



Corporate Culture and Corporate Liability:

The Importance of Developing a Compliance Culture

Introduction

Although a corporation is a legal entity, it is not a person and does not strictly have a mind of its own. A lot of offences (criminal and otherwise) involve a fault element, which involves a state of mind. How to attribute a state of mind to a corporation has long been a contentious issue.

There are two primary ways that corporations have been found guilty of offences with a fault element. A corporation can be found *vicariously* liable for the crimes of their employees working within their genuine or apparent authority. Or more topically in recent years, they have been found *directly* liable – where a state of mind is projected on to the corporation, fulfilling the fault element of the offence.

In these pages, I address exactly *how* a corporation is found to be directly liable for an offence with a fault element. Of particular interest is the effect of corporate culture on the fault element of an offence.

Historical Framework for Direct Liability

Traditionally, direct liability has only been attributed to a company where the act or omission was performed by an employee who was authorized to “embody” the corporation. A string of case law revolves around the “Tesco principle”, derived from *Tesco Supermarkets Ltd v Natrass*¹.

Directly liability has tended to be imposed only when the person performing the act or omission was a director or similarly high on the corporate hierarchy. Australian law has tended to follow this precedent.

From a policy perspective, this is problematic. Decision-making is delegated to people who do not quite embody the corporation as required by the *Tesco* principle, and accountability in large corporations is often diluted and confused, making it impossible to establish the necessary fault element when obvious wrong-doing has occurred.

There are, however, indications that we are moving away from this traditional framework in Australia.

The Criminal Code

The Commonwealth Criminal Code (the Code) was established by the *Criminal Code Act 1995*. It relates to the subset of crimes that are under the Commonwealth’s jurisdiction. Part 2.5 of the Code (which incorporates Division 12 discussed below) creates new ground with regards to corporate responsibility in the way it deals with the fault element of offences.

Section 12.1 of Division 12 of the Code makes clear that the “Code applies to bodies corporate in the same way as it applies to individuals” and clarifies that, contrary to a long common law tradition, a “body corporate may be found guilty of any offence, including one punishable by imprisonment.”

Section 12.2 speaks to the physical element of an offence – if “an employee, agent or officer... acting within the actual or apparent scope [or authority of their] employment... the physical element must also be attributed to the body corporate.”

¹ [1972] AC 153

Section 12.3 starts referring to the fault elements of an offence. Division 12.3(1) reads:

If intention, knowledge or recklessness is a fault element in relation to a physical element of an offence, that fault element must be attributed to a body corporate that expressly, *tacitly or impliedly authorised or permitted* the commission of the offence. [Italics added.]

The phrase “tacitly or impliedly authorized or permitted” is relevant to our discussion. Subsections 12.3(2)(c) and (d) expand on this and explicitly refer to corporate culture. This is a significant extension to the *Tesco* principle.

Paragraph 12.3(2)(d) is the broader definition. It discusses a failure “to create and maintain a corporate culture that require[s] compliance” (a compliance culture). Paragraph 12.3(2)(c) discusses a culture that actively “[directs, encourages, tolerates or leads] to non-compliance”, which I suggest falls within 12.3(2)(d)’s reach.

Corporate culture is defined in 12.3(6) 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.” So although it includes policies and rules, it can extend more broadly to attitudes and courses of conduct or practice. Where there is a conflict, there is discretion to weigh whether the written policies, or what is actually done, within an organisation constitute the corporate culture.

Subsection 12.4(b) states that if “the person who committed the offence reasonably believed or “entertained a reasonable expectation... that a high managerial agent of the body corporate would have authorised or permitted the commission of

the offence”, this is a relevant factor. As most people are aware, silence can be complicity.

These sections apply only to Commonwealth criminal offences, and this is a very small subset of offences within the realm of criminal law, where the states tend to have jurisdiction. But this legislation may be an indication of what future federal and state legislation will look like.

Section 1311 of the *Corporations Act 2001*, for example, states that any contravention of the Act constitutes an offence. Given the nature of this Act, most relevant offences will be tailored so that a fault element for a corporation can be concretely determined. There is a note, however, in s 1311 that “Chapter 2 of the *Criminal Code* sets out the general principles of criminal responsibility.”

Chemeq

French J discussed similar concerns in the context of a *Corporations Act 2001* contravention in the *Chemeq* case². He stated that “[i]n considering the appropriate penalty for the contravention by a corporation of a regulatory requirement... it is relevant to consider whether the corporation has in place policies and procedures designed to achieve compliance with such requirements.”

Importantly, French J states that “[t]he Court will consider the form and content of the policies and procedures and also the measures adopted by the corporation to ensure that they are understood and applied. A well drafted set of policies and procedures will mean little if there is no follow up in terms of training of company officers (including directors) and, where appropriate, refresher training.” (Italics added.)

² *Australian Securities and Investments Commission, in the matter of Chemeq Limited (ACN 009 135 264) v Chemeq Limited (ACN 009 135 264)* [2006] FCA 936

In *Chemeq*, a “culture of compliance” – “a degree of awareness and sensitivity to the need to consider regulatory obligations as a routine incident of corporate decision-making” – is stated as a positive obligation.

French J’s judgment has been widely discussed, but no further cases have addressed this issue. Like the Commonwealth Criminal Code it is likely to be an indication of how the fault element of offences will be dealt with in the future. Corporate culture is becoming a significant factor in determining culpability.

Difficulties with the Corporate Culture Approach

There are difficulties associated with inferring a fault element from a corporate culture. Authorising or permitting an offence is quite different from having an *intention* to perform an action, and this may be relevant where intention is necessary to constitute an offence. A corporate culture can be difficult to prove – meaning that written procedures may be given more precedence than is really justified. A sufficiently large company may have a superb compliance culture, with one aberrant cultural pocket: determining the bounds of corporate culture could be difficult. These are nuances that will need to be addressed over time. I personally believe that these issues pale in comparison to those issues associated with the *Tesco* principle.

Conclusion

Corporations, as legal entities, can commit offences, even where the offences have a fault element. Whereas the traditional approach was for corporations to be vicariously liable for their employees, they later became directly responsible for acts or omissions caused by their directors representing the organisation. The inadequacies of this approach are becoming clear. The Criminal Code and the *Chemeq*

case suggest that the law is evolving so that corporate culture is an important factor in determining whether the fault element of an offence is met.

This means that, in order to avoid liability, management should take an active approach to ensuring that their company is complying with its legal obligations. Drafting policies that articulate these obligations will not be enough: they will need to be implemented and internalised within the organisation. In essence, behaviour needs to reflect the stated values of the organisation. As corporate culture starts to carry more weight when looking at the fault element, it will become necessary for management to create and maintain a compliance culture within the organisation.

The law is current as at March 2009.

Please note that this paper is a summary of the law only and is not a substitute for legal advice. Holley Nethercote is able to assist companies in meeting their obligations in this area by providing practical and prompt legal advice. Licensing, training and creation of compliance programs are also available via an associated business, Compact- Compliance and Corporate Training – www.compliance-training.com.au.

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