentencing process. As one Scottish judge put it when fining a corporation that killed nine people and injured 33 others, 'the ability of the company to pay a fine and yet remain in business and provide employment' means that the punishment does 'not reflect the harm done to society', nor 'the gain made by the firm', in avoiding its safety obligations.[4] In many cases, corporate fines are 'externalised', passed on to stakeholders such as consumers in the form of higher prices, or to workers as lay-offs and corporate downsizing. But this 'deterrence trap', as it is often referred to by regulation scholars, has as ingenious and effective solution.

The 'equity fine' is a proposal to punish corporate offending by requiring the offending company to issue additional shares to a state-run victim compensation fund or other independent trustee. The trustee then liquidates or manages the shares to maximise returns to its State beneficiary in a manner similar to a superannuation fund. The process of adding shares to the existing share pool punishes shareholders by diluting share ownership. In effect,

[1] WorkSafe Australia, Fatality statistics, 2003-2016: https://www.safeworkaustralia.gov.au/statistics-and-research/statistics/fatalities/fatality-statistics#year-to-date-2019-preliminary-worker)

[2] Department of the Environment and Energy, *Hazardous Waste Australia 2017* (May 2017), xi.

[3] Karen Maley, 'Banking royal commission: Which bank boss made the best witness?', *Australian Financial Review*, 30 November 2018.

[4] Sentencing Statement of Lord Brodie in *HMA v ICL Tech Limited and ICL Plastics Limited* (28 August 2007) High Court of Justiciary (Scotland), as cited in Dukes, Braithewaite and Moloney, *Pharmaceuticals, Corporate Crime and Public Health* (Edward Elgar, 2014) 352.

equity fines penalise the value of the corporation, rather than its liquid assets, inhibiting the firm from passing-on the cost of fines to consumers and workers. In this way, equity fines punish those who benefit from the proceeds of corporate crime while motivating shareholders and managers to change corporate decision-making (discussed further below).[5]

Equity fines were originally conceived of by North American jurist, John Coffee, in the early 1980s.[6] At that time, they were embraced by the Australian Law Reform Commission as well as federal politician, Gareth Evans. Since then, equity fines have fallen-off the legislative agenda, largely due to a damning New South Wales (NSW) enquiry in 2003 and a failed legislative bid in Scotland in 2010.[7] It is noted that the Scottish attempt to implement equity fines is referred to throughout the article as a useful comparative approach. Scotland maintains a similar Anglo-common law legal system to the jurisdiction of NSW, faces similar socio-legal problems in the realm of corporate criminality and is frequently led by a progressive legislature. Meanwhile, in both jurisdictions, the scale of corporate enterprise continues to grow, often defying regulation through complex legal relationships, lack of jurisdictional sovereignty and inadequate punishment. Accordingly, this article seeks to clarify certain misapprehensions surrounding equity fines, arguing for their resurrection to punish corporate crime. In dismantling arguments against equity fines, this piece investigates and challenges NSW Law Reform Commission findings that equity fines: i) impose an unfair burden on shareholders and fail to discriminate against more powerful shareholders; ii)

[5] John Coffee, '"No Soul to Damn: No Body to Kick": An unscandalized inquiry into the problem of corporate punishment' 79 (1981) *Michigan Law Review* 386, 412-424.
[6] Ibid.
[7] NSW Law Reform Commission (NSWLRC), *Sentencing Corporate Offenders* (Report No 102, June 2003), 'Recommendation 5' and 105-114; Criminal Sentencing (Equity Fines) Bill 2010 (Scottish Parliament, hereafter, 'Equity Fines Bill').

trivialise offending by placing a 'price' on punishment; iii) are too difficult to administer; iv) have limited application; and v) fail to prevent future offending (deterrence).[8]

Unfairness to shareholders – shareholder or stakeholder value?

Academic and law reform discourse regarding equity fines has been characterised by a debate between neoliberal 'shareholder value' theorists, on the one hand, and the proponents of 'stakeholder value' - often regulation scholars (discussed below). When it comes to corporate wrongdoing, shareholder value theorists favour punishing either the company as a whole, or individual directors. For shareholder value theorists of the Chicago School, fines against the company are a preferable punishment because their cost to shareholders may be readily externalised in the form of higher prices or a reduction in company overheads[9] (i.e. passed-on to worker and consumer stakeholders). This approach means that pecuniary punishments can never be too severe - ensuring leniency against the corporation, lest they punish innocent stakeholders. A similar rationale holds sway among traditional conservative proponents of shareholder value who favour punishing individual directors over the company as a whole because it makes individuals accountable for corporate wrongdoing without affecting 'innocent shareholders'.[10] This position conveniently overlooks the fact that it is shareholders who profit from the misdeeds of their directors that benefit the company. To clarify, the concept of 'corporate crime' that is the subject of this article is often defined as that which benefits the company, as opposed to 'entrepreneurial crime' in which individuals in

[8] NSWLRC, above n 7, 110-113.
[9] Richard Posner, *Economic Analysis of Law* (Walters Kluwer Law & Business, 1977/2014) 165-167.
[10] Lord Dawson, in *Royal Ordnance Case* in Hazel Croall and Jenifer Ross, 'Sentencing the Corporate Offender: Legal and Social Issues', in Cyrus Tata and Neil Hutton (eds), *Sentencing and Society: International Perspectives* (Routledge, 2002) 528-547, 541. Such an approach is sometimes referred to as a 'behaviouralist' understanding of corporate crime.

controlling positions within corporations (mostly managers) dishonestly derive personal benefit at the expense of the company.[11] Problematically, the conservative approach to shareholder value fails to distinguish between both types of crime. On thisview, errant individual directors become convenient scapegoats whose sacrifice perpetuates the enrichment of shareholders from the proceeds of corporate crime. It was this approach that was reflected in the NSW Law Reform enquiry which concluded that 'in reality, the majority of shareholders are … innocent and … impotent', a notion that is challenged below.[12]

By contrast, stakeholder value theories of corporate punishment seek to maximise deterrence, or severely punish corporate crime, in such a way as to mitigate consequential harm to stakeholders. Equity fines are a practical example of this approach because by punishing shareholders (a group that often includes directors), they avoid punishing innocent stakeholders while targeting those who profit from corporate wrongdoing. Companies that increase shareholder profits by skimping on safety and injuring workers, for instance, might be more readily brought to justice by the imposition of an equity fine. Scholarly discussion of the appropriate magnitude of such a tariff indicates that a fine of between five and ten per cent of corporate equity might be appropriate for a first offence, followed by further fines of up to twenty-five per cent for repeat offenders.[13]

A sub-theme of the shareholder value position outlined in the NSW findings is that equity fines would punish minor shareholders more harshly than major shareholders.[14] This claim

[11] Australian Institute of Criminology, *Entrepreneurial Crime: Impact, Detection and Regulation*, No. 34 (1992) 1.
[12] NSWLRC, above n 7, 111.
[13] Coffee, above n 5, 414.
[14] NSWLRC, above n 7, 110.

misunderstands the concept of share dilution inherent within an equity fine: that any further shares issued by a company dilute the value of existing shares by the amount of shares issued (e.g. issuing new shares at five per cent of the company's value diminishes the value of existing shares by five per cent). As a matter of logic, shareholders who own more shares will be more effected by any dilution or fine on the equity of the company. The very 'ingeniousness' of the equity fine is, as Canadian corporate legal scholar, Harry Glasbeek, put it, that it 'makes available the means to get at those who profit from' corporate crime, 'the flesh and blood accumulators and controllers of capital'.[15]

The 'innocent shareholder' argument also ignores the fact that by purchasing shares, shareholders assume a risk that their stocks may lose value or that they be pressuredto take responsibility.[16] Most importantly, it underestimates shareholder power. The Shareholder's Association of Australia, for instance, is an organised shareholder rights body that represents various blocks of small to medium shareholder interests within the internal governance structures of large corporations. Glasbeek has calculated that 'in Australia, in 100 major listed corporations, 5 shareholders controlled 54 per cent of the shareholding; 10 controlled 64 per cent and 20 shareholders in these corporations controlled 70 per cent of the shares'.[17] Much like directors, these owners of capital are few, easily identifiable as the beneficiaries and controllers of corporate conduct.[18]

[15] 'Why Corporate Deviance is Not Treated as a Crime" The Need to Make "Profits" a Dirty Word', in Tullio Caputo et al (eds), *Law and Society: A Critical Perspective* (Harcourt Brace, 1989), 126-145, 136, 140.
[16] Equity Fines Bill, above n 7, 23.
[17] Harry Glasbeek, *Capitalism: A crime story* (Between the Lines, 2018) 110.
[18] Ibid.

As Glasbeek helpfully points out, legal mechanisms already exist that allow decision-makers to identify larger or majority shareholders for the purpose of regulation.[19] Canadian insider trading provisions, for instance, subject particular large shareholders to certain rules, while securities regulation also requires the identification of parent/subsidiary and beneficiary relationships and controlling interests in the shares of companies.[20] Recent Australian legislation regulating the conduct of franchisees in relation to their employees also pierces the corporate veil in a similar way, requiring the identification of parent/subsidiary, franchisee and franchisor companies.[21] Accordingly, if legislation already requires identification of large shareholding interests for the purpose of regulation in one sphere of corporate law, there is no reason why it could not apply to the calculation of equity fines.

Triviality

The NSW Law Reform Commission further suggests that equity fines trivialise significant wrongdoing because they are a crude and materialistic punishment that sometimes fails to reflect the gravity of offending.[22] A once common critique, this view of fines has since been outdated by recent theoretical criminology. In 2009, criminologist Pat O'Malley conducted extensive research into the history and meaning of the modern fine, revealing that in most cases, 'money still registers the magnitude of the wrong' and 'is the means by which we invest in, express, live and display ourselves and through which we may even express our oppositions and resistances'.[23] His work nevertheless shows that against corporate

[19] Glasbeek, above n 16, 141.
[20] *The Securities Act*, R.S.O. 1980, c. 466, ss. 1, 88 (now the *Securities Act,* R.S.O. 1990, s. 1, 137-138); *Foreign Investment Review Act*, R.S.C. 1980, c. 46, s. 3(2) (now the *Investment Canada Act,* R.S.O. 1985, c. 28, ss. 28, 27, 38-40).
[21] *Fair Work Act* 2009 (Cth), ss. 588A-588B (amended by the *Fair Work Amendment (Protecting Vulnerable Workers) Act* 2017).
[22] NSWLRC, above n 7, 112.
[23] Pat O'Malley, 'Theorizing Fines' (2009) 11(1) *Punishment & Society* 67, 73, 76, 78.

defendants, fines are either too low or ineffective.[24] And, as the proponents of equity fines have argued since the early 1980s, pecuniary sanctions are entirely appropriate against corporations or so-called 'legal persons' that have 'no soul to damn and no body to kick',[25] i.e. they cannot be sent to gaol. Meanwhile, sentencing individual directors for the wrongs of the company effectively punishes them in the place of the shareholders. Where such corporate sanctions are both too low and inaccurately targeted, they must be made large enough and redirected toward those who might feel their pain.

The view that fines are trivial and crude also fails to engage with the material difference between an equity fine and a conventional corporate fine. Conventional corporate fines enable companies to shift the burden of the fine to stakeholders, while equity fines engage the very purpose of the corporation, penalising shareholder profit. For shareholders, such a punishment is the antithesis of triviality. Indeed, the concern shown for shareholders by opponents of equity fines would seem to contradict their own accusation of 'triviality'.

Administration

The NSW Law Reform Inquiry foresaw difficulties in the administration of equity fines – a credible observation. Drawing on submissions to the Inquiry by the Australian Tax Office and Fair Trading NSW, the report writers observed that administration of equity fines by these public sector agencies could give rise to a conflict of interest in the management, investment and benefits accrued through State-owned equity shares in convicted corporations.[26] As Coffee reminds us, however, the propriety of government profit from

[24] Ibid, 73, 80.
[25] Coffee above n 5.
[26] NSWLRC, above n 7, 112.

criminal conduct is accounted for by a redistribution of the proceeds of crime to the wider community, including a class of victims of criminal corporate conduct.[27] Redistributing the profits of criminal activity is certainly preferable to seeing the money returned to a suite of private investors or a liquidator. Indeed, if forfeiting proceeds of crime were illegitimate, all fines and criminal forfeitures might be tainted with illegitimacy.

Clearly, however, equity fines do not shut-down corporations and by obtaining an issue of shares in the convicted company, the State might be said to become a partner in its continued operation. That the corporation continues to operate, employing its workers and servicing a community, is indeed the point of an equity fine. And that the State maintains a share in the enterprise until selling to maximise revenue, serves a deterrent effect that constitutes the rehabilitative capacity of the equity fine (discussed in more detail, below).

A further administrative problem cited by the NSW Inquiry and raised in a submission by the Australian Stock Exchange (ASX), is that it is difficult to regulate the sale of shares. According to the ASX, regulating any decision to sell shares to maximise return is made too complex by the unpredictability of market fluctuations.[28] This appears to be an argument that the 'maximum value' of shares can never be known due to the rise and fall of share-prices. Once again, the existing literature as well as the Scottish equity fine proposal are instructive. As outlined in the introduction, the proposal for equity fines has never implicated the state (or its agencies) as the direct controller of its shares in the convicted company. Rather, shares are to be held by an external trustee or fiduciary, on behalf of the State. The State remains a mere

[27] Coffee, above n 5, 434-450.
[28] NSWLRC, above n 7, 113.

beneficiary. Such a relationship mirrors existing Australian compulsory superannuation laws in which a portion of all wages is deducted and held on trust by a superannuation fund. In turn, the trust or fund is controlled by a broker or trustee who invests the money – usually in the sharemarket – in order to grow the investment and achieve a return. Clearly, the 'complexity' involved in this financial relationship has not been an obstacle to the establishment of the Australian superannuation industry, which now presides over one of the largest pools of capital ever to be brought into being.[29]

Reflecting on this regulatory relationship associated with equity fines, the Scottish Parliament envisioned that decisions regarding the management and liquidation of State equity shares would be entrusted to independent investment firms. Firms would proceed to liquidate shares subject to specific judicial guidelines ordered on a case-by-case basis under the general proviso that shares be 'issued and promptly sold' for the highest reasonable price within a relatively short period of time (e.g. 24 months), rather than held and managed indefinitely by government agencies.[30]

Scope of Application

That equity fines do not have universal application was yet another criticism of the NSW Law Reform Commission. Indeed, equity fines are not an appropriate punishment in every case - just as court-ordered drug and alcohol rehabilitation or indeed community service is not appropriate in every case. As a sentencing disposition, equity fines are designed to add to

[29] Australian superannuation funds are the fourth largest pool of retirement savings in the world, valued at $1.9 trillion (US). This figure amounts to the sixth largest pool of managed funds in the world: Australian Trade and Investment Commission: https://www.austrade.gov.au/News/Economic-analysis/australian-pension-fund-assets-growth-among-the-worlds-strongest, accessed 26 September 2019.
[30] Equity Fines Bill, above n 7, 26.

a sentencing 'mix', enhancing the ability of the judiciary to impose more proportionate and just outcomes on offenders.

Nevertheless, the Law Reform Commission observed that equity fines might encounter difficulties in their application against smaller private companies in which shares are held by family members, commenting that it would be 'inappropriate' to widen the shareholding base of small-scale enterprise.[31] Proponents of equity fines do not suggest otherwise, discussing share dilution squarely in the context of large corporations.[32] The larger the company, the easier it is to apply an equity fine given that equity in larger, publicly listed companies is more readily and openly traded on the share market. The fact that equity fines apply almost exclusively to large corporate offenders is what makes them so attractive as a sentencing disposition, particularly in light of the fact that conventional fines have little deterrent effect on larger corporate entities.

By way of illustration, the strength of this law to impact upon large corporate institutions such as banks or indeed entities such as Facebook, should not be overlooked. In the US in early 2019, Facebook incurred a fine of $5 billion dollars - the largest in US legal history. This figure represented roughly a single month's worth of company revenue and saw the market respond with a massive surge in the value of Facebook shares.[33] In such a market, it is not difficult to see the public benefit of a stake in the company derived from an equity fine.

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[31] NSWLRC, above n 7, 113.
[32] Glasbeek, above n 14; Coffee, above n 5.
[33] Makena Kelly, 'FTC hits Facebook with $5 billion fine and new privacy checks', *The Verge,* 24 July 2019: https://www.theverge.com/2019/7/24/20707013/ftc-facebook-settlement-data-cambridge-analytica-penalty-privacy-punishment-5-billion

Any subsequent increase in share-price would swell State revenue while any consequent decrease would punish the company at no cost to the State.

Deterrence

The final condemnation from the Law Reform Commission is that equity fines lack deterrent effect because shareholders are powerless to effect corporate change.[34] This is a widely cited criticism of equity fines, originally argued by Australian corporate regulation scholar, Brent Fisse.[35] As Fisse contends, such powerlessness on the part of shareholders to improve corporate behaviour means that equity fines do not guarantee positive change and may see shareholders desert the company. Instead, Fisse suggests further compliance management strategies.[36]

This position ignores a number of basic facts about the power and collective motivations of shareholders. It discounts the existence of powerful organisations and lobbyists that already exist on behalf of shareholders such as the Shareholder's Association of Australia, mentioned above. In this way, equity fines may indeed be require shareholders to act more co-operatively and collectively in order to avoid sanctions.

That shareholders may not respond ignores the intimidating or deterrent effect of equity fines. In such an entrenched neoliberal system of private corporate ownership, little else could be more threatening to capitalists than fear of state ownership or interference with their assets.

[34] NSWLRC, above n 7, 111-114.
[35] Brent Fisse, 'Sentencing Options Against Corporations' (1990) 1(2) *Criminal Law Forum* 211, 232-234.
[36] Ibid, 232. Instead, he proposes 'probation and punitive injunctions' and, failing these interventions, further compliance measures: 234-236.

'As penalties increase', wrote Coffee, 'the hard-boiled investor becomes interested in the corporation's posture vis-à-vis such topics as the environment, design safety and discrimination – because he cannot afford not to be concerned'.[37] Such fears are heightened by the chance of hostile corporate takeover resulting from a subsequent sale of the State's equity share in the company.

There is by now a swollen literature on the inefficacy of compliance-based regulation and its contribution to corporate crime. Indeed, the association between compliance strategy and corporate crime was a key finding of the recent Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. For all the 'compliance managers' afforded by the State to the largest and wealthiest corporations, their inability to comply with the law (and indeed incur prosecution for basic wrongdoing) was described by the Royal Commissioner, Justice Kenneth Hayne, as 'heavily influenced by industry interests'.[38] The notion that the State must involve itself in compliance in lieu of shareholder action also assumes that the criminal law must micromanage the 'internal procedures' and rectification measures of the offending corporation. As the Scottish Parliament concluded, for such regulation to be effective, its depth and breadth would have to be 'spectacular' in scope.[39] Elaborate intervention of the kind envisioned by compliance theorists is simply not the role of the criminal law, which rarely affords this level of treatment for most working-class criminal defendants. That it should do so for the wealthiest corporations is a suggestion bordering on the perverse.

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[37] Coffee, above n 5, 422.
[38] Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, 2019, vol 1, 283.
[39] Equity Fines Bill, above n 7, 24.

Conclusion

Where corporate crime continues unabated by conventional fines and punishment, so too does popular moral outrage at the inequality of outcomes in the criminal justice system. This moral outrage is neither 'populist', nor hysterical. It is an entirely rational response to the fact that there exists one punishment for the rich and another for everyone else - a design feature of neoliberal 'shareholder value' theory in its application to law. In the face of this enduring inequality, equity fines present a small intervention – less than a systemic overhaul but more than a mere tweak – that remain open to law reform bodies to campaign for, and legislators to implement.

The misplaced and dismissive attitude of the NSW Law Reform Commission toward equity fines has mostly succeeded in terminating their legislative prospects in that jurisdiction to date. But as this article has shown, equity fines are a viable alternative sentencing option to the currently ineffective system of fines for large corporate offending. Equity fines have been embraced by a Scottish legislature (only to stumble at constitutional hurdles). And they are accepted by a range of academic commentators and scholars. In this respect, equity fines remain a powerful remedy to corporate wrongdoing that target the nerve centre of the corporation. By targeting the misuse of capital and those who own and profit from it, the equity fine is neither unfair nor trivial but an efficient and deterrent sanction that minimises the impact of corporate punishment on stakeholders.

Future scholarship and law reform analysis on the issue might focus on the capacity of this legal mechanism to regulate and rein in the power of some of the newest and largest global

corporations whose business model is built on the foundations of evading law and regulation or ‘regulatory entrepreneurship’. The example of Facebook, cited above, is but a minor illustration of the large possibilities that lay in store for the equity fine in relation to new invasive forms of surveillance capitalism. Indeed, as corporations outgrow and outmanoeuvre the law, equity fines present a compelling sentencing alternative.