Submission by Professor Fiona Haines, Criminology, School of Social and Political Sciences, University of Melbourne to the Senate Standing Committee on Economics Inquiry into the Penalties for White Collar Crime

I welcome the opportunity to make a submission to the Senate Standing Committees on Economics inquiry into the penalties for white collar crime. The comments below are designed to assist the committee in their deliberations by providing a framework for understanding the competing and complex dynamics that are at play when designing, and attempting to implement, a sentencing regime in the white collar crime context.

The submission below frames the issues associated with penalties for white collar crime through an analysis of two interrelated elements. These are:

- the instrumental and the symbolic dimensions of law enforcement in the context of white collar offences;
- the challenges associated with enforcement against white collar offending including, but not limited to, the resources of the defendant.

For the purposes of this submission the term white collar crime is considered to include both offending by individuals and businesses.

Instrumental and the symbolic dimensions of enforcement targeting white collar offences

A common separation is made in the criminological and socio-legal literature between the instrumental and the symbolic dimensions of the legal and regulatory responses to white collar offending (see e.g. Wells 2001, Chapter 2). A consideration of both is important in understanding the effectiveness or otherwise of penalties for white collar offending.

Instrumental considerations

An instrumental approach to white collar offending focuses on the deterrent impact of prosecution for a given white-collar offence, including any sentence imposed, against an individual or business entity. The contours of deterrence in the context white-collar crime are well canvassed (see e.g. Fisse and Braithwaite 1993, Short 2013, Yeung 2004). In the case of specific deterrence, deterrence theorists argue that the probability of prosecution and the severity of the penalty need to outweigh the benefits gained from the offence. In the case of general deterrence, an additional penalty may be imposed for the purposes of sending a message to the broader community at risk of offending. There is evidence that, in general, deterrence can be secured through penalties applied in white collar offences (Simpson 2013). However, deterrence is limited where the law or the regulator is not respected or seen as legitimate (Black 1997, Gezelius 2011).

A focus on deterrence necessarily brings the means of the offender into clear view. A financial penalty that has a serious deterrent effect on one individual or company may have limited impact on another simply by virtue of the ability to pay. For this reason, the principles of specific deterrence would suggest that the level of penalty should be tailored to the capacity of the individual offender. Further, a penalty that includes loss of any material benefit gained by the offending makes sense irrespective of the capacity of individual business to pay a further penalty.

The calculation of penalty for the purposes of securing deterrence, however, is always an inexact science. The means of the offender are not always easy to ascertain. The probability of detection

(often argued to be more important than the level of the penalty) is similarly opaque particularly for some financial offences (although not others, a toxic release of chemicals may be more immediately apparent for example (Simpson 2013)). Further, sentencing often requires the inclusion of other, sometimes competing concerns that complicate an exclusive focus on deterrence. Finally, the impact of deterrence (at least in the case of civil penalties) may be mediated by third parties, for example through the availability of insurance (Short 2013).

A discussion of deterrence can include a consideration of over-deterrence. Over-deterrence is understood to apply where an overzealous prosecution of a particular white-collar offence, or too harsh a penalty, exerts a chilling impact on desirable business behaviour especially entrepreneurial and innovative business practices (Yeung 2004). A concern to avoid over-deterrence can wield considerable influence over regulatory decision-making and policymaking. A focus on the impact of over-deterrence can animate many of the concerns of business as well as government initiatives aimed at reducing 'red tape' (Haines 2011).

The concept itself, however, has been subject to criticism particularly as it applies to the motives that should animate regulatory enforcement. In the wake of the global financial crisis, avoiding over-deterrence appears to have been a major consideration in the prosecutorial strategies of senior regulators and the failure to prosecute senior executives responsible for fraudulent or reckless behaviour that led to the crisis. This generated considerable debate within the United States with the arguments of many that over-deterrence should not be considered as a proper consideration for financial regulators and prosecutorial agencies (for an analysis see Taibbi 2014). Critics argued that regulators should have a single purpose: to ensure the law was respected and followed (Taibbi 2014, Calathes and Yeager 2016, Pontell, Black, and Geis 2014). A similar argument, namely the importance of a single compliance and enforcement focus for regulatory agencies, is also found in the context of the prevention of industrial disasters (Carson 1982).

The dual concerns of business confidence and public confidence in business animate these debates. It is well understood that both forms of confidence are critical to the sustainability of the financial system (Swedberg 2013). A significant policy challenge has always been how to separate the confidence necessary to underpin productive business behaviour from activities that result from over-speculation (Kindleberger and Aliber 2005). The line between confidence and overconfidence of investors and, from the perspective of the recipient of finance, the lines between a sound business strategy, recklessness and a confidence trick are not always clear particularly before disaster strikes (Haines 2014). It is in the aftermath of collapse and crisis widespread fraud may be found and indeed may characterise some markets. There is evidence for this in the case of both the Enron Collapse (McBarnet 2006) and the 2008-2009 financial crisis (Fligstein and Roehrkasse 2015).

Restoring business and investor confidence in the wake of a crisis in particular is complex and has significant implications for enforcement against white collar offenders. Swedberg (2013) argues that there is evidence from the 2008-2009 financial crisis that restoring confidence in the financial system (specifically inter-bank lending) required the US government to turn a blind eye to illegalities that were instrumental in generating the crisis. However, he goes on to comment that in doing so government itself risked losing the confidence of the general public in terms of the perception of the fairness of the criminal justice system (Swedberg 2013). He further intimates that the regulatory strategies needed to maintain the financial system and those needed to ensure the health of the real economy may differ.

A preferable strategy is to ensure a robust regulatory response – and indeed a regulatory framework itself – is an intrinsic component of non- crisis economic conditions. The basic requirement of a robust regime is one where adequate monitoring is undertaken by regulators, independent auditors and effective compliance personnel within the businesses themselves. When clear examples of egregious business practices are uncovered through monitoring strong sanctions should be applied. In such cases, there is a clear public interest in ensuring accountability of both individuals and businesses whose breaches of the law have been central to generating over-speculation and were fraudulent intent is clear. In these cases, imprisonment is clearly justified. Although beyond the remit of this enquiry, such an approach may assist in ensuring the dynamism of the financial system remains focussed on the needs of the real economy.

A robust response requires that criminal penalties with significant sanctions need to be present across the range of relevant regulatory regimes and that they are used. There needs to be not only the legal basis for prosecution (a threat) but demonstrated cases where prosecution in the case of egregious business practice have led to significant criminal penalties being applied.

However, imprisonment of individual offenders and significant penalties against businesses is never a sufficient response. Indeed, alone they may deflect attention from the need for more thoroughgoing reform. Enforcement must be accompanied by a secure understanding by the regulator of the businesses they regulate and the way these businesses pursue profit. The overall thrust of the regulatory framework should be to ensure business profitability is best secured in a manner that minimises the risk of harm of that business activity to investors, clients, workers and the public in general. As Fligstein and Roehrkasse (2015) argue:

> …regulators should pay more attention to understanding business models—that is, how firms actually make money. They should then monitor competitive conditions and structural changes in markets to anticipate when the eroding viability of business models might reach tipping points that drive many firms toward illegal behavior (p.35-6)

This state of affairs cannot be achieved by application of the criminal law alone. Regulatory regimes should be cognisant of the structure of the industry concerned and have in place a range of measures that regulators can use to ensure ethical business practice (Ayres and Braithwaite 1992, Gunningham and Grabosky 1998). The economic and political context, together with the regulatory regime will determine how businesses compete and whether they do so in a manner that is consistent with ethical business practice (Haines 2011).

Symbolic considerations

The character, or lack, of enforcement of the law against white collar offenders not only reinforces but also generates norms around business conduct. A lack of enforcement of a breach of the law generates the perception of business that this breach is insignificant and the perception of the public that businesses and executives are not subject to the same requirements as ordinary citizens. It can even be argued that a lack of enforcement condones such illegality (Wells 2001). Further, it can lead to the view that the pursuit of profit through business model that breaches the law is, in of itself, acceptable to government.

This argument should extend beyond the realm of business executives to investors and shareholders. Investors and shareholders, where they are not the direct victims of offences, also need to be disciplined to understand that a return on investment should not accrue by virtue of

illegal business practice. As Glasbeek (2002) notes, in the case of public companies, investors and shareholders are protected through limited liability provisions. They cannot be seen to gain through business practices that may generate considerable return but do so based on routine breaches of the law. Regulatory standards are always part and parcel of the business context. Governments necessarily shape the legal and regulatory conditions under which businesses compete. Proper enforcement of those laws is essential to the creation of economic transactions that can bring about the greatest long-term public interest.

Compliance with the law cannot be determined independently from the business context. What is considered to be compliance is determined in the interaction between regulated businesses and regulators (including government regulators and internal and external compliance officers). Edelman, for example, has long argued that compliance is intimately shaped in this interaction (see also Edelman and Talesh 2011, Short 2013). This is important. The nature of compliance without law enforcement is likely to diverge significantly from compliance that has been determined by a consistent enforcement of relevant law.

The problem of resources and the challenges associated with enforcement

Regulatory enforcement is challenging in part since businesses routinely may have access to greater legal resources, both within their firms and outside of them, than either regulatory agencies or prosecution services. In the words of one criminal defence barrister on the strategy to use when defending a client "the first rule is don't rush … so what you do is steer well clear of the fact and say there's a problem with the legal requirements…" (cited in Haines and Beaton-Wells 2012 p.962). Superior legal and financial resources can be used to wear down regulatory and prosecutorial agencies and to result in a settlement that falls well short of transparent and full accountability for breaches of the law. The requirement for the prosecutor to act as a model litigant may be a consideration here.

Care is needed, though, in recommending reforms that change the law in an attempt to rectify the imbalance. Changes to rules of evidence and the nature of liability (e.g. strict liability offences), for example, need to be seen as part of a long history of reform that attempts to level the playing field between business and regulatory agencies so that the resources demanded of agencies are less onerous (for an historical example see Carson 1980). The problem here, though, is that reforms that lower the standard around evidence and that reduce a requirement for criminal intent feed back into the perception of the breach of the law itself. Laws which were intended as criminal statute become viewed as something less than this, as quasi-criminal. Different historical trajectories between different legislative regimes also may result in markedly different standards that pertain to white collar offences when taken as a whole. The resulting complexity of the law through this process and the ensuing challenges of compliance may also lead to demands by the business and legal communities for reform to ensure greater formal equality. Taken together, the net result of a patchwork of laws in the area with different requirements and standards is not surprising. One further element is notable here. That is a political process that sees clauses placed in legislation that are designed to appease a particular audience and yet undermine the work ability of legislation in practice (Haines 2011).

The net result of these dynamics is that very different conditions may accrue to different legislative and regulatory arenas. I would caution against a view that these differences necessarily constitute a lack of fairness. Each regime needs to be understood in light of its own historical trajectory and the

particular rules of competition, or business models at play, in a particular industry. Specific requirements that may be needed to uphold business integrity in any one area may not apply in another. Nonetheless, where there is no justification for differences between areas than some attention to formal equality is appropriate.

Conclusion

This inquiry is timely and important. It is essential for the general public to have faith in a legal system where all are subject to the same expectations in terms of conduct. The processes of the criminal law and the penalties applied not only deter criminal conduct but also are woven into the fabric of the society itself. A lack of recourse to the criminal law shapes how people view not only the conduct but also the fairness or otherwise of the law. The nature of compliance that results from regulatory enforcement in turn forms a very real part of the rules of competition that apply in any given industry. Weak expectations in terms of what constitute compliance risk a gradual lowering of the standards of business behaviour.

Criminal prosecution cannot form a single component of a regulatory regime. Too great a reliance on it risks deflecting attention from more systemic problems that may plague some particular regulatory arenas. Nonetheless, it should be an option not only in theory but tested in practice. As part of a suite of enforcement options and broader strategies it can be seen as an anchor of the regulatory regime.

Ensuring this state of affairs is not an easy task. The imbalance of resources can be a significant issue as can the particular burdens on the state in terms of evidence and so on. Further, reforms aimed at securing easier convictions may in turn change perceptions of the law itself as something less than criminal.

This is not to suggest that reform is not warranted. Rather, that we should be cognisant of the lessons of history in understanding what consequences may flow from a particular reform and how the likely adverse consequences might best be dealt with.

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