
Corporate and personal liability for “culture” in corporations?

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The Australian Securities and Investments Commission (ASIC) has proposed introducing personal and corporate liability for the culture of a corporation. This article argues that ASIC’s position should be rejected. First, culture cannot be effectively defined. Culture is also not capable of precise measurement. The need for certainty in defining and measuring culture is necessary for culture to be a basis for individual or corporate liability. Secondly, culture is not a concept that should be regulated. Thirdly, the proposed laws could significantly expand ASIC’s powers and such powers may be open to abuse.

INTRODUCTION

The Australian Securities and Investments Commission (ASIC) has proposed introducing liability for corporations and personal liability for officers and directors based on the culture of the corporation. We agree with ASIC that culture can play an important function in business. However, culture cannot and should not be used to impose liability on corporations, directors and officers.

There are three points that we want to emphasise.

First, culture should not be regulated. Corporate culture is not a settled discipline.¹ Culture has different meanings in different contexts. It cannot be defined and measured in an objective sense which would be necessary for culture to be the foundation for civil or criminal liability under the *Corporations Act 2001* (Cth).

Secondly, even if culture could be regulated, more regulation is not the answer. ASIC’s proposal would have a detrimental effect on, and add to the regulatory burden faced by, corporations, directors and officers.

Thirdly, ASIC’s proposed amendments would significantly and unnecessarily expand ASIC’s powers. These powers could be open to abuse.

ASIC’S PROPOSED OVERSIGHT OF CULTURE

ASIC’s oversight of culture

ASIC has stated that it intends to monitor culture in a proactive and preventative manner, in order to identify patterns of poor culture, which it argues may indicate poor conduct.² ASIC has argued that “culture is a major risk to investor trust and confidence” and the “fair, orderly and transparent operations” of financial markets.³

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¹ The terms “organisational culture” and “corporate culture” are used interchangeably in this article.

² Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Oversight of the Australian Securities and Investments Commission (Parliament of Australia, Canberra, August 2015) 6 (Greg Medcraft); see generally G Medcraft, “Putting the Customer First: Creating a Win-Win” (Speech delivered at the CFA Australia Investment Conference, Sydney, 13 October 2015) 6 <<http://download.asic.gov.au/media/3374848/speech-greg-medcraft-cfa-australia-investment-conference-published-14-october-2015.pdf>>; J Price, “Culture and Conduct” (2015) September *Company Director* 17.

³ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6 (Greg Medcraft).

Culture will be integrated into ASIC’s surveillance and regulatory functions in four ways.⁴ ASIC stated that it will:

1. incorporate culture into “risk-based surveillance reviews”;⁵
2. use “surveillance findings” to understand how culture influences conduct in the organisations that it regulates;⁶
3. communicate with firms where ASIC has an issue with the firm’s culture and conduct;⁷ and
4. seek to enforce the law where it perceives that the “wrong culture” is “driving bad outcomes”.⁸

Proposed amendments to the ASIC Act and Corporations Act 2001

In June 2015, ASIC recommended amendments to the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act 2001* (Cth) (*ASIC Act*) to assist in its oversight of culture. The laws would:

- expose a corporation, and directors and officers as accessories, to criminal liability, by extending Pt 2.5 of the *Criminal Code*⁹ to the provisions of the *Corporations Act 2001* regulating financial services and markets (Ch 7) (Financial Services Amendments);¹⁰ and
- introduce new offences that impose civil penalties and administrative sanctions on directors and officers as accessories to contraventions of the law, by enacting a new offence with a civil standard of proof (Accessory Liability Amendments)¹¹ (together, the Proposed Amendments).

An officer includes a director or secretary of the corporation, or a person “who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation”.¹²

Part 2.5 of the *Criminal Code* provides that the *Criminal Code* applies to bodies corporate in the same way that it applies to individuals¹³ and that a body corporate may be found guilty of any offence.¹⁴ Section 12.3 of the *Criminal Code* provides that if intention, knowledge or recklessness is a fault element of an offence, that “fault element must be attributed to [the] body corporate that

⁴ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6 (Greg Medcraft); see also Australian Securities and Investments Commission, *ASIC Enforcement Outcomes: January to June 2015* (August 2015) [18] <<http://download.asic.gov.au/media/3315413/rep444-published-5-august-2015.pdf>>; G Tanzer, “The Importance of Culture to Improving Conduct within the Financial Industry” (Speech delivered at the Thomson Reuters’ Third Australian Regulatory Summit, Sydney, 27 May 2015) 7 <<http://download.asic.gov.au/media/3252192/importance-of-culture-to-improving-conduct-within-the-financial-industry-speech-27-may-2015.pdf>>.

⁵ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6 (Greg Medcraft); Price J, “Challenges for our Capital Markets” (Speech delivered at Deloitte Australia, Melbourne, 24 September 2014) 3 <<http://download.asic.gov.au/media/3359556/speech-to-deloitte-australia-john-price-published-24-september-2015.pdf>>.

⁶ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6 (Greg Medcraft).

⁷ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6 (Greg Medcraft).

⁸ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6 (Greg Medcraft).

⁹ *Criminal Code Act 1995* (Cth), Schedule.

¹⁰ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6, 10 (Greg Medcraft). See also Evidence to the Senate Economics Legislation Committee (Parliament of Australia, Canberra, 21 October 2015) 55 (Greg Medcraft): “Another thing that we will be talking about is the idea of extending the Crimes Act. As you know, it has a provision related to a culture that enables the breaking of the law. What is most important about culture and breaking the law is making sure that individuals are prosecuted, not simply companies”. See finally Evidence to the Parliamentary Joint Committee on Corporations and Financial Services (Parliament of Australia, Canberra, 16 October 2015) 15 (Greg Medcraft): “What we have suggested, and it is obviously a matter for government, is that perhaps this provision [Pt 2.5 of the *Criminal Code*] should extend through to Ch 7, ‘Financial products and markets’, of the Corporations Law”.

¹¹ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6, 10 (Greg Medcraft).

¹² *Corporations Act 2001* (Cth), s 9 (definition of “officer”).

¹³ *Criminal Code*, s 12.1(1).

¹⁴ *Criminal Code*, s 12.1(2).

expressly, tacitly or impliedly authorised or permitted the commission of the offence”.¹⁵ It can be established that a corporation “authorised or permitted” the offence where:

- a “corporate culture existed within the body corporate that directed, encouraged, tolerated or led to non-compliance with the relevant provision”;¹⁶ or
- the “body corporate failed to create and maintain a corporate culture that required compliance with the relevant provision”.¹⁷

“Corporate culture” means “an attitude, policy, rule, course of conduct or practice existing within the body corporate generally or in the part of the body corporate in which the relevant activities takes place”.¹⁸

Currently, Pt 2.5 of the *Criminal Code* does not apply to either Ch 7 of the *Corporations Act 2001* or the financial services provisions (Pt 2 Div 2 Subdiv G) of the ASIC Act¹⁹ (together, the financial services provisions). That is, if intention, knowledge or recklessness is the element of an offence under the financial services provisions of the *Corporations Act 2001* or ASIC Act, the body corporate’s corporate culture (or lack thereof) cannot presently provide the fault element of that offence. Instead, the fault elements for offences under the financial services provisions are based on models of vicarious liability.²⁰

ASIC has reiterated that it will incorporate culture into its existing risk surveillance reviews to understand how culture influences the conduct of corporations. Where ASIC is of the opinion that the corporation has poor culture and that is “driving bad outcomes”,²¹ it will enforce the law.²² ASIC has also indicated that it “want[s] to share information with boards and management when ASIC’s surveillance suggests they want to do the right thing but there may be cultural problems within their firm that they are not aware of”.²³

In August 2015, ASIC confirmed that it intended to monitor the culture and conduct of financial gatekeepers. ASIC stated that “[i]f we find culture lacking”, this may signal “broader regulatory problems” and that it intends to “address ... culture not just in markets but in financial services more broadly, and we will be very closely looking at the link between culture and conduct”.²⁴

¹⁵ *Criminal Code*, s 12.3(1).

¹⁶ *Criminal Code*, s 12.3(2)(c).

¹⁷ *Criminal Code*, s 12.3(2)(d).

¹⁸ *Criminal Code*, s 12.3(6) (definition of “corporate culture”).

¹⁹ *Australian Securities and Investments Commission Act 2001* (Cth), s 12GH(6); *Corporations Act 2001* (Cth), s 769A.

²⁰ *Australian Securities and Investments Commission Act 2001* (Cth), s 12GH; *Corporations Act 2001* (Cth), s 769B. For the purposes of the *Corporations Act 2001*, see also Explanatory Memorandum, *Financial Services Reform Bill 2001* (Cth), [6.115]: “The Criminal Code will apply on commencement to all ‘offences based on’ provisions in the proposed Chapter 7, that is, all offences created by the provision itself or created through the operation of subsection 1311(1) or [s 1314] (continuing offences), (see proposed definition of ‘offence based on’ (Item 250 of Schedule 1, Part 2)). Therefore, in most instances the default fault elements specified in the Criminal Code of intention in relation to conduct and recklessness in relation to results or circumstances will be implied into offences.”

The “proposed Ch 7 contains a provision that sets out when a person is responsible for the conduct of other people (proposed s 769B), it has effect instead of Part 2.5 of the *Criminal Code* which provides a default rule dealing with corporate criminal responsibility”: [6.116].

²¹ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6 (Greg Medcraft).

²² Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra 3 June 2015) 6 (Greg Medcraft); cf Price, n 2.

²³ Price, n 5, 3.

²⁴ Evidence to Parliamentary Joint Committee on Corporations and Financial Services – Oversight of the Australian Securities and Investments Commission (Parliament of Australia, Canberra, 14 August 2015) 2 (Greg Medcraft).

In October 2015, ASIC stated that it “cannot regulate culture”.²⁵ Rather, instead “what we have to do is have the incentives to get the right culture in corporations and the financial system”.²⁶ However, ASIC continued to suggest that Pt 2.5 of the *Criminal Code* could be extended to apply to Ch 7 of the *Corporations Act 2001*.²⁷ It also indicated that the focus of its regulation would be managers of corporations.²⁸ Although ASIC does not intend to directly regulate culture, using culture as the means by which liability is imposed on directors and officers will necessarily indirectly regulate culture. It may even require a degree of conformity in how companies approach the development of their corporate culture.

ASIC made two further proposals concerning culture in October 2015. First, ASIC proposed introducing a “financial services disciplinary panel” to “nudge” culture.²⁹ While it is unclear how this would operate and what law it would apply, it would be highly problematic if this was used as a backdoor method of imposing liability by reference to corporate culture. Secondly, ASIC has also recommended strengthening whistleblower laws.³⁰

What does ASIC mean by “culture”?

ASIC has recognised that “culture” is a far-reaching concept in two key ways. First, ASIC has stated that “culture is a very broad topic”³¹ – it is not easily defined, nor is there any agreement as to what culture is.³² Secondly, ASIC acknowledges that:

- culture will “likely vary within an organisation”;³³ and
- it is common for “sub-cultures” to emerge in organisations.³⁴

ASIC has not clearly indicated what “culture” would be for the purposes of the Proposed Amendments. ASIC has stated that “culture” is both:

- “a set of shared values or assumptions. It reflects the underlying mindset of an organisation. It lies at the heart of how an organisation and its staff think and behave. It shapes and influences people’s attitudes and behaviours towards, for example, customers and compliance”;³⁵ and
- “the internal controls (ie policies, rules, courses of conduct, practices or attitudes) within a firm which shape its behaviour or mindset”.³⁶

²⁵ Evidence to the Senate Economics Legislation Committee (Parliament of Australia, Canberra, 21 October 2015) 54 (Greg Medcraft); Evidence to the Parliamentary Joint Committee on Corporations and Financial Services (Parliament of Australia, Canberra, 16 October 2015) 18 (Greg Medcraft).

²⁶ Evidence to the Senate Economics Legislation Committee (Parliament of Australia, Canberra, 21 October 2015) 54 (Greg Medcraft).

²⁷ Evidence to the Parliamentary Joint Committee on Corporations and Financial Services (Parliament of Australia, Canberra, 16 October 2015) 15 (Greg Medcraft).

²⁸ Evidence to the Parliamentary Joint Committee on Corporations and Financial Services (Parliament of Australia, Canberra, 16 October 2015) 15 (Greg Medcraft).

²⁹ Evidence to the Senate Economics Legislation Committee (Parliament of Australia, Canberra, 21 October 2015) 55 (Greg Medcraft).

³⁰ Evidence to the Parliamentary Joint Committee on Corporations and Financial Services (Parliament of Australia, Canberra, 16 October 2015) 15 (Greg Medcraft).

³¹ Tanzer, n 4, 1.

³² This is addressed below in “What is culture and can it be effectively regulated?”.

³³ Tanzer, n 4, 5.

³⁴ Tanzer, n 4, 5.

³⁵ Tanzer, n 4, 1–2.

³⁶ Medcraft, n 2, 2.

There are suggestions that ASIC appears to view culture as consisting of “good” and “bad” cultures.³⁷ ASIC has stated that a “positive culture” embeds values that promote both “doing the right thing”³⁸ and “good outcomes for customers” in “all ... business practices”,³⁹ and “a good culture ... [is] one that puts the customer’s long term interests first”.⁴⁰ ASIC has identified that a positive culture is also influenced by:⁴¹

- the “tone from the top” of the organisation;
- the leadership ensuring that the organisation’s values “cascade” throughout the organisation;
- holding staff accountable for their conduct;
- promoting a culture of open communication and challenging business practices;
- aligning recruitment, training and incentives with the firm’s values; and
- ensuring that the board monitors and assesses how the organisation’s culture influences conduct.

ASIC also has stated that a positive culture should underpin a business’ operations and decisions, and “the day-to-day conduct of its employees”.⁴² Conversely, ASIC argues that “there is a strong connection between poor culture and poor conduct”.⁴³

ASIC’s rationale for the Proposed Amendments

The Proposed Amendments appear to target three purported deficiencies in the existing regulatory framework, namely:

1. a perception that fining the company only penalises shareholders;⁴⁴
2. as Pt 2.5 of the *Criminal Code* is difficult to prove because of the high standard of proof (beyond reasonable doubt), the proposed Accessorial Liability Amendments will be easier to prosecute, as the standard of proof will be the balance of probabilities;⁴⁵ and
3. ASIC is limited in the ways in which it can address corporate culture under existing laws.⁴⁶

We consider that more regulation is not the right approach, particularly as ASIC “is not even trying to get the penalties that it can get under the current law in a sufficiently aggressive and satisfactory way in many of the problem areas that exist”.⁴⁷

ASIC has justified its oversight of culture on several bases. ASIC has:

- argued that the culture of financial institutions was a “root cause”⁴⁸ of the Global Financial Crisis (GFC); and

³⁷ See, eg, Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6 (Greg Medcraft): “bad culture often leads to bad conduct ... we will intend to enforce where we see the wrong culture that is driving bad outcomes”; Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 8 (Greg Medcraft): “You can have the right culture, or you can have the wrong culture”.

³⁸ Tanzer, n 4, 4.

³⁹ Tanzer, n 4, 4, 6.

⁴⁰ G Medcraft, “The Financial System Inquiry: A regulator’s perspective” (Speech delivered at the 32nd annual conference of the Banking and Financial Services Law Association, 4 September 2015, Brisbane) 4 <<http://download.asic.gov.au/media/3343239/bfsla-the-financial-system-inquiry-a-regulators-perspective-4-september-2015.pdf>>. See also Medcraft, “Putting the customer first: Creating a win-win”, n 4, 1, 6.

⁴¹ Tanzer, n 4, 5–7.

⁴² Tanzer, n 4, 4.

⁴³ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6 (Greg Medcraft); see also Price, n 5, 3.

⁴⁴ J Dage, “Chief Offenders”, *Herald Sun* (Melbourne), 4 June 2015, 46.

⁴⁵ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6 (Greg Medcraft).

⁴⁶ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 6–8 (Greg Medcraft).

⁴⁷ Evidence to Senate Economics References Committee (Parliament of Australia, Canberra, 21 February 2014) 11, 17 (Professor Bob Baxt AO), cited in Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission* (Parliament of Australia, 2014) 367 [23.11] <http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/ASIC/Final_Report/index>.

⁴⁸ Tanzer, n 4, 2; see also Financial Stability Board, *Guidance on Supervisory Interaction with Financial Institutions on Risk*

- increased its focus on culture following concerns about the manipulation of interbank and benchmark rates⁴⁹ and the Senate Inquiry into the Performance of the Australian Securities and Investments Commission (Senate Inquiry), which reported evidence of poor corporate cultures in several financial institutions.⁵⁰

We note that the extent to which the GFC can be attributed to issues of corporate culture is controversial. It is well recognised that the GFC was the result of other factors, including aspects of regulation of the financial sector.⁵¹

The events that have increased regulators’ focus on culture are regrettable. Although ASIC has stated that “markets recover [but] people do not”,⁵² this does not justify using “corporate culture” as a means to impose personal liability on directors and officers. The answer to improving the culture of financial institutions does not lie in prescriptive regulations or penalties.⁵³

WHAT IS “CULTURE” AND CAN IT BE EFFECTIVELY REGULATED?

Culture is an important part of the management of a company and is a necessary element of, and complement to, business strategy.⁵⁴ Businesses routinely acknowledge the importance of culture in driving long-term sustainable success.⁵⁵ Culture is part of how companies do business.⁵⁶ The organisational literature is clear that:

- Culture and strategy must be aligned,⁵⁷ because culture is crucial for an organisation to achieve its strategic objectives⁵⁸ and sustain its long-term performance.⁵⁹

Culture – A Framework for Assessing Risk Culture (FSB, 2014) 1 <<http://www.financialstabilityboard.org/wp-content/uploads/140407.pdf>>. See also J O’Brien and O Dixon, “The Common Link in Failures and Scandals at the World’s Leading Banks” (2013) 36 *Seattle University Law Review* 941, 944–945.

⁴⁹ See, eg, Tanzer, n 4, 4. See also D Awrey, W Blair and D Kershaw, “Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation?” (2013) 38 *Delaware Journal of Corporate Law* 191, 194; J O’Brien and G Gilligan, “Introduction – Regulating Culture: Problems and Perspectives” in J O’Brien and G Gilligan (eds), *Integrity, Risk and Accountability in Capital Markets* (Hart Publishing, 2013) xv, xxvi–xxvii; S Miller, “The Libor Scandal: Culture, Corruption and Collective Action Problems in the Global Banking Sector” in J O’Brien and G Gilligan (eds), *Integrity, Risk and Accountability in Capital Markets* (Hart Publishing, 2013) 111, 111–14.

⁵⁰ Senate Economics References Committee, Parliament of Australia, *Performance of the Australian Securities and Investments Commission* (2014) 186–7 [13.18]–[13.19] <http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/ASIC/Final_Report/index>.

⁵¹ See generally SP Kothari and R Lester, “The Role of Accounting in the Financial Crisis: Lessons for the Future” (MIT Sloan School of Management, 2011) 1 <<http://ssrn.com/abstract=1972354>>.

⁵² Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 7 (Greg Medcraft).

⁵³ Commonwealth of Australia, *Financial System Inquiry Final Report* (2014) 7–8 <http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf>; see also D Walker, “Trust and Trustworthiness in Banks and Bankers” (Speech delivered at the Federal Reserve Bank of New York, 20 October 2014) <<http://www.barclays.com>>.

⁵⁴ See, eg, N Merchant, “Culture Trumps Strategy, Every Time” (2011) *Harvard Business Review* <<https://hbr.org/2011/03/culture-trumps-strategy-every>>; G Sadri and B Lees, “Developing Corporate Culture as a Competitive Advantage” (2001) 20 *Journal of Management Development* 853, 853–4; see generally H Schwartz and SM Davis, “Matching Corporate Culture and Business Strategy” (1981) 10 *Organizational Dynamics* 30.

⁵⁵ In this respect, it is likely that organisations and regulators agree about the importance of culture. Wayne Byres, chairman of the Australian Prudential Regulation Authority, has observed that “strengthening culture, like strengthening capital, is critical to long-run stability”: see J Eyers, “APRA Calls for Banks to Change Pay to Improve Culture”, *The Australian Financial Review* (online), 29 May 2015 <<http://www.afr.com/business/banking-and-finance/financial-services/apra-calls-for-banks-to-change-pay-to-improve-culture-20150528-ghc7un>>.

⁵⁶ For example, some organisations have created the role of a Chief Cultural Officer: S DuBois, “The Rise of the Chief Cultural Officer”, *Fortune* (online), 30 July 2012 <<http://fortune.com/2012/07/30/the-rise-of-the-chief-culture-officer>>.

⁵⁷ JR Katzenbach, I Steffen and C Kronley, “Cultural Change That Sticks” (2012) July–August *Harvard Business Review* 110, 113.

⁵⁸ S Keller and C Price, “Organizational Health: The Ultimate Competitive Advantage” (2011) June *McKinsey Quarterly* 1, 8–9 <http://www.mckinsey.com/insights/organization/organizational_health_the_ultimate_competitive_advantage>.

⁵⁹ Keller and Price, n 58, 13.

- Organisational culture is necessary for an organisation to achieve a sustainable competitive advantage in the medium- to long-term.⁶⁰
- Culture can benefit the organisation's relationships with its stakeholders.⁶¹

Culture is shaped by the organisation's internal and external environments. For example, a society's economic culture is shaped by many factors, such as the country's social policies.⁶² These forces shape the environment in which the company operates and ultimately influence its corporate culture.

Attempting to regulate the culture of an organisation is complex. Imposing personal liability on directors and officers for problems in an organisation's culture raises key questions, such as whether culture can be defined and whether culture can be effectively regulated.

Can culture be defined?

Culture is the subject of significant academic discussion.⁶³ Culture is "an inherently slippery concept"⁶⁴ and is conceptually imprecise.⁶⁵ There is no universally accepted definition of culture.

The "term 'culture' ... has had multiple meanings in different disciplines and different contexts".⁶⁶ The same applies for corporate culture. "Corporate culture", or "organisational culture", is influenced by internal structures, what people bring to work – such as their nationalities, beliefs, religion and norms – and the external environment in which the organisation operates.

There is little commonality in the definitions of organisational culture. Several frequently cited – and not exhaustive – definitions of organisational culture explain that it is:

- "a pattern of shared basic assumptions learned by a group as it solved its problems of external adaptation and internal integration, which has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems";⁶⁷
- the "collective programming of the mind which distinguishes the members of one organization from another";⁶⁸ and
- the "way we do things around here".⁶⁹

⁶⁰ Group of Thirty, *Banking Conduct and Culture – A Call for Sustained and Comprehensive Reform* (Group of Thirty, 2015) 11 <<http://group30.org/images/PDF/BankingConductandCulture.pdf>>. See also KS Cameron and RE Quinn, *Diagnosing and Changing Organizational Culture – Based on the Competing Values Framework* (3rd ed, John Wiley and Sons, 2011) 5, cited in M Power, S Ashby and T Palermo, *Risk Culture in Financial Organisations* (London School of Economics, 2013) 17 <<http://www.lse.ac.uk/accounting/CARR/pdf/final-risk-culture-report.pdf>>. Anecdotal evidence also supports the view that corporate culture can be a significant competitive advantage: see, eg, M Lévy, M Eskew, WH Bernotat and M Barner, "Who Owns the Long Term?: Perspectives from Global Business Leaders" (2007) July–August *Harvard Business Review* (online) <<https://hbr.org/2007/07/who-owns-the-long-term-perspectives-from-global-business-leaders>>.

⁶¹ Walker, n 53.

⁶² M Porter, "Attitudes, Values, Beliefs, and the Microeconomics of Prosperity" in LE Harrison and SP Huntington, *Culture Matters – How Values Shape Human Progress* (Basic Books, 2000) 24.

⁶³ EH Schein, *Organizational Culture and Leadership* (4th ed, Jossey-Bass, 2010) 13-5.

⁶⁴ Awrey, Blair and Kershaw, n 49, 205.

⁶⁵ O'Brien and Gilligan, n 49, xvii: the authors state that a "universal hermetic definition of what constitutes culture is perhaps impossible. It is, therefore, perhaps more fruitful to accept the conceptual imprecision that permeates debates about culture and understand it as a complex interaction between networks of specific epistemic communities that aggregate interweaving dimensions"; see also DA Westbrook, "The Culture of Financial Institutions: The Institution of Political Economy" in O'Brien and Gilligan, n 49, 3, 7; see also Group of Thirty, n 60, 17.

⁶⁶ SP Huntington, "Foreword" in Harrison and Huntington, n 62, xiii, xv.

⁶⁷ Schein, n 63, 18.

⁶⁸ G Hofstede, *Cultures and Organizations: Software of the Mind* (McGraw Hill UK, 1991) 262, quoted in G Hofstede, "Identifying Organizational Subcultures: An Empirical Approach" (1998) 35 *Journal of Management Studies* 1, 2.

⁶⁹ M Bower, "Company Philosophy: 'The Way We Do Things Around Here'" (2003) May *McKinsey Quarterly* <http://www.mckinsey.com/insights/leading_in_the_21st_century/company_philosophy_the_way_we_do_things_around_here>.

There is a lack of consensus in defining “culture”. This is also the case in attempting to describe culture. For example, Schein observes that the concept of organisational culture implies four key elements. These are:

- structural stability: culture provides stability, predictability and meaning to organisations;⁷⁰
- depth: culture is deeply embedded in, and is an unconscious part of, the group;⁷¹
- breadth: culture is pervasive and affects how the organisation performs its functions, the organisation’s internal operations and how it responds to its external environments;⁷² and
- patterning or integration: the elements of culture are part of a “larger paradigm ... that ties together into a coherent whole”.⁷³

However, Hofstede’s Organisational Cultural Model uses eight dimensions to explain how “members of an organisation relate to each other, their work and the outside world”.⁷⁴ These are:⁷⁵

- means-oriented vs goal-oriented: in a highly means-oriented culture, “people perceive themselves as avoiding risks and making only a limited effort in their jobs”, whereas in a highly goal-oriented culture, employees seek to achieve “specific internal goals or results, even if these involve substantial risks”;
- internally-driven vs externally-driven: in a highly internally-driven culture, “employees perceive their task towards the outside world as totally given” and is driven by ethics and honesty; whereas an externally-driven culture is one where results are the most important outcome for the organisation;
- easygoing work discipline vs strict work discipline: this refers to the extent of internal structures and controls;
- local vs professional: in a local culture, “employees identify with the boss and/or the unit in which one works”, whereas in a professional culture, an employee’s identity is shaped by the profession and the content of their role;
- open system vs closed system: the accessibility of the organisation to those within, and outsiders to, the organisation;
- employee-oriented vs work-oriented: an employee-oriented culture prioritises the welfare of employees above the performance of a task; a work-oriented culture is the reverse;
- degree of acceptable leadership style: the extent to which a supervisor’s leadership style reflects a person’s preferences; and
- degree of identification with the organisation: the extent to which an employee identifies with the organisation.

Gerry Johnson, Richard Whittington and Kevan Scholes⁷⁶ identify six elements that constitute an organisation’s “cultural web” – namely, what the organisation does and its values. These are:

- control systems: the formal and informal systems the organisation utilises to monitor and support the actions of “people within and around an organisation”;⁷⁷
- organisational structures: the “roles, responsibilities and reporting relationships in organisations”;⁷⁸
- power structures: how power is distributed to groups of people within the organisation;

⁷⁰ Schein, n 63, 16.

⁷¹ Schein, n 63, 16.

⁷² Schein, n 63, 17.

⁷³ Schein, n 63, 17.

⁷⁴ *Organisational Culture* (2015) The Hofstede Centre <<http://geert-hofstede.com/organisational-culture.html>>. Hofstede also developed a model of national culture that consists of six dimensions: *National Culture* (2015) The Hofstede Centre <<http://geert-hofstede.com/national-culture.html>>.

⁷⁵ *Organisational Culture*, n 74.

⁷⁶ G Johnson, R Whittington and K Scholes, *Exploring Strategy* (9th ed, Prentice Hall, 2011) 176–8.

⁷⁷ Johnson, Whittington and Scholes, n 76, 178.

⁷⁸ Johnson, Whittington and Scholes, n 76, 178.

- rituals: the “activities or special events that emphasise, highlight or reinforce what is important in the culture”;⁷⁹
- routines: the “‘way we do things around here’ on a day-to-day basis”;⁸⁰
- stories: these represent what the organisation values; and
- symbols: “objects, events, acts or people that convey, maintain or create meaning over and above their functional purpose”.⁸¹

Attempts have been made to formulate definitions of “corporate culture” in a legal context. However, this contemplates a culture of compliance with the law – this is different to organisational culture, which is a key component of business strategy. French J (as his Honour then was) observed that a “corporate culture of compliance means a set of attitudes and behaviours or an ethos predisposed to obedience to the law”.⁸² It has also been described as “the link between documented rules and policies and how they are actually implemented”.⁸³ It is clear that ASIC’s Proposed Amendments far exceed this approach and it appears that ASIC’s view of culture is more than a predisposition to obeying the law; it encompasses, for example, acting in the customer’s best interests.⁸⁴ It is unclear, however, how this latter view would fit with the duty of directors to act in the best interests of the company, particularly where these duties conflict.

The Commonwealth *Criminal Code* may provide some guidance on ASIC’s direction. The *Criminal Code* defines “corporate culture” as “an attitude, policy, rule, course of conduct or practice existing within the body corporate generally or in the part of the body corporate in which the relevant activities takes place”.⁸⁵ This is similar to the definition of “culture” in a recent statement by ASIC.⁸⁶ The definition addresses some of the uncertainty as to what constitutes “culture” by focussing on objective criteria that may be used as evidence of the corporate culture – namely, policies, rules and a course of conduct. Although the *Criminal Code* defines culture, this does not mean that it is in fact “organisational culture”; it is the result of a legislative attempt to reduce organisational culture to a black-letter law concept. The understanding of “culture” in the organisational literature is far broader and more complex. As Dr Robert Kay has recognised, a difficulty in defining corporate culture is that a definition may place the wrong emphasis on the wrong factors, or not deal with those factors that might actually be central to a particular culture being studied.⁸⁷

While this discussion is by no means exhaustive, it demonstrates that there is significant difficulty in defining “culture”. What is the “right culture” is unique to each institution; there is no single “best practice” culture that regulators can define.⁸⁸ There is also a significant danger that, in trying to define culture for the purposes of legal liability, this may actually make the very thing trying to be corrected worse.

Can culture be accurately measured for the purposes of imposing legal liability?

How culture is measured will ultimately depend on how it is defined and for what purpose it is being measured. This requires that metrics of “culture” are chosen and may require a desired culture to be

⁷⁹ Johnson, Whittington and Scholes, n 76, 177.

⁸⁰ Johnson, Whittington and Scholes, n 76, 177.

⁸¹ Johnson, Whittington and Scholes, n 76, 177.

⁸² RS French, “The Culture of Compliance – A Judicial Perspective” (Paper presented at the Australian Compliance Institute, Sydney, 3–5 September 2003).

⁸³ M Legg, “Class Actions and Regulating Culture in Financial Organisations” in O’Brien and Gilligan, n 51, 229, 230.

⁸⁴ Tanzer, n 4, 3.

⁸⁵ *Criminal Code* (Cth) s 12.3 (definition of “corporate culture”).

⁸⁶ See “What does ASIC mean by ‘culture’?”; see also Medcraft, n 2, 2.

⁸⁷ Interview with Dr Robert Kay (Sydney, 18 September 2015).

⁸⁸ See generally Group of Thirty, n 60, 23; JC Trichet, “Getting Banking Culture Right” *Project Syndicate* (online), 2 September 2015 <<http://www.project-syndicate.org/commentary/getting-bank-culture-right-by-jean-claude-trichet-2015-09>>.

defined.⁸⁹ Even if these metrics are well-defined, it is extremely difficult to collect valid data.⁹⁰ The approach of the Financial Conduct Authority in the United Kingdom, for example, “is to draw conclusions about culture from what we observe about a firm – in other words, joining the dots rather than assessing culture directly”.⁹¹ ASIC has admitted that “there is no algorithm or ... formula that you can put a bunch of variables into and it says definitively: this firm has a bad culture”.⁹² In its surveillance function, ASIC is “joining the dots ... to give [it] a better picture of ... [the] culture [of corporations] and how that might affect consumer outcomes”.⁹³ This certainly would not be a valid means by which to impose legal liability, particularly where the consequence may include, for corporations, penalties or, for directors and officers, penalties or removal from their position.

The difficulties of attempting to measure “culture” will be a key problem if organisational culture is regulated. The regulation of culture will force businesses to consider how regulators and courts measure culture and to respond to those assessments and judgments. This may encourage organisations to focus predominantly on compliance and lead organisations, directors, officers and regulators to consider the wrong factors and not address more important issues that may contribute to a potentially problematic corporate culture.

How is culture changed?

In order for the regulation of culture to be effective, it is necessary that those persons on whom liability is imposed – directors, officers and the organisation – can implement changes to avoid the risk of liability. If the corporation, directors or officers cannot ensure that the corporate culture can be changed, corporate culture cannot and should not be regulated or be the subject of ASIC’s enforcement.

Although it is possible to agree that culture can sometimes be changed, it is well-recognised that this is not a simple process. Organisational change is notoriously difficult,⁹⁴ and changing culture is no exception.⁹⁵ McKinsey estimates that nearly 70% of organisational transformations fail.⁹⁶ It has been known for “a long time that it takes years to alter how people think, feel, and behave, and even then, the differences may not be meaningful”.⁹⁷ Attempting to change culture is complex and is likely to be met with resistance because culture can be deeply ingrained in organisations.

⁸⁹ See generally C Dewar and S Keller, “Three Steps to a High-Performance Culture”, *Harvard Business Review* (online), 26 January 2012 <<http://hbr.org/2012/01/three-steps-to-a-high-performa>>.

⁹⁰ Sydney Finkelstein, a management professor at Dartmouth College’s Tuck School of Business, cited in E Glazer and C Rexrode, “As Regulators Focus on Culture, Wall Street Struggles to Define It”, *Wall Street Journal* (online), 1 February 2015 <<http://www.wsj.com/articles/as-regulators-focus-on-culture-wall-street-struggles-to-define-it-1422838659>>.

⁹¹ C Adamson, “The Importance of Culture in Driving Behaviours of Firms and How the FCA will Assess This” (Speech delivered at the CFA Society – UK Professionalism Conference, London, 19 April 2013) <<http://www.fca.org.uk/news/regulation-professionalism>>.

⁹² Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Oversight of the Australian Securities and Investments Commission (Parliament of Australia, Canberra, August 2015) 7 (John Price).

⁹³ J Price, “Trust and Culture: What Consumers Want” (Speech delivered at the 2015 Customer Owned Banking Convention, Darwin, 21 September 2015) 2 <<http://download.asic.gov.au/media/3358612/speech-to-the-custom-owned-banking-convention-2015-published-21-september-2015.pdf>>.

⁹⁴ See, eg, M Kets de Vries, L Gulli n Ramo and K Korotov, *Organizational Change, Leadership, Change, and Stress*, Faculty and Research Working Paper (INSEAD, 2009) 3 <<http://www.insead.edu/facultyresearch/research/doc.cfm?did=41924>>; S Denning, “How Do You Change An Organizational Culture?” *Forbes* (23 July 2011) <<http://www.forbes.com/sites/sites/stevedenning/2011/07/23/how-do-you-change-an-organizational-culture>>.

⁹⁵ See, eg, T Kell and GT Carrott, “Culture Matters Most” (2005) May *Harvard Business Review* 22, 23, describing changing the culture of an organisation as “a mammoth task”.

⁹⁶ M Meaney and C Pung, “Creating organizational transformations” (2008) July *McKinsey Quarterly* 1–7; see also D Jacquemont, D Maor and A Reich, *How to Beat the Transformation Odds* (McKinsey & Company, April 2015) <http://www.mckinsey.com/insights/organization/how_to_beat_the_transformation_odds>; see generally T Basford, B Schaninger and E Viruleg, *The Science of Organizational Transformations* (McKinsey & Company, September 2015) <http://www.mckinsey.com/insights/organization/the_science_of_organizational_transformations>.

⁹⁷ Katzenbach, Steffen and Kronley, n 57, 112; see also Trichet, n 88; Economist Intelligence Unit, *A Crisis of Culture – Valuing*

All levels of the organisation must embrace the cultural transformation in order for it to be successful. This requires the buy-in of employees, managers and the board, often across many departments, sub-cultures and geographic locations. Cultural change can, in turn, affect the entire organisation as it is significantly influenced by internal systems and processes,⁹⁸ including recruitment, induction and training programs,⁹⁹ compliance systems and the alignment of strategy and culture.¹⁰⁰ While the board of a large company can articulate the purposes and values of the company, the board itself cannot ensure the company develops a particular culture. This is particularly true for non-executive directors, who are not engaged in the day-to-day management of the organisation.

While anecdotal evidence suggests that organisations can learn from cultural transformations at other companies, it is necessary for the organisation to develop its own “model” of culture.¹⁰¹ If a third party, such as ASIC, attempts to change an organisation’s culture, the organisation may not sufficiently embrace the transformation effort. Even if it is assumed that ASIC’s proposal has merit, where a cultural transformation fails (which appears to be the current probability in any event), this may lead to further negative cultural issues and adversely affect the organisation’s performance.

As culture is a “moving target”,¹⁰² it may also be unintentionally changed. The culture of the organisation can be adversely affected by shifts in the organisational strategy.¹⁰³ For example, if the organisation undergoes significant organic growth, has recently merged with or acquired another business, or is under financial stress, its culture will be affected.¹⁰⁴ Furthermore, it is possible that attempts to positively change the organisation’s culture could adversely affect its culture. This may, for example, be influenced by a perception that the intervention of management in business units signals a lack of trust in those business units.¹⁰⁵

Can culture be effectively regulated?

As discussed above, there are significant difficulties in attempting to regulate something as uncertain as corporate culture. In order to impose liability on directors, officers and the company, there must be an identifiable “offence” – the culture of the organisation must fall short of some legal standard. It is, however, extremely difficult to define that standard.

ASIC’s Proposed Amendments touch upon the boundaries of what are properly the reasonable limits of the law. First, the law must be “appropriately clear and determinate in meaning”.¹⁰⁶ However, as culture cannot be readily defined and cannot be measured against an objective standard, it is extremely difficult for the company, directors and officers to know if enough has been done to satisfy the statutory prescription of “culture” or to know whether any liability has arisen. Secondly,

Ethics and Knowledge in Financial Services (The Economist Intelligence Unit Ltd, 2013) 5 <<http://www.economistinsights.com/sites/default/files/LON%20-%20SM%20-%20CFA%20WEB.pdf>>; JD Durrett, “Recovering from Crisis” in T Dickson (ed), *Voices on transformation 2* (McKinsey & Company) 40–1: “Cultural transformations may take a significant amount of time, lead to employee turnover and customer attrition, in addition to failing to grow – the company is ultimately in a favourable position, but it is a difficult transition”; see also Group of Thirty, n 60, 5.

⁹⁸ Walker, n 53.

⁹⁹ Kell and Carrott, n 95, where the authors note that “[i]t is possible to change a company’s culture-or at least to prod it a bit in one direction or another. That is best achieved by continually hiring people who represent the direction in which you are headed”.

¹⁰⁰ Financial Stability Board, n 48, 9–10.

¹⁰¹ J Ahlberg and T Naucler, “How to improve a successful corporate culture” in T Dickson, n 97, 62.

¹⁰² Power, Ashby and Palermo, n 60, 18.

¹⁰³ Deloitte, *Global Human Capital Trends 2015 – Leading in the New World of Work* (Deloitte University Press, 2015) 38 <http://dupress.com/wp-content/uploads/2015/08/DUP_GlobalHumanCapitalTrends2015.pdf>.

¹⁰⁴ Deloitte, n 103, 38.

¹⁰⁵ DC Langevoort, “Chasing the Greased Pig Down Wall Street: A Gatekeeper’s Guide to the Psychology, Culture and Ethics of Financial Risk Taking” (2011) 96 *Cornell Law Review* 1209, 1244.

¹⁰⁶ RS Summers, “The Principles of the Rule of Law” (1999) 74 *Notre Dame Law Review* 1691, 1693.

corporations, directors and officers must actually be able to comply with the law.¹⁰⁷ As stated previously, culture takes a significant amount of time to change and attempts to change culture may not necessarily be successful.¹⁰⁸ A director or officer may have no indication that, at the time the relevant act occurs, the organisation’s culture does not conform to the standard set by the organisation, let alone some artificial standard imposed by law. It may not be possible for a corporation or its directors or officers to actually comply with the standard required by ASIC. If this is the case, the powers conferred by ASIC’s Proposed Amendments could be used in an arbitrary and capricious way.

As observed,¹⁰⁹ ASIC has argued an organisation can “have the right culture, or ... the wrong culture”.¹¹⁰ However, is it possible to state definitively what is a “good” or “bad” culture?¹¹¹ Culture is specific to each organisation at a particular time and at a particular stage of its evolution; it is not simply “good” or “bad”. Where a corporation is doing the “wrong thing”, this should be dealt with under existing laws, in accordance with the rule of law.

Culture cannot be effectively controlled by a regulator.¹¹² Organisational culture is driven by behaviours, and behaviours “are not amenable to legislation or regulation”.¹¹³ As the standard of corporate culture is extremely vague, it is not clear how businesses should respond to regulations addressing culture. Furthermore, it is also highly unlikely that there will ever be a single culture in a large organisation.¹¹⁴ There may also be many subcultures.¹¹⁵ To impose personal liability on directors and officers for the subculture of a business unit fails to recognise that directors and officers may have had little or no knowledge of the business unit’s subculture.

As culture takes a significant amount of time to change, it may be difficult to identify which directors and managers are responsible for a particular breach under ASIC’s Proposed Amendments. If a manager inherits a culture that ASIC considers problematic, yet takes reasonable steps to change this culture, and a contravention then occurs, would that manager be liable under ASIC’s Proposed Amendments?

It might be argued that the organisation’s role is to align behaviours with the organisation’s values. Although there may be a role for the regulator proactively engaging with the organisation, it should not interfere in the internal management of that organisation. The Financial Stability Board has recognised this: regulators must “strike the right balance between taking a more intensive, proactive approach and not unduly influencing strategic decisions of the institution’s management”.¹¹⁶ Attempts to regulate corporate culture are a significant intrusion into the internal management of business, are likely to fail and are likely to cause much greater damage than any potential benefits they might lead to.

WILL REGULATING CULTURE MAKE IT A COMPLIANCE ISSUE?

ASIC’s Proposed Amendments may make corporate culture a compliance issue. The threat of civil and criminal liability on organisations and personal liability on directors and officers is a significant one, particularly where it is uncertain what is necessary in order for the organisation to understand or to

¹⁰⁷ See generally Summers, n 106, 1693–94.

¹⁰⁸ See “How is culture changed?”.

¹⁰⁹ See “What does ASIC mean by ‘culture’?”.

¹¹⁰ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 8 (Greg Medcraft).

¹¹¹ See, eg, Trichet, n 88.

¹¹² Group of Thirty, n 60, 23.

¹¹³ Group of Thirty, n 60, 55.

¹¹⁴ See, eg, Economist Intelligence Unit, n 97, 5–6.

¹¹⁵ See generally Hofstede, n 68.

¹¹⁶ Financial Stability Board, n 48, 4; see also Group of Thirty, n 60, 15.

comply with ASIC's Proposed Amendments. Attempts to indirectly regulate culture, or to prescribe the culture that an organisation should have, are likely to create unnecessary and significant compliance costs.¹¹⁷

ASIC has indicated that regulating culture is “not about compliance”¹¹⁸ and creating a “good culture should not mean mountains of red tape and armies of compliance staff”.¹¹⁹ Rather, it is to “clean ... up culture”,¹²⁰ do “the right thing”¹²¹ and restore “trust and confidence where culture and conduct is a problem”.¹²² ASIC argues that a “good culture should remove the need for a lot of internally generated red tape”¹²³ because “doing the right thing by your customers”¹²⁴ will reduce the overall burden of compliance. These justifications do not mean that corporate culture will not become a compliance issue once an offence is entrenched in the *Corporations Act 2001*, as proposed by ASIC. In fact, it would be unlikely not to see a whole new range of compliance policies and procedures arise in this area, with attendant consultants and advisors.

Overregulation

Government regulation already imposes a significant burden on Australian companies. Australia has a reputation as a country in which it is highly or overly regulated to do business. This is an additional barrier to Australia becoming an “agile” and “innovative” economy, as sought by Prime Minister Turnbull.¹²⁵ For example, the World Economic Forum recognises that Australia's overall competitiveness has declined since 2010. Over the same period, government regulation has become more burdensome.

Year	Overall competitiveness (ranking)	Burden of government regulation (ranking)
2010–11 ¹²⁶	16/139	60/139
2011–12 ¹²⁷	20/142	75/142
2012–13 ¹²⁸	20/144	96/144
2013–14 ¹²⁹	21/148	128/148

¹¹⁷ Commonwealth of Australia, n 53, 7–8.

¹¹⁸ Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 7 (Greg Medcraft).

¹¹⁹ G Medcraft, “Trust and Confidence, Culture and Ethics: The Right Nudge in Shaping Communities Globally and Locally” (Speech delivered at the Annual dinner of the Paddington Society, Sydney, 6 August 2015) 3 <<http://download.asic.gov.au/media/3324144/speech-to-the-paddington-society-published-11-august-2015.pdf>>.

¹²⁰ Evidence to Senate Standing Committees on Economics, n 3, 7.

¹²¹ Evidence to Senate Standing Committees on Economics, n 3, 7.

¹²² Evidence to Senate Standing Committees on Economics, n 3, 7.

¹²³ Price, n 5, 3.

¹²⁴ Price, n 5, 3.

¹²⁵ Turnbull M, *Transcript: Vote on the Liberal Party Leadership* (14 September 2015) <<http://www.malcolmturbull.com.au/media/transcript-vote-on-the-liberal-party-leadership>>.

¹²⁶ K Schwab (ed), *The Global Competitiveness Report 2010–2011*, World Economic Forum, 84–85 <http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf>.

¹²⁷ K Schwab (ed), *The Global Competitiveness Report 2011–2012*, World Economic Forum, 102–103 <http://www3.weforum.org/docs/WEF_GCR_Report_2011-12.pdf>.

¹²⁸ K Schwab (ed), *The Global Competitiveness Report 2012–2013*, World Economic Forum 95 <http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2012-13.pdf>.

¹²⁹ K Schwab (ed), *The Global Competitiveness Report 2013–2014*, World Economic Forum 111 <http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf>.

Year	Overall competitiveness (ranking)	Burden of government regulation (ranking)
2014–15 ¹³⁰	22/144	124/144
2015–16 ¹³¹	21/140	80/140

ASIC’s intention to regulate “culture” through its enforcement programs and Proposed Amendments will only exacerbate the burden of regulation and add to the pressure on boards to concentrate more on conformance than performance. For example, in the second half of 2015, the Australian Institute of Company Directors (AICD) observed that:

- around 40% of directors perceived that legislation imposing liability on directors adversely impacted their business decisions;¹³²
- over 60% of directors perceived “governance regulations as onerous”;¹³³
- more than 50% of directors considered director liability legislation would adversely affect their willingness to accept new appointments to boards;¹³⁴
- almost 75% of directors considered there to be a “risk-averse decision-making culture on Australian boards”;¹³⁵ and
- 85% of directors agreed that the “risk of personal liability has caused them to take an overly cautious approach in their business decision-making”.¹³⁶

Similar observations have been made by AICD since 2011.¹³⁷ Attempts to regulate culture, whether directly or indirectly,¹³⁸ will further exacerbate these issues and will likely limit the capacity of organisation’s to take calculated risk-taking, which is necessary for innovation and growth.

ASIC and the Australian Prudential Regulation Authority (APRA) have both indicated that they intend to monitor culture and raise issues of culture with boards and management.¹³⁹ In order to avoid the risk of overregulation, regulators need to manage carefully to ensure that they are not duplicating their work in this area, and to avoid creating regulatory confusion and further compliance costs.

¹³⁰ K Schwab (ed), *The Global Competitiveness Report 2014–2015*, World Economic Forum (3 September 2014) 115 <http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2014-15.pdf>.

¹³¹ K Schwab (ed), *The Global Competitiveness Report 2015–2016*, World Economic Forum (30 September 2015) 101 <http://www3.weforum.org/docs/gcr/2015-2016/Global_Competitiveness_Report_2015-2016.pdf>; cf World Bank Group, *Ease of Doing Business in Australia* <<http://www.doingbusiness.org/data/exploreeconomies/australia>>.

¹³² Australian Institute of Company Directors, *Director Sentiment Index: Research Findings Second Half 2015* (November 2015) 50 <<http://www.companydirectors.com.au/director-resource-centre/research-reports/director-sentiment-index/2015>>.

¹³³ Australian Institute of Company Directors, n 132, 49.

¹³⁴ Australian Institute of Company Directors, n 132, 50.

¹³⁵ Australian Institute of Company Directors, n 132, 52.

¹³⁶ Australian Institute of Company Directors, n 132, 52.

¹³⁷ Australian Institute of Company Directors, *Directors’ Sentiment Index: Research Findings – Executive Summary Second Half 2011* (November 2011) 19–20 <<http://www.companydirectors.com.au/director-resource-centre/research-reports/director-sentiment-index>>; Australian Institute of Company Directors, *Director Sentiment Index: Research Findings Second Half 2012* (14 November 2012) 18 <<http://www.companydirectors.com.au/director-resource-centre/research-reports/director-sentiment-index>>; Australian Institute of Company Directors, *Director Sentiment Index: Research Findings Second Half 2013* (November 2013) 20, 76–7 <<http://www.companydirectors.com.au/director-resource-centre/research-reports/director-sentiment-index>>; Australian Institute of Company Directors, *Director Sentiment Index: Research Findings Second Half 2014* (5 November 2014) 9, 15, 77–8 <<http://www.companydirectors.com.au/director-resource-centre/research-reports/director-sentiment-index>>; Australian Institute of Company Directors, *Director Sentiment Index: Research Findings First Half 2015* (April 2015) 12 <<http://www.companydirectors.com.au/director-resource-centre/research-reports/director-sentiment-index/2015>>.

¹³⁸ Evidence to the Senate Economics Legislation Committee (Parliament of Australia, Canberra, 21 October 2015) 54–5 (Greg Medcraft). Although it was stated that “[w]e [ASIC] cannot regulate culture and we cannot be looking over everyone’s should going forward”; compare the statements in Evidence to the Senate Economics Legislation Committee, n 10, 55.

¹³⁹ W Byres, “Regulation: Responding to Market Change or Driving it?” (Speech delivered at the Actuaries Institute of Banking on Change Seminar, Sydney, 16 September 2015) 7–8 <<http://www.apra.gov.au/Speeches/Documents/12%20IAAust%20-%20regulation%20responding%20to%20market%20change%20or%20driving%20it%20-%202016%20September%202015.pdf>>; I Laughlin, “Stay Ahead of the Risk: Risk Governance and Risk Culture” (Speech delivered at the Institute of Actuaries of

AICD noted that it continued to have concerns over personal liability for corporate fault. AICD went on to state that, unless the law provides appropriate protection to directors who acted with honesty and integrity, there would be a negative impact upon “business decision-making, business outcomes and a serious negative impact on the willingness of directors to accept new board appointments”.¹⁴⁰ Similar observations were made in the CLERP3 report, which noted concerns that imposing greater liability on directors was focussing the attention of directors on compliance issues, rather than creating wealth for shareholders.¹⁴¹

ASIC’s proposal on personal liability

ASIC’s Proposed Amendments risk eroding the value of “the greatest single discovery of modern times”: the limited liability corporation.¹⁴² Imposing personal liability on directors and officers solely because of their positions in a corporation and based on the conduct of another person, particularly one over whom those directors and officers could have had no effective oversight, is anathema to traditional concepts of criminal and civil liability and, in our view, the rule of law. This risk of personal liability is also an unjustified piercing of the corporate veil.

Any attempt to reverse the onus of proof by requiring directors and officers to establish a defence should be rejected. This goes against significant work by COAG and CAMAC, which were critical of legislative provisions that placed the burden of proof on directors,¹⁴³ and is troubling, particularly in the year of the 800th anniversary of the Magna Carta, a document to which the rule of law is traced.¹⁴⁴

WHAT IS THE CURRENT REGULATORY FRAMEWORK?

Australia has a robust regulatory framework. ASIC’s Proposed Amendments are not required for cultural change to occur in financial institutions.

The Criminal Code (Cth)

The corporate culture provisions in the *Criminal Code* provide a means to establish the statutory fault element of certain offences.¹⁴⁵ The Code does not provide that a certain corporate culture is, by itself, an offence.

Australia, Sydney, 20 May 2013) 1, 8 <<http://www.apra.gov.au/Speeches/Documents/Ian-Laughlin-IAA-20-May-2013.pdf>>, observing that “APRA is increasing the attention it gives to both risk governance and risk culture, and in the process further developing our thinking and supervisory practices”.

¹⁴⁰ Australian Institute of Company Directors, *The Honest and Reasonable Director Defence* (7 August 2014) 6 <http://www.companydirectors.com.au/~media/resources/director%20resource%20centre/policy%20on%20director%20issues/2014/the%20honest%20reasonable%20director%20defence%20a%20proposal%20for%20reform_august%202014_f.ashx>; see also A Herzberg and H Anderson, “Stepping Stones – From Corporate Fault to Directors’ Personal Civil Liability” (2012) 40 *Federal Law Review* 181, 195, where it is observed that imposing an unacceptable degree of liability would discourage qualified persons from taking up board positions; but see M Byrne, “Directors’ Fear of Derivative Liability and Occupational Health and Safety Laws” (2011) 29 *Company and Securities Law Journal* 213.

¹⁴¹ See generally Corporate Law and Economic Reform Program, *Directors’ Duties and Corporate Governance – Facilitating Innovation and Protecting Investors – Proposals for Reform Paper 3* (1997) 9 <<http://archive.treasury.gov.au/documents/283/PDF/full.pdf>>.

¹⁴² N Butler, *Why Should We Change our Form of Government? Studies in Practical Politics* (C Scribner’s Sons, 1912) 82.

¹⁴³ Corporations and Markets Advisory Committee, *Personal Liability for Corporate Fault Report* (September 2006) 33–4 [3.4] <[http://www.camac.gov.au/camac/camac.nsf/byheadline/pdf/final-reports+2006/\\$file/personal_liability_for_corporate_fault.pdf](http://www.camac.gov.au/camac/camac.nsf/byheadline/pdf/final-reports+2006/$file/personal_liability_for_corporate_fault.pdf)>; Council of Australian Governments, *Personal Liability for Corporate Fault – Guidelines for applying the COAG principles* 9–10, 17 <<https://www.coag.gov.au/sites/default/files/Personal%20Liability%20for%20Corporate%20Fault%20-%20Guidelines%20for%20Applying%20the%20COAG%20Principles.pdf>>.

¹⁴⁴ J Spigelman, “Magna Carta: The Rule of Law and Liberty” (2015) 40 *Australian Bar Review* 212.

¹⁴⁵ See “Proposed Amendments to the ASIC Act and Corporations Act”.

By explicitly incorporating the corporation’s culture (or lack thereof) as a mechanism to establish the fault requirement of a criminal offence, Pt 2.5 of the *Criminal Code* is intended to “incentivise ... corporate self-monitoring and the development of a general culture of compliance”.¹⁴⁶

To extend Pt 2.5 of the *Criminal Code* to Ch 7 of the *Corporations Act 2001* would be a significant intrusion into the internal governance of corporations. The provisions are “vague and provide little guidance to companies and their lawyers about what is required” to comply with Pt. 2.5 of the *Criminal Code*.¹⁴⁷ The “corporate culture” model of criminal liability is still yet to be tested in a criminal prosecution.¹⁴⁸

Existing directors’ duties

The duties of directors in Australia are well-known. Through the duties imposed under statute, common law and equity, Australia has some of the strictest directors’ duties laws.

ASIC’s Proposed Amendments raise two issues.

First, ASIC could seek to use alleged contraventions by the corporation of the proposed Financial Services Amendments to impose personal liability on directors.¹⁴⁹ ASIC has previously brought proceedings against a corporation for breaches of the *Corporations Act 2001* and then commenced an action against a director alleging it has breached one or more of the duties in ss 180–182 for having exposed the corporation to the risk of criminal or civil liability. However, in *Australian Securities and Investments Commission v Mariner Corporation Ltd*,¹⁵⁰ Beach J rejected the notion that a contravention of the *Corporations Act 2001* by a company necessarily means that its directors are in breach of their duty of care and diligence.¹⁵¹

Secondly, ASIC’s Proposed Amendments provide a timely reminder of the need for a comprehensive and effective defence for directors. The limitations of the existing business judgment rule in s 180(2) of the *Corporations Act 2001* are well-canvassed.¹⁵² Although the business judgment rule in s 180(2) is available as a defence for a breach of s 180(1), it is narrowly circumscribed¹⁵³ and does not apply to other contraventions of the *Corporations Act 2001*. Other provisions of the *Corporations Act 2001* that impose personal liability on directors do not necessarily contain an exculpatory defence for directors.

¹⁴⁶ O Dixon, “Corporate Criminal Liability: The Influence of Corporate Culture” in O’Brien and Gilligan, n 49, 252.

¹⁴⁷ C Parker and O Conolly, “Is there a Duty to Implement a Corporate Compliance System in Australian Law?” (2002) 30 *Australian Business Law Review* 273, 283.

¹⁴⁸ As of June 2015, ASIC and the Commonwealth Department of Public Prosecutions were “interested in ... perhaps pursuing a case”: see Evidence to Senate Standing Committees on Economics (Parliament of Australia, Canberra, 3 June 2015) 7 (Greg Medcraft).

¹⁴⁹ See Herzberg and Anderson, n 140, 182–3.

¹⁵⁰ *Australian Securities and Investments Commission v Mariner Corporation Ltd* (2015) 106 ACSR 343; [2015] FCA 589.

¹⁵¹ *Australian Securities and Investments Commission v Mariner Corporation Ltd* (2015) 106 ACSR 343; [2015] FCA 589, 421–2 [444]–[452] (Beach J).

¹⁵² See, eg, Australian Institute of Company Directors, n 140, 6.

¹⁵³ See, eg, *Australian Securities and Investments Commission v Fortescue Metals Group* (2011) 190 FCR 364; [2011] FCAFC 19, 427 [197] (Keane CJ): “[T]he decision not to disclose the true effect of the agreements cannot be described as ‘business judgment’ at all. A decision not to make accurate disclosure of the terms of a major contract is not a decision related to the ‘business operations’ of the corporation. Rather it is a decision related to compliance with the requirements of the Act.”

The limited relevance of culture to determining penalties

While corporate culture may be a relevant factor in determining penalties for contraventions of the continuous disclosure regime¹⁵⁴ and for certain contraventions of the *Competition and Consumer Act 2010* (Cth),¹⁵⁵ we consider that to do so is not without difficulty, for the reasons identified in this article.

THE POSSIBILITY OF ABUSE BY ASIC OF THE PROPOSED AMENDMENTS

ASIC's Proposed Amendments would provide expanded powers to ASIC to regulate a very controversial and uncertain area. There is significant scope for these powers to be misused.

The difficulties in defining, measuring and regulating culture make it inherently open to abuse. Once an allegation of a poor corporate culture is made against the corporation, it is extremely difficult for the corporation, directors or officers to rebut this allegation. An allegation of poor corporate culture could cause significant reputational damage to the corporation and directors. Attempts to defend such an allegation would likely be costly because of the inherent uncertainty in trying to define and measure culture.

Further, conferring broad powers on ASIC that are based on an uncertain standard of culture may erode public confidence in ASIC and, potentially, the rule of law. It is well-recognised that law should be certain and objectively ascertainable. Heydon J noted that “[t]hose who seek to foster the rule of law prize certainty”.¹⁵⁶ This has been echoed by Allsop CJ, who observed that “[c]ertainty goes to the heart of the conception of the rule of law, not of men”.¹⁵⁷

The difficulties inherent in using “corporate culture” in the law was recognised by Gleeson CJ of the Supreme Court of New South Wales (as his Honour then was). In considering the then proposed corporate criminal liability provisions of the *Criminal Code*, his Honour observed:¹⁵⁸

What exactly does it mean to say that there is an attitude existing within a body corporate? ... Legislation which creates criminal offences should be reasonably clear in its application. And what happens if there exists within a body corporate both an attitude and the opposite of the same attitude?

...

I have enormous difficulties about attaching criminal sanctions to attitudes, and I am bound to say that I do not think that expressions like “corporate culture” have a place in the criminal law.

The Proposed Amendments are uncertain and could grant ASIC the power to regulate companies based on the vague standard of “culture”. This uncertainty, and the risk of abuse of the Proposed Amendments by ASIC and others, may undermine the rule of law.

CONCLUSION

Corporate culture is important for all companies. There has been much important and interesting work in this area and we commend ASIC for discussing culture with boards and management. However, we do not agree with ASIC's Proposed Amendments. ASIC's Proposed Amendments are extensive and appear to go significantly beyond the “corporate culture” provisions in the *Criminal Code* by imposing accessory liability on directors and officers.

¹⁵⁴ B Baxt, “Should the Commonwealth Criminal Code apply to civil provisions in the Corporations Act? An ASIC request that deserves proper examination!” (2015) 11(4) *Baxt Report* 2, 3; see, eg, *Australian Competition and Consumer Commission v Singtel Optus Pty Ltd (No 4)* (2011) 282 ALR 246; [2011] FCA 761, 251 [11] (Perram J); *Australian Competition and Consumer Commission v Chopra* [2015] FCA 539, [40] (Middleton J); *Australian Competition and Consumer Commission v OmniBlend Australia Pty Ltd* [2015] FCA 871, [82] (Beach J); *Australian Competition and Consumer Commission v Lux Distributors Pty Ltd (No 2)* [2015] FCA 903, [10] (Jessup J).

¹⁵⁵ Some cases consider the corresponding provisions of the *Trade Practices Act 1974* (Cth).

¹⁵⁶ *PGA v The Queen* (2012) 245 CLR 355; [2012] HCA 21, 401 [125] (Heydon J).

¹⁵⁷ *Paciocco v Australia and New Zealand Banking Group Ltd* (2015) 321 ALR 584, 644 [265] (Allsop CJ) (appeal pending).

¹⁵⁸ AM Gleeson, Submission No 2 to Senate Standing Committee on Legal and Constitutional Affairs, *Inquiry into the Criminal Code Bill 1994*, 26 September 1994, 2.

There are significant issues with ASIC’s Proposed Amendments.

First, it is extremely difficult to define and measure culture for the purposes of imposing legal liability. While some companies use tools to measure culture, this is often in the context of business management and strategy; these measurements of culture are not used to impose liability. Even if a corporation introduces programs to change its culture, it is not certain that such changes will be effective in the way that either the corporation or ASIC may want, and these changes may not be long-lasting. It may be difficult to rebut allegations of poor corporate culture because of the vagaries of defining and measuring culture. ASIC’s Proposed Amendments do not overcome these difficulties and would be open to abuse.

Secondly, if we want to encourage entrepreneurial activity in Australia, regulating culture by imposing further liability on companies, directors and officers sends a contradictory message to the business community. ASIC’s Proposed Amendments would add to the compliance and regulatory burden faced by companies.

Thirdly, further accessorial liability provisions should not be inserted into the *Corporations Act 2001*. The case has not been made out for introducing further provisions of this type of liability for directors and officers. The proposed Accessorial Liability Amendments go against significant work by CAMAC, COAG and AICD and the winding back of these types of accessorial liability provisions at the Commonwealth, State and Territory levels. These types of liability would be further exacerbated by a lack of a proper business judgment rule in the *Corporations Act 2001*.

What then, is the answer?

ASIC should, as foreshadowed, engage in dialogue with companies and industry bodies to help identify and encourage best practices, while recognising that work on culture depends on each organisation and that there is no one standard of a “good” or “bad” organisational culture. Industry bodies, universities and companies can take the lead and promote education programs and awareness of the latest developments in this area.

The answer to cultural shortcomings is developing high standards of professionalism and excellence¹⁵⁹ and continuing to experiment with cultural change, if required. It will take time and it must be recognised that an approach specific to the organisation is necessary.

More regulation based on corporate culture is not the answer.

¹⁵⁹ In its response to the Financial System Inquiry, the Turnbull Government agreed “to develop legislative amendments to raise the professional, ethical and educational standards of financial advisers by requiring advisers to hold a degree, pass an exam, undertake continuous professional development, subscribe to a code of ethics and undertake a professional year”: see Australian Government, *Improving Australia’s Financial System – Government Response to the Financial System Inquiry* (Commonwealth of Australia, 2015) 21 <http://www.treasury.gov.au/~media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20Financial%20System%20Inquiry/Downloads/PDF/Government_response_to_FSI_2015.ashx>.