Corporate Culture and Liability

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Draft Paper

1. Introduction

A developing theme in corporate governance is the extent to which public corporations are expected to play a positive role in society. In 2018, for example, Larry Fink, CEO of BlackRock, one of the world's largest institutional investors, declared that companies 'must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate'.[1]

This is not the first time that corporations have been urged to play a greater public role. In the early 1970s, a period in US history of great political upheaval and environmental concern, members of the Rockefeller Foundation's board of trustees stated that American corporations 'must assert an unprecedented order of leadership in helping to solve the social problems of our time'.[2] During the 1980s, however, this managerialist paradigm gave way to an essentially private conception of the business organization, which quickly became the dominant corporate law paradigm.[3]

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1 See BlackRock, Larry Fink's Annual Letter to CEOs, *A Sense of Purpose*, Jan. 12, 2018; Peter Horst, 'BlackRock CEO Tells Companies to Contribute to Society. Here's Where to Start', *Forbes*, Jan. 16, 2018.

2 *Time*, 1 June 1970, 55 (cited in Phillip I. Blumberg, 'The Politicalization of the Corporation' (1971) 51 *B.U. L. Rev.* 425, 462).

3 See generally William T. Allen, 'Our Schizophrenic Conception of the Corporation' (1992) 14 *Cardozo L. Rev.* 261. Some scholars argued, however, that developments during the 20th century greatly eroded the justification for adopting a 'private' conception of major business organizations. See, for example, Gerald E. Frug, 'The City as a Legal Concept' (1980) 93 *Harv. L. Rev.* 1057, 1129*ff*. Tension between a private and public conception of the corporation is also apparent in the famous Berle-Dodd debate of the early 1930s. See Adolf A. Berle, Jr., 'Corporate Powers as Powers in Trust' (1931) 44 *Harv. L. Rev.* 1049; E. Merrick Dodd, Jr., 'For Whom Are Corporate Managers Trustees?' (1932) 45 *Harv. L. Rev.*

A variety of recent international corporate governance developments that emphasize corporate culture suggest that the pendulum is again swinging toward a more public conception of the corporation, as a social, rather than a merely economic, entity.[4]

The corporation, which Adam Smith regarded as having little future,[5] has become entrenched in modern times as 'a basic unit of communal activity'.[6] However, recent corporate history provides numerous examples of corporate scandals involving communal activity that falls well short of providing benefit to society. Scandals, such as the Wells Fargo fraudulent accounts scandal among others, epitomize the damage that flawed corporate cultures can inflict on stakeholders, communities, trust and corporate reputation.

This study is less about how to use corporations to benefit 'all of their stakeholders…and the communities in which they operate'[7] than it is about how to ensure accountability, when corporations harm their stakeholders and society as a whole. Legal regimes need to respond adequately to serious corporate wrongdoing.[8] The study explores liability for defective corporate cultures through the lens of legal theory. It focuses on two specific types of liability for misconduct arising from flawed corporate cultures: (i) criminal liability of the corporation as a legal person ('entity criminal liability'); and (ii) personal liability of directors and officers for breach of duty to their company. It examines these forms of liability from a comparative perspective, focusing on the legal regimes in the United States, the United Kingdom and Australia. As this study shows, corporate theory and the ambiguous private/public nature of the corporation are highly relevant to this inquiry.

1145; Adolf A. Berle, Jr., 'For Whom Corporate Managers Are Trustees: A Note' (1932) 45 *Harv. L. Rev.* 1365.

4 See Phillip I. Blumberg, 'The Politicalization of the Corporation' (1971) 51 B.U. L. Rev. 425, 425-26.

5 Robert L. Heilbroner, *The Worldly Philosophers* 71 (6th ed. Simon & Schuster, NY, 1986).

6 Christopher D. Stone, 'The Place of Enterprise Liability in the Control of Corporate Conduct' (1980) 90 *Yale L.J.* 1.

7 BlackRock, Larry Fink's Annual Letter to CEOs, *A Sense of Purpose*, Jan. 12, 2018; Peter Horst, 'BlackRock CEO Tells Companies to Contribute to Society. Here's Where to Start', *Forbes*, Jan. 16, 2018.

8 See Sarah Sun Beale and Adam G. Safwat, 'What Developments in Western Europe Tell Us About American Critiques of Corporate Criminal Liability' (2004) 8 *Buff. Crim. L. Rev.* 89, 96; United States Department of Justice, *Deputy Attorney General Sally Quillian Yates Delivers Remarks at New York University School of Law Announcing New Policy on Individual Liability in Matters of Corporate Wrongdoing*, Sept. 10, 2015.

2. The Rise of 'Corporate Culture' as a Regulatory Concept and Some Examples of Flawed Corporate Culture

Commentators have described the expression, 'corporate culture', as 'inherently slippery'.[9] This is partly because the concept, although frequently used, is rarely defined.[10] Even when it is defined, meanings vary significantly.[11] One useful definition is that adopted by the Australian Securities and Investments Commission ('ASIC'), which has described corporate culture as 'a shared set of values or assumptions which reflects the underlying mindset of an entity'.[12] Culture is also linked to the notion of collective corporate conscience;[13] and is often described as representing an organisation's DNA.[14]

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9 Dan Awry, William Blair and David Kershaw, 'Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation' (2013) 38 *Del. J. Corp. L.* 191, 205. See also, Dan Awrey and David Kershaw, 'Toward a More Ethical Culture in Finance' in Morris and Vines (eds), *Capital Failure: Rebuilding Trust in Financial Services*, 278; Justin W. Schulz, 'Tapping the Best That is Within: Why Corporate Culture Matters' (2001) 42 *Management Quarterly* 29, 32. See also John M. Conley and William M. O'Barr, 'The Culture of Capital: An Anthropological Investigation of Institutional Investment' (1992) 70 *N.C. L. Rev.* 823.

10 See, for example, Susan S. Silbey, 'Taming Prometheus: Talk About Safety and Culture' (2009) 35 *Annual Review of Sociology* 341, 343-44, 350*ff* (discussing varying conceptions of 'culture' in contemporary debate concerning 'safety culture').

11 *Id*, 350 (describing culture as 'an actively contested concept').

12 John Price, ASIC Commissioner, 'Culture, Conduct and the Bottom Line: A Key Aspect of Good Governance is Getting the Culture Right', *The Company Director*, September 2015. This definition is not dissimilar to the definition of corporate culture adopted by Awry, Blair and Kershaw – namely, 'the body of non-legal norms, conventions or expectations shared by actors when operating in social or institutional settings'. Dan Awry, William Blair and David Kershaw, 'Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation' (2013) 38 *Del. J. Corp. L.* 191, 206. See also Australian Prudential and Regulation Authority ('APRA'), Information Paper, *Risk Culture* (October, 2016), 7 (adopting a definition of organizational culture as '…a system of shared values (that define what is important) and norms that define appropriate attitudes and behaviours for organisational members (how to feel and behave)') (citing Charles A. O'Reilly and Jennifer A. Chatman, 'Culture as Social Control: Corporations, Cults and Commitment' (1996) 18 *Research in Organizational Behavior* 157, 160); The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (Commonwealth of Australia, 2019), 334 (describing culture as 'shared values and norms that shape behaviors and mindsets'); ASIC, *ASIC's Corporate Plan 2016-17 to 2019-20* (available at https://download.asic.gov.au/media/3997927/corporate-plan-2016-published-31-august-2016.pdf), 3 (describing culture simply as 'mindset of firms').

13 See Carrie Bradshaw, Corporations, Responsibility and the Environment. Doctoral Thesis, (2013) University College London), 165*ff*. See, also Lynn Stout, 'Cultivating Conscience: How Laws Make Good People (Princeton University Press, 2010), pp 11, 13-14.

14 See, for example, Simon Longstaff AO, 'Corporate Culture and the Duties of Directors', The Ethics Centre, Sydney, Australia (2016), 8; David Roth, 'Creating a Great Corporate Culture – Your Company's

In spite of its definitional elusiveness, corporate culture has now become part of the regulatory dialect. Numerous international regulators, including ASIC,[15] the Basel Committee on Banking Supervision ('Basel Committee'),[16] the UK's Financial Reporting Council ('FRC')[17] and the Central Bank of Ireland,[18] have promoted the need for a positive corporate culture for a variety of different reasons – for example, compliance;[19] professionalism, integrity and accountability;[20] and 'long-term business and economic success'.[21] Culture is also viewed as a vital component of effective risk management.[22] The New York Federal Reserve, for example, has recently introduced the concept of 'cultural capital' as a way of mitigating misconduct risk in financial institutions.[23]

Culture has also become an increasingly important feature of corporate governance codes, such as the 2018 UK Corporate Governance Code ('2018 UK CG Code')[24] and the 2019 Australian Securities and Exchange Corporate Governance Principles and Recommendations ('2019 ASX

Foundational DNA', *Forbes*, May 29, 2012; Mark Bonchek, 'How to Discover Your Company's DNA', *Harv. Bus. Rev.*, Dec. 12, 2016.

15 For example, Michael Roddan, 'Culture at Top of Watch List: ASIC Boss', *The Australian*, 17 February 2018, 29.

16 See Basel Committee on Banking Supervision Guidelines, *Corporate Governance Principles for Banks*, Principle 1, [29]-[32], 'Corporate Culture and Values' (2015).

17 See FRC, *Corporate Culture and the Role of Boards: Report of Observations* (2016).

18 See Central Bank of Ireland, *Behaviour and Culture of the Irish Retail Banks* (2018).

19 See, for example, United States Sentencing Guidelines Manual, §8B2.1 (a)(2) (which requires an organization to promote a 'culture that encourages ethical conduct and a commitment to compliance with the law'). See also OECD, *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*, 47 (stating that '[t]he adoption of appropriate corporate governance practices is…an essential element in fostering a culture of ethics within enterprises').

20 Central Bank of Ireland, *Behaviour and Culture of the Irish Retail Banks* (2018), 12.

21 See, for example, FRC, *Corporate Culture and the Role of Boards: Report of Observations*, 2 (2016).

22 See, for example, Basel Committee on Banking Supervision Guidelines, *Corporate Governance Principles for Banks*, Principle 1, [29] (July 2015); Australian Prudential Regulation Authority, Information Paper, *Risk Culture* (October 2016), 6-9; Australian Prudential Regulation Authority, *Prudential Standard CPS 220: Risk Management* (July 2017), 3, 8.

23 See Kevin J. Stiroh, Executive Vice President, Federal Reserve Bank of New York, 'Reform of Culture in Finance from Multiple Perspectives', *Remarks at the GARP Risk Convention*, New York City, Feb. 26, 2019.

24 The 2018 UK Corporate Governance Code builds upon previous recommendations made in FRC, *Corporate Culture and the Role of Boards: Report of Observations* (2016).

CG Principles & Recommendations').[25] The 2018 UK CG Code, for example, states that directors must lead by example to establish a culture of integrity,[26] that is aligned with the organization's 'purpose, values and strategy'.[27] In Australia, the 2019 ASX CG Principles & Recommendations include a significantly reworked provision stating that a listed entity should 'articulate and disclose its values'[28] and 'instil a culture of acting lawfully, ethically and responsibly'.[29]

A number of codes and reform proposals focus on the social role and responsibilities of public corporations. The 2018 UK CG Code notes that the role of a successful company is not only to create value for shareholders, but also to contribute to 'wider society'.[30] Culture and 'societal purpose' are also central aspects of The British Academy's current high profile research project on 'The Future of the Corporation'.[31] Similarly, proposed amendments to the German Corporate Governance Code stress the need for awareness of the 'enterprise's role in the community and its responsibility vis-à-vis society'.[32]

Australia's 2019 ASX CG Principles & Recommendations also reflect this trend. In 2018, the ASX Corporate Governance Council released a Consultation Draft ('ASX Consultation Draft')[33] of proposed changes to the code, which referred to a listed entity's 'social licence to operate'.[34] This phrase, however, created a furore in sections of the Australian business

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25 ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th edition (February 2019).

26 See FRC, *The UK Corporate Governance Code*, 1, 4, Principle B (July 2018).

27 *Id*, 4, Principle B.

28 ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th edition (February 2019), Recommendation 3.1.

29 *Id*, Principle 3.

30 FRC, *The UK Corporate Governance Code*, 4, Principle A (July 2018).

31 See The British Academy, 'Future of the Corporation: Research Summaries', 26-7, 32-3, 48-9 (2018).

32 See Government Commission on the German Corporate Governance Code, *Draft of an Amended German Corporate Governance Code*, Oct. 25, 2018, 2.

33 ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th edition, Consultation Draft (2018).

34 *Ibid*. According to the See also Bryan Horrigan, 'Does Corporate Performance Now Include a Social Licence to Operate?', *Australian Institute of Company Directors*, December 2018.

community,[35] and was, accordingly, excluded from the final version of the 2019 ASX CG Principles & Recommendations.[36] Yet, although the phrase was jettisoned, it was replaced by 'essentially synonymous'[37] terms, such as 'reputation' and 'standing in the community'.[38] In launching the 2019 ASX CG Principles & Recommendations, Elizabeth Johnstone, Chair of the ASX Corporate Governance Council, stated that the Council considered it 'imperative that listed entities align their culture and values with community expectations to help arrest the loss of trust in business'.[39]

The visions of culture under both the 2018 UK CG Code and the 2019 ASX CG Principles & Recommendations involve heightened attention to stakeholder interests. In the United Kingdom, directors have a statutory duty under s 172(1) of the UK *Companies Act* 2006 ('UK *Companies Act*') to 'promote the success of the company for the benefit of its members as a whole'.[40] The section states that, in so doing, directors must consider the interests of a non-exhaustive list of stakeholders and the impact of corporate actions on the community and the environment.[41] This provision adopts an 'enlightened shareholder value' approach to corporate governance.[42] The 2018 UK CG Code goes further in this regard, even though its provisions

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35 Criticism levied at use of the expression, 'social licence to operate' included arguments that it was vague, uncertain, subjective, a product of political correctness, inconsistent with directors' fiduciary duties, and potentially unfair to companies in certain industries, such as gaming, alcohol, tobacco and mining. See, for example, Patrick Durkin, 'Board Outrage Over Push to Have a Social Licence', *Australian Financial Review*, Aug. 1, 2018; Australian Institute of Company Directors, *Submission to the Review of the ASX Corporate Governance Principles and Recommendations*, July 27, 2018; Janet Albrechtsen, 'There's a Corporate Rebellion Brewing Over Fanatical Social Justice Movements', *The* Australian, Aug. 3, 2018; Anne Davies, 'Corporate Australia is Locked in a Culture War, But It's Not About Left and Right', *The Guardian*, Aug. 10, 2018. *Cf*, however, ASX Corporate Governance Council, Launch of the 4th Edition of the Corporate Governance Principles & Recommendations, *Address by the Chair of the ASX Corporate Governance Council, Elizabeth Johnstone*, Feb. 27, 2019.

36 *Cf* ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th edition, Consultation Draft (2018), Principle 3 and ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th edition (February 2019), Principle 3. See Joanna Mather, 'ASX Dumps "Social Licence to Operate"', *Australian Financial Review*, Feb. 28, 2019, 4.

37 ASX Corporate Governance Council, Launch of the 4th Edition of the Corporate Governance Principles & Recommendations, *Address by the Chair of the ASX Corporate Governance Council, Elizabeth Johnstone*, Feb. 27, 2019, 4.

38 *Ibid*.

39 *Id*, 5.

40 Companies Act 2006, c. 46, s 172(1) (UK).

41 *Id*. See generally Paul L. Davies and Sarah Worthington, Gower & Davies Principles of Modern Company Law (10th ed., Sweet & Maxwell, 2016), [16-37] – [16-39].

42 See id, [16-38]; Andrew Keay, 'The Duty to Promote the Success of the Company: Is it Fit for Purpose in a Post-Financial Crisis World?' in Joan Loughrey (ed), *Directors' Duties and Shareholder Litigation*

are non-binding.[43] First, it bolsters s 172(1) of the UK *Companies Act*, by stating that the board should describe in the company's annual report how the interests of stakeholders have been considered in board decision-making.[44] Secondly, whereas s 172(1) involves protection of stakeholder interests,[45] the 2018 UK CG Code promotes actual participation in corporate governance by a particular stakeholder group, namely, employees.[46]

Stakeholder interests also play an important role in the 2019 ASX CG Principles & Recommendations,[47] which envisage 'meaningful dialogue' between the company and both shareholders and other stakeholders.[48] The code also stresses that 'the broader community' has

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in the Wake of the Financial Crisis (Edward Elgar, 2013), 50, 60; Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach'' (2007) 29 *Sydney L. Rev.* 577.

43 UK companies are required under the Listing Rules to make a statement as to how they have applied the five core Principles in the UK Corporate Governance Code. These broad principles are supported by more detailed Provisions, which operate on a 'comply or explain' basis. The ASX Corporate Governance Principles operate on an analogous 'if not, why not?' basis. This form of regulation requires listed companies to explain their departure from the relevant principles. See, for example, FRC, *The UK Corporate Governance Code* (2018), 1-3; ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (3rd ed, 2014), 3.

44 FRC, *The UK Corporate Governance Code* (2018), 1, 5. The Code also states that the board should 'understand the views' of the company's non-shareholder stakeholders. *Ibid.*

45 It is also noteworthy that this protection is limited, in the sense that the directors are only required to consider the interests of stakeholders to the extent that such consideration is likely to promote the success of the company for the benefit of its members as a whole. See Paul L. Davies and Sarah Worthington, Gower & Davies Principles of Modern Company Law (10th ed., Sweet & Maxwell, 2016), [16-3].

46 In particular, the 2018 UK Corporate Governance Code highlights the need for structural features to ensure workforce participation in corporate governance by a company's employees. See FRC, *The UK Corporate Governance Code* (2018), 1, 5.

47 See, for example, the ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th edition (February 2019), Commentary to Recommendation 3.1, which refers to the need for a listed entity to 'preserve and protect its reputation and standing in the community and with key stakeholders, such as customers, employees, suppliers, creditors, law makers and regulators'. See also *id*, 24.

48 *Id*, 2. The final version of the code did not go as far as the earlier ASX Consultation Draft, which explicitly stated that directors and managers were expected to consider the views and interests, and engage with, a wide variety of stakeholders, and that listed companies were, moreover, expected to be 'good corporate citizens'. See ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th edition, Consultation Draft (2018), 25. The proposed revision concerning stakeholders was criticized on the basis that the list of stakeholder interests was inconsistent with Australian law regarding directors' duties, which contains no provision analogous to s 172(1) of the UK *Companies Act* 2006. See Will Heath and Lauren Beasley, 'Proposed Fourth Edition of ASX Corporate Governance Principles', King & Wood Mallesons, June 6, 2018. Note, however, that the Australian Institute of Company Directors has recently signalled its support for 'stakeholder voice' as a non-mandatory input for boards. See Australian Institute of Company Directors, *Forward Governance Agenda: Lifting Standards and Practice* (April 2019), 17.

an expectation that listed companies will act 'lawfully, ethically and responsibly'.[49]

3. Corporate Scandals and Flawed Corporate Culture

Recent corporate history provides numerous examples of flawed corporate cultures,[50] which fell well short of the aspirational goals discussed above, and which resulted in significant harm to stakeholders and society as a whole. These scandals include the Wells Fargo fraudulent accounts scandal,[51] the Volkswagen ('VW') emissions scandal,[52] the BP Deepwater Horizon Oil Spill ('BP Oil Spill')[53] and sexual harassment claims at several companies, including Fox News[54] and, more recently, the US media company, CBS.[55]

There have also been allegations in Australia of widespread misconduct at some of the country's leading financial institutions.[56] Two important reports suggest that the alleged misconduct was directly tied to defective corporate culture.[57] One report, by the Australian Prudential Regulation Authority ('APRA'), in 2018, assessed the governance, culture and

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49 ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th edition (February 2019), Commentary to Recommendation 3.1.

50 Although this study is restricted to recent examples of flawed corporate cultures, there is, in fact, a limited number of corporate misconduct patterns, which have recurred over time and across jurisdictions. See generally FICC Markets Standards Board, *Behavioural Cluster Analysis: Misconduct Patterns in Financial Markets* (July 2018).

51 See Jackie Wattles, Ben Geier, Matt Egan and Danielle Wiener-Bronner, 'Wells Fargo's 20 Month Nightmare', *CNN Money*, Apr. 24, 2014 (setting out a time line of the Wells Fargo scandal).

52 See John Armour, 'Volkswagen's Emissions Scandal: Lessons for Corporate Governance? (Part 1)', *Oxford Business Law Blog*, May 17, 2016; John Armour, 'Volkswagen's Emissions Scandal: Lessons for Corporate Governance? (Part 2)', *Oxford Business Law Blog*, May 18, 2016.

53 See Katie Allen, 'Everyone Loses Out When Corporate Governance Falls by the Wayside', *The Guardian*, Sept. 11, 2016; Raffi Khatchadourian, 'The Gulf War', *New Yorker*, Mar. 14, 2011.

54 See Emily Steel, '21st Century Fox Pressed by Investment Group to Overhaul Board', *N.Y. Times*, Oct. 12, 2017.

55 See Ron Barusch, 'CBS and the Need to Hold Directors Accountable', *Wall St. J.*, Sept. 17, 2018.

56 These allegations, and the inquiries they engendered, were influential in prompting the 2019 amendments to the ASX Corporate Governance Principles and Recommendations, discussed above. See ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 4th edition (February 2019); Launch of the 4th Edition of the Corporate Governance Principles & Recommendations, *Address by the Chair of the ASX Corporate Governance Council, Elizabeth Johnstone*, Feb. 27, 2019, 2-3.

57 Indeed, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (Commonwealth of Australia, 2019) contains over 300 references to 'culture'.

accountability structures of the Commonwealth Bank of Australia ('APRA Prudential Report'),[58] after several incidents at the bank, including breaches of anti-money laundering and counter-terrorism laws.[59] The other report, by the Australian Financial Services Royal Commission,[60] examined alleged misconduct in the financial services industry.[61] Interim findings were published in September 2018,[62] and the Commission released its Final Report in February 2019.[63]

There are numerous similarities, but also some interesting differences, between these scandals. It is noteworthy, for example, that several of the corporations initially denied the existence of any systemic risk management problems involving flawed corporate cultures. One senior VW executive directed blame to 'a couple of software engineers',[64] stressing that the board had never approved the relevant conduct.[65] At Wells Fargo, management originally attributed the wrongdoing to a 'few bad apples',[66] although the bank, in fact, sacked more than 5,300

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58 See APRA, *Prudential Inquiry into the Commonwealth Bank of Australia* (Apr. 30, 2018).

59 See *id*, 6, 15-16.

60 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry ('Australian Financial Services Royal Commission'), *Terms of Reference* (Dec. 14, 2017).

61 For background on the establishment of the Australian Financial Services Royal Commission, see H. Kevin McCann AM, 'Corporate Governance: Lessons from the Interim Report of the Financial Services Royal Commission', Conference Presentation, The Supreme Court of New South Wales Annual Corporate and Commercial Law Conference 2018, *Directors' Duties, Corporate Culture and Corporate Governance* (Nov. 20, 2018), 3-7.

62 See Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, Vol. 1 (Commonwealth of Australia, 2018); Gareth Hutchens, 'Why Kenneth Hayne's Banking Royal Commission is a Game-Changer', *The Guardian*, Sept. 28, 2018; Gareth Hutchens, 'Banking Royal Commission: All You Need to Know – So Far', *The Guardian*, Apr. 19, 2018 (discussing key aspects of the inquiry); H. Kevin McCann AM, 'Corporate Governance: Lessons from the Interim Report of the Financial Services Royal Commission', Conference Presentation, The Supreme Court of New South Wales Annual Corporate and Commercial Law Conference 2018, *Directors' Duties, Corporate Culture and Corporate Governance* (Nov. 20, 2018).

63 See Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, Vol. 1 (Commonwealth of Australia, 2019). The Australian Financial Services Royal Commission Final Report contained 76 Recommendations. See *id*, 20-42.

64 See, for example, comments of Michael Horn, Head of VW's US operations, in response to questioning by US House of Representatives Oversight and Investigations panel, October 2015; 'Top U.S. VW Exec Blames "A Couple of Software Engineers" for Scandal', *Reuters Associated Press*, Oct. 8, 2015.

65 *Ibid*. *Cf* Andreas Cremer, 'Volkswagen's CEO Says Changing the Automaker Corporate Culture Is 'Not an Easy Undertaking', *Reuters*, May 23, 2017.

66 See Lucinda Shen, 'Former Wells Fargo Employees to CEO John Stumpf: It's Not Our Fault', Fortune, Sept. 19, 2016.

employees between 2011 and 2016 for creating unauthorized accounts.[67] This seems to be a classic situation where the problem is less about rotten apples than about rotting barrels.[68]

Perverse financial incentives were a consistent theme in these scandals. Some scandals, such as the one at Wells Fargo, involved unrealistic sales targets and bonus arrangements, which induced employees to engage in fraud.[69] However, others further up the corporate hierarchy also benefited from the misconduct due to the prevalence of performance-based pay. According to the Australian Financial Services Royal Commission, remuneration practices and policies were the main drivers of culture at the relevant financial institutions.[70] In the Australian Financial Services Royal Commission interim findings, Commissioner Hayne made the 'simple, but telling observation'[71] that all the impugned conduct delivered financial benefits for the individuals and entities concerned. The Final Report devoted an entire chapter to 'Culture, Governance and Remuneration'.[72]

The scandals also highlighted the importance of non-financial risks. Indeed, one of the key findings of the APRA Prudential Report was that the Commonwealth Bank of Australia's impressive and ongoing financial success had 'dulled the senses' of the institution and senior management to the dangers posed by non-financial risks.[73] The risk of reputational loss due to

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67 See Renae Merle, 'Wells Fargo Fired 5,300 Workers for Improper Sales Push. The Executive in Charge is Retiring with $125 Million', *Washington Post*, Sept. 13, 2016.

68 See Susan S. Silbey, 'Rotten Apples or a Rotting Barrel: How Not to Understand the Current Financial Crisis', (2009) XXI No. 5 *MIT Faculty Newsletter*. Indeed, an alternate blame-shifting device to the 'few bad apples' argument is to seek to spread guilt across the entire industry, a tactic which was also employed by VW. See Patrick McGee, 'Car Emissions Scandal: Loopholes in the Lab Tests', *Financial Times*, Aug. 6, 2018 (arguing that by trying to spread blame across the entire industry, VW sought to transform the 'Volkswagen Scandal' into the 'Car Scandal').

69 Renae Merle, 'Wells Fargo Fired 5,300 Workers for Improper Sales Push. The Executive in Charge is Retiring with $125 Million', *Washington Post*, Sept. 13, 2016. See generally Jennifer G. Hill, 'What Do Colonialism and Pizza Delivery Policies Have to Do with the Wells Fargo Scandal?', *Oxford Business Law Blog*, Nov. 2, 2016.

70 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, Vol. 1 (Commonwealth of Australia, 2018), 301.

71 *Ibid*.

72 See Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, Vol. 1 (Commonwealth of Australia, 2019), Chapter 3.5.

73 See APRA, *Prudential Inquiry into the Commonwealth Bank of Australia* (Apr. 30, 2018), 3.

non-financial risks and a culture of 'nonchalance toward compliance'[74] was also a strong theme in the Australian Financial Services Royal Commission.[75]

The scandals, and their regulatory consequences,[76] demonstrated that flawed corporate cultures can result in serious harm to corporate stakeholders, including employees, creditors, customers and shareholders. In some cases, the damage was to society at large. The VW emissions scandal and the BP Oil Spill, for example, had disastrous environmental consequences.[77]

Some of the scandals, such as Wells Fargo and those identified by the Australian Financial Services Royal Commission, represented a typical scenario involving misconduct within large corporations. This is where wrongful acts are committed by relatively low-level employees in response to encouragement or unrealistic firm-wide goal directives from senior management.[78] For example, at Wells Fargo, where the average wage for bank tellers was US$ 12.40 per hour, employees risked losing their jobs if they failed to meet targets, but received bonuses if they

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74 H. Kevin McCann AM, 'Corporate Governance: Lessons from the Interim Report of the Financial Services Royal Commission', Conference Presentation, The Supreme Court of New South Wales Annual Corporate and Commercial Law Conference 2018, *Directors' Duties, Corporate Culture and Corporate Governance* (Nov. 20, 2018), 17.

75 One commentator criticized the Commission's Final Report on the basis that it was driven by 'ethical norms'. See Michael Pelly, 'Banking Royal Commission: Kenneth Hayne May Get Lesson in the Courts, Says Former Judge', *Australian Financial Review*, Mar. 7, 2019. However, the Commission was, by its Terms of Reference, authorized to enquire, not only into actual misconduct, but also conduct that fell 'below community standards and expectations', so its consideration of ethical norms was not surprising. See Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Terms of Reference* (Dec. 14, 2017).

76 For example, after negotiating a US$ 4.3bn settlement with US regulators in 2017, VW was fined a further €1bn by German authorities in 2018. See Reuters, 'Volkswagen Confirms $4.3bn Payment Over Diesel Emissions', *The Guardian*, Jan. 10, 2017; Reuters, 'VW Fined €1bn by German Prosecutors', *The Guardian*, Jun. 14, 2018.

77 In the VW scandal, the relevant cars emitted up to 40 times more nitrous oxide on the road than in test conditions. See John Armour, 'Volkswagen's Emissions Scandal: Lessons for Corporate Governance? (Part 1)', *Oxford Business Law Blog*, May 17, 2016; Jenna R. Krall and Roger D. Peng, 'The Difficulty of Calculating Deaths Caused by the Volkswagen Scandal', *The Guardian*, Dec. 9, 2015. The BP Oil Spill, as well as resulting in the deaths of 11 people, resulted in the discharge of 4.9 million barrels of oil into the Gulf of Mexico. See Mark Kinver, 'BP Oil Spill: The Environmental Impact One Year On', *BBC*, Apr. 20, 2011; Oliver Milman, 'Deepwater Horizon Disaster Altered Building Blocks of Ocean Life', *The Guardian*, June 28, 2018.

78 See Samuel W. Buell, 'The Responsibility Gap in Corporate Crime' (2018) 12 *Crim. L. & Phil.* 471. See generally John C. Coffee, ''No Soul to Damn: No Body to Kick': An Unscandalized Inquiry into the Problem of Corporate Punishment' (1981) 79 *Mich. L. Rev.* 386, 397*ff.* Such techniques can also be used to insulate top management from personal liability. See Reinier H. Kraakman, 'Corporate Liability Strategies and the Costs of Legal Controls' (1984) 93 *Yale L.J.* 857, 860.

met them.[79] In contrast, some other scandals, such as the sexual harassment incidents at Fox News and CBS, involved extremely high-level employees. In these cases, the problem was not perverse incentives; it was inadequate policing of the company's culture. It appears that the misconduct was tolerated when it was committed by senior employees, who were particularly valuable to the organization.[80]

The individual wrongdoers in these scandals were sometimes, but not always, identifiable. For example, in the BP Oil Spill and the Commonwealth Bank of Australia anti-money laundering and counter-terrorism breaches, which involved complex computer systems and technology, it is far more difficult to pinpoint the responsible individuals.

These scandals raise critical corporate governance questions. For example, how should the law (both criminal and civil) deal with widespread intra-firm wrongdoing due to flawed corporate culture? Should the law target those who actually commit the wrongful acts? Or the organizations itself? Or senior executives and directors of the firm?

4. Corporate Theory, Accountability and Liability

Corporate theory, and the concept of legal personhood, is directly relevant to the issue of who should be accountable for wrongful acts arising from flawed corporate cultures, and, in particular, whether the law should target the organization itself or the individuals within it.

There was vibrant theoretical debate about the nature of corporate personality from the late 19th century, but it waned in the 1920s, disappearing for several decades.[81] The debate resurfaced, however, in the late 20th century,[82] with the advent of several modern theories of the corporation,

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79 Lucinda Shen, 'Former Wells Fargo Employees to CEO John Stumpf: It's Not Our Fault', Fortune, Sept. 19, 2016.

80 See, for example, Emily Steel and Michael S. Schmidt, 'Bill O'Reilly Thrives at Fox News, Even as Harassment Settlements Add Up', *N.Y. Times*, Apr. 1, 2017.

81 This long hiatus in the corporate theory debate is often attributed to publication in the mid-1920s of an influential article by US philosopher, John Dewey. See John Dewey, 'The Historic Background of Corporate Legal Personality' (1926) 35 *Yale L.J.* 655, 666-68. See also Katsuhito Iwai, 'Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance' (1999) 47 *Am. J. Comp. L.* 583, 585, 600-605 (for a contemporary version of Dewey's 'indeterminacy thesis').

82 See Katsuhito Iwai, 'Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance' (1999) 47 *Am. J. Comp. L.* 583; William T. Allen, 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 *Cardozo L. Rev.* 261.

including the nexus of contracts model of the firm,[83] communitarianism,[84] and the 'team production' theory espoused by Professors Blair and Stout.[85]

Two broad approaches have underpinned debates about the nature of the firm throughout the history of business law. The first approach, which flourished in the late 19th century and reappeared approximately a century later under the nexus of contracts theory, [86] adopted an aggregational view of the corporation ('aggregate theory'). According to this approach, the corporation was a mere fiction, comprising natural persons.[87] Professor Max Radin, an early proponent of this individualistic thesis, described the corporation as nothing more than a verbal symbol or mathematical expression to describe its human components.[88] Under this theory, corporate personhood is 'a matter of convenience rather than reality'.[89] In fact, it assumes that there is 'no such thing as a company'.[90]

The aggregate theory had clear implications for corporate responsibility and accountability. Early treatment of the corporation as a *persona ficta* meant that corporations were incapable of *mens rea*, and therefore protected from liability for certain kinds of wrongdoing.[91] The theory

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83 See, for example, William W. Bratton, 'The 'Nexus of Contracts' Corporation: A Critical Appraisal' (1989) 74 *Cornell L. Rev.* 407.

84 See, for example, David K. Millon, 'New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law' (1993) 50 *Wash. & Lee L. Rev.* 1373.

85 Margaret M. Blair and Lynn A. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Va. L. Rev*. 247.

86 See, for example, Katsuhito Iwai, 'Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance' (1999) 47 *Am. J. Comp. L.* 583, 585; William W. Bratton, 'The New Economic Theory of the Firm: Critical Perspectives from History' (1989) 41 *Stan. L. Rev.* 1471, 1472-73.

87 Under the nexus of contracts theory, for example, the corporation is viewed merely as a 'complex set of explicit and implicit contracts'. Frank H. Easterbrook and Daniel R. Fischel, 'The Corporate Contract' (1989) 89 *Colum. L. Rev.* 1416, 1418.

88 Max Radin, 'The Endless Problem of Corporate Personality' (1932) 32 *Colum. L. Rev.* 643, 658. This view is not dissimilar from the nexus of contracts interpretation of the corporation as 'matter of convenience, rather than reality'. See, for example, Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, Cambridge, 1991), 12. See also Jonathan R. Macey, 'Agency Theory and the Criminal Liability of Organizations' (1991) 71 *B.U.L. Rev.* 315.

89 Frank H. Easterbrook and Daniel R. Fischel, 'The Corporate Contract' (1989) 89 *Colum. L. Rev.* 1416, 1426.

90 *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, 507 (per Hoffmann L.J.).

91 See Christopher D. Stone, 'The Place of Enterprise Liability in the Control of Corporate Conduct' (1980) 90 *Yale L.J.* 1, 3, 70; Gerhard O. W. Mueller, 'Mens Rea and the Corporation' (1957) 19 *U. Pitt. L. Rev.*

posited that all legal wrongs are committed by 'flesh and blood' persons,[92] and the goal of the law should be to identify those individuals and bring them to justice.[93] The notion that only natural, and not juridical, persons can be subject to criminal liability still operates in parts of continental Europe, such as Germany, which continues to adopt the approach taken in the early English cases that 'a legal entity cannot be blameworthy'.[94]

The second major theory of the corporation views it holistically, as a separate legal person ('entity theory').[95] Legal personhood in this respect is a two-edged sword. It can be used to gain legal rights for corporations;[96] it can also potentially be used to impose duties on them.[97] This approach, which recognizes the corporation as an autonomous actor,[98] offers far more scope for criminal accountability of the corporation as a legal person ('entity criminal liability').[99]

21, 22. This conclusion was also encapsulated in the legal maxim, '*societas delinquere non potest'* (or 'a legal entity cannot be blameworthy'). See Olivia Dixon, 'Corporate Criminal Liability: The Influence of Corporate Culture', in O'Brien and Gilligan (eds.), *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Oxford, Hart Publishing, 2013), 251, n.4.

92 According to Professor Radin, these 'flesh and blood' persons constitute the 'irreducible human unit of society'. See Max Radin, 'The Endless Problem of Corporate Personality' (1932) 32 *Colum. L. Rev.* 643, 665.

93 *Id*, 661.

94 See Edward B. Diskant, 'Comparative Corporate Criminal Liability: Exploring the Uniquely American Doctrine Through Comparative Criminal Procedure' (2008) 118 *Yale L.J.* 126, 129. This is not to say that corporations are completely immune under German law. Rather, regulation and punishment of corporations is effected under an administrative regulatory system, which includes civil liability for corporations, arguably blurring the boundary between criminal and civil penalties. *Id*, 143. European resistance to corporate criminal liability also weakened in the closing decades of the 20th century, when several Western European countries adopted some form of criminal liability for corporations. See generally Sara Sun Beale and Adam G. Safwat, 'What Developments in Western Europe Tell Us About American Critiques of Corporate Criminal Liability' (2004) 8 *Buff. Crim. L. Rev.* 89, 90, 122-23.

95 See, for example, Susan Watson, 'How the Company Became an Entity: A New Understanding of Corporate Law' [2015] *J. Bus. L.* 120.

96 See Gregory A. Mark, 'The Personification of the Business Corporation in American Law' (1987) 54 *U. Chi. L. Rev*. 1441; Gunther Teubner, 'Enterprise Corporatism: New Industrial Policy and the 'Essence' of the Legal Person' (1988) 36 *Am. J. Comp. L.* 130.

97 See, for example, See Phillip I. Blumberg, 'The Corporate Entity in an Era of Multinational Corporations' (1990) 15 *Del. J. Corp. L.* 283, 285; C.V. Clarkson, 'Kicking Corporate Bodies and Damning their Souls' (1996) 59 *Mod. L. Rev.* 557.

98 See generally Paul E. Wilson, 'Barring Corporations from the Moral Community - The Concept and the Cost' (1992) 23 *J. Soc. Phil.* 74.

99 *Cf*, however, the institutional version of the nexus of contracts model of the corporation, where the firm exists 'as a single maximizing unit, not simply as an artifact of transactions among maximizing individuals. William W. Bratton, 'The New Economic Theory of the Firm: Critical Perspectives from

Entity criminal liability bypasses several accountability problems under aggregate theory. First, it can overcome potential difficulties of identifying the individual wrongdoer in large corporations with opaque and diffuse operations. Secondly, entity criminal liability can address issues involving relative blameworthiness of individuals within the firm, in situations where the misconduct is committed by low to mid-level employees, but is generated by unrealistic goal directives from senior management.[100] It has been argued, for example, that low paid Wells Fargo employees were 'squeezed…to the breaking point' by arbitrary cross-selling targets set by more senior managers.[101] Thirdly, entity criminal liability can obviate the associated danger of organizational 'scapegoating'[102] to protect senior managers.[103] It can be used as a means of signalling managerial fault,[104] and can have important reputational effects for the entity itself, which may deter future misconduct.[105] Finally, the threat of entity criminal liability can provide incentives for companies to engage in self-regulation via effective compliance programs.[106]

Some recent developments in the United States and Australia highlight the tension between the aggregate and entity theories of the corporation, and its implications for accountability. In the United States, for example, following the global financial crisis, there was strong criticism of a of

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History' (1989) 41 *Stan L Rev* 1471, 1480.

100 See Samuel W. Buell, 'The Responsibility Gap in Corporate Crime' (2018) 12 *Crim, L. Phil* 471, 473. See generally John C. Coffee Jr., '"No Soul to Damn: No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment' (1981) 79 *Mich. L. Rev.* 386, 397*ff.*

101 See 'Senator Elizabeth Warren Questions Wells Fargo CEO John Stumpf at Banking Committee Hearing', 20 September 2016 (https://www.youtube.com/watch?v=xJhkX74D10M).

102 See, for example, Brent Fisse and John Braithwaite, Corporations, Crime and Accountability (Cambridge University Press, Cambridge, 1993), 219 (discussing the possible *ex ante* appointment of 'vice-presidents responsible for going to jail'). See also Michael Volkov, 'The Danger of Corporate Scandals – When CEOs and Senior Executives Circle the Wagon to Impugn a CCO', *Corruption, Crime and Compliance*, (2017), https://blog.volkovlaw.com/2017/05/danger-corporate-scandals-ceos-senior-executives-circle-wagons-impugn-cco/ (last visited Nov 9, 2018). The 'few bad apples' argument is often used as a scapegoating technique, and was common in the 17th century, when scientific performances before the Royal Society failed. See Susan S. Silbey, 'Taming Prometheus: Talk About Safety and Culture' (2009) 35 *Ann. Rev. Soc.* 341, 363 (citing Simon Shapin and Steven Schaffer, *The Leviathan and the Air-Pump*, Princeton University Press, Princeton, NJ, 1985).

103 See Reinier H. Kraakman, 'Corporate Liability Strategies and the Costs of Legal Controls' (1984) 93 *Yale L.J.* 857, 860.

104 See generally Samuel W. Buell, 'The Blaming Function of Entity Criminal Liability' (2006) 81 *Ind. L.J.* 473.

105 *Id*, 477-78.

106 See generally Deborah A. DeMott, 'Organizational Incentives to Care About the Law' (1997) 60 *Law & Contemp. Probs.* 39.

a prosecutorial trend over several decades towards targeting corporations, rather than senior managers.[107] Describing this trend as 'technically and morally suspect',[108] Judge Jed Rakoff channelled aggregated theorists when he declared that '[c]ompanies do not commit crimes; only their agents do'.[109] In 2015, in response to criticism of this kind, the US Department of Justice ('DoJ') announced a major change in prosecutorial policy, which was designed to restore the focus on accountability for individuals within the firm.[110]

In the recent Australian Financial Services Royal Commission inquiry, Commissioner Hayne criticized the fact that only criminal prosecutions arising from the banking scandals to date had been directed at individuals, and not the banks themselves.[111] Although the banks had agreed to certain enforceable undertakings and payment of fines under infringement notices, he noted that they had made no admissions of wrongdoing.[112] Echoing similar concerns to those prompting the DoJ's 2015 prosecutorial policy change,[113] Commissioner Hayne suggested that the Australian banks effectively controlled the relevant sanctions, which they treated as 'just a

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107 This trend was accompanied by increasing use of deferred prosecution agreements ('DPAs') and non-prosecution agreements ('NPAs'), which were designed to pressure companies into transforming their corporate cultures to prevent future wrongdoing. See Jed S. Rakoff, 'The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?', *The New York Review of Books*, 9 January 2014. See also Cindy R. Alexander and Jennifer Arlen, 'Does Conviction Matter? The Reputational and Collateral Effects of Corporate Crime', 87, in Jennifer Arlen (ed.), *Research Handbook on Corporate Crime and Financial Misdealing* (2018, Edward Elgar Publishing Ltd) (discussing the operation of DPAs).

108 Jed S. Rakoff, 'The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?', *The New York Review of Books*, 9 January 2014.

109 *Ibid*. See also Nathanial Popper, 'Judge Jed Rakoff Taps into Nation's Outrage over Economic Crisis', *L.A. Times*, 10 April 2010.

110 See United States Department of Justice, *Individual Accountability for Corporate Wrongdoing*, 9 September 2015; Matt Apuzzo and Ben Protess, 'Justice Department Sets Sights on Wall Street Executives', *N.Y. Times*, 9 September 2015.

111 See, for example, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, Vol. 1 (Commonwealth of Australia, 2018), 271. These individuals, however, tended to be fairly low level employees, such as financial planners, and the penalties imposed were trivial. See, for example, Clancy Yeates, 'Former CBA Planner Ricky Gillespie Gets $3k Fine, No Conviction', *Sydney Morning Herald*, Dec. 13, 2017.

112 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, Vol. 1 (Commonwealth of Australia, 2018), 271.

113 See, for example, comments by Judge Jed Rakoff in *U.S. Securities and Exchange Commission v Citigroup Global Markets Inc.*, 8*ff* (11 Civ. 7387 (S.D.N.Y.) (2011). See also Edward Wyatt, 'Judge Blocks Citigroup Settlement with SEC', *N.Y. Times*, Nov. 28, 2011. The SEC amended its policy in this regard in 2012. See Edward Wyatt, 'SEC Changes Policy on Firms' Admission of Guilt', *N.Y. Times*, Jan. 6, 2012.

cost of doing business'.[114] In the Financial Services Royal Commission's Final Report, Commissioner Hayne stated that ASIC itself now accepted that the regulator's first question, upon becoming aware of any entity's breach of the law, should be 'Why not litigate?'[115]

5. Targeting the Corporation – Entity Criminal Liability for Wrongs Arising from a Flawed Corporate Culture

In spite of early English case law's treatment of the corporation as a *persona ficta* incapable of criminal wrongdoing,[116] most jurisdictions today, including the United States, the United Kingdom and Australia, accept criminal liability for corporations ('entity criminal liability').[117] Nonetheless, conceptual problems exist as to the scope and contours of that liability. A coherent theory of corporate criminal liability has proven elusive,[118] and this is particularly so with respect to misconduct involving a flawed corporate culture.

Historically, the United States, United Kingdom and Australia used very different tests to determine whether a corporation was criminally liable.[119] US law, for example, adopted a broad

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114 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, Vol. 1 (Commonwealth of Australia, 2018), 288. In her 2015 announcement in the United States, then-Deputy Attorney General, Sally Q. Yates explicitly stated that the DoJ's new prosecutorial policy would preclude the danger of entity liability being viewed as a mere cost of doing business. United States Department of Justice, *Individual Accountability for Corporate* Wrongoing, 9 September 2015, https://www.justice.gov/archives/dag/file/769036/download.

115 See Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, Vol. 1 (Commonwealth of Australia, 2019), 427.

116 See Olivia Dixon, 'Corporate Criminal Liability: The Influence of Corporate Culture', in Justin O'Brien and George Gilligan (eds.), *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Oxford, Hart Publishing, 2013), 251; Kathleen F. Brickey, 'Corporate Criminal Accountability: A Brief History and an Observation' (1982) 60 *Wash. U.L.Q.* 393, 396 (citing Chief Justice Holt in an anonymous case as stating 'A corporation is not indictable but the particular members of it are' (Anonymous, 88 Eng. Rep. 1518 (KB 1701)).

117 See Samuel W. Buell, 'The Blaming Function of Entity Criminal Liability' (2006) 81 *Ind. L.J.* 473, 476.

118 See Kathleen F. Brickey, 'Corporate Criminal Accountability: A Brief History and an Observation' (1982) 60 *Wash. U.L.Q.* 393, 401; Samuel W. Buell, 'The Responsibility Gap in Corporate Crime' (2018) 12 *Crim. L. & Phil* 471; Jeffrey S. Parker, 'Doctrine for Destruction: The Case of Corporate Criminal Liability' (1996) 17 *Managerial & Decision Econ.* 381, 382.

119 See Kathleen F. Brickey, 'Corporate Criminal Accountability: A Brief History and an Observation' (1982) 60 *Wash. U.L.Q.* 393, 397*ff* (for an historical overview of the development of corporate criminal liability under UK and US law).

vicarious liability test,[120] based on the doctrine of *respondeat superior*.[121] This approach, which was rooted in notions of strict corporate liability detached from an entity's 'moral blameworthiness',[122] created significant criminal liability risks for US corporations.[123] They could potentially be criminally liable for the wrongful acts of any employee.[124] Corporate culture ultimately plays an important role at the sentencing stage. Under the United States *Federal Sentencing Guidelines*, culture can operate as a mitigating factor, if a corporation can show that it had an effective compliance and ethics program and a culture that encouraged compliance with the law.[125]

The traditional Anglo-Australian approach to determining entity criminal liability operated quite differently. It was far narrower and created far less risk of criminal liability for corporations than the US model.[126] The Anglo-Australian approach was based upon the famous UK House of Lords decision, *Tesco Supermarkets Ltd v Nattrass*.[127] The so-called 'Tesco principle' principle, itself a narrow form of vicarious liability, held that the requisite mental and conduct elements were only attributable to the entity if they could be traced directly to the upper echelons of the corporate

120 See Pamela H. Bucy, 'Corporate Ethos: A Standard for Imposing Corporate Criminal Liability' (1991) 75 *Minn. L. Rev.* 1095, 1102*ff*; Alan L. Adlestein, 'A Corporation's Right to a Jury Trial Under the Sixth Amendment' (1994) 27 *U. Cal. Davis L. Rev.* 375, 383*ff.*

121 See Kathleen F. Brickey, 'Corporate Criminal Accountability: A Brief History and an Observation' (1982) 60 *Wash. U.L.Q.* 393, 413-418; Edward B. Diskant, 'Comparative Corporate Criminal Liability: Exploring the Uniquely American Doctrine through Comparative Criminal Procedure' (2008) 118 *Yale L.J.* 126, 135; 'Developments in the Law – Corporate Crime: Regulating Corporate Behavior through Criminal Sanctions' (1979) 93 *Harv. L. Rev.* 1227, 1247-1251.

122 Kathleen F. Brickey, 'Corporate Criminal Accountability: A Brief History and an Observation' (1982) 60 *Wash. U.L.Q.* 393, 422-423.

123 See *id*, 393-4 (noting how the escalation of prosecutions against corporations in the 1970s highlighted the 'true breadth' of corporate exposure to criminal liability); Edward B. Diskant, 'Comparative Corporate Criminal Liability: Exploring the Uniquely American Doctrine through Comparative Criminal Procedure' (2008) 118 *Yale L.J.* 126, 140.

124 See *id*; Pamela H. Bucy, 'Corporate Ethos: A Standard for Imposing Corporate CriminalLiability' (1991) 75 *Minn. L. Rev.* 1095, 1102*ff*; Alan L. Adlestein, 'A Corporation's Right to a Jury Trial under the Sixth Amendment' (1994) 27 *U. Cal. Davis L. Rev.* 375, 383*ff.*

125 See *United States Federal Sentencing Guidelines Manual*, §8B2.1. See generally Olivia Dixon, 'Corporate Criminal Liability: The Influence of Corporate Culture', in Justin O'Brien and George Gilligan (eds.), *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Oxford, Hart Publishing, 2013), 251, 257-8; Donald C. Langevoort, 'Cultures of Compliance' (2017) 54 *Am. Crim. L. Rev.* 933, 934; Thomas C. Baxter Jr., 'Keynote Address: The Changing Face of Corporate Compliance and Corporate Governance' (2016) 21 *Fordham J. Corp. & Fin. L.* 61, 61-2.

126 Edward B. Diskant, 'Comparative Corporate Criminal Liability: Exploring the Uniquely American Doctrine through Comparative Criminal Procedure' (2008) 118 *Yale L.J.* 126, 130.

127 [1972] AC 153.

hierarchy - to the board of directors, senior management or someone to whom management powers had been delegated.[128]

As a result of this restriction, the *Tesco* principle effectively provided liability protection to any large public corporation, which had diffuse operations and delegated day-to-day functions.[129] The unduly narrow scope of the *Tesco* principle led the UK courts to seek more appropriate tests for imposing entity criminal liability. In the 1995 UK decision, *Meridian Global Funds Management Asia Ltd v Securities Commission* ('Meridian case'),[130] Lord Hoffman criticized the rigidity of the *Tesco* principle and substituted a more flexible, policy-based attribution test based on construction of the relevant statute or rule of law, rather than the company's own internal hierachy.[131]

In the same year as the Meridian case, Australia embarked on an even more radical departure from the Tesco principle, when it passed the *Criminal Code Act* (Cth) 1995 ('Criminal Code').[132] This Act introduced 'corporate culture' as a central feature of entity criminal liability in Australia.[133]

A major goal of the Criminal Code reforms was to cast a substantially broader and 'much more realistic net of responsibility over corporations'.[134] Part 2.5 of the code jettisoned the narrow *Tesco* principle, substituting a regime based upon organizational blameworthiness, which is assessed by reference to factors, such as corporate policies, operating systems and, notably, culture.[135]

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128 See generally Jennifer Hill, 'Corporate Criminal Liability in Australia: An Evolving Corporate Governance Technique?' [2003] *J. Bus. L.* 1, 10-12.

129 *Id*, 12.

130 [1995] 2 AC 500.

131 *Id*, 511. See generally Ross Grantham, 'Attributing Responsibility to Corporate Entities: A Doctrinal Approach' (2001) 19 *Co. & Sec. L.J.* 168, 174-75; Ross Grantham, 'Corporate Knowledge: Identification or Attribution?' (1996) 59 *Mod. L. Rev.* 732, 734; Paul L. Davies and Sarah Worthington, *Principles of Modern Company Law* (10^{th} ed., 2016, Sweet & Maxwell), [7-40] – [7-41]).

132 See generally Jennifer Hill, 'Corporate Criminal Liability in Australia: An Evolving Corporate Governance Technique?' [2003] *J. Bus. L.* 1, 16*ff.*

133 The concept of culture had already regularly appeared in case law involving corporate penalties and compliance programs, particularly in the trade practices area. See Christine Parker and Vibeke Lehmann Nielsen, 'Do Businesses Take Compliance Systems Seriously? An Empirical Study of the Implementation of Trade Practices Compliance Systems in Australia' (2006) 30 *Melb. U.L. Rev* 441.

134 See Standing Committee of Attorneys-General, Criminal Law Officers Committee, *Model Criminal Code, Chapter 2, Final Report: General Principles of Criminal Responsibility* (AGPS, Canberra, 1993), Part 5.

135 See generally Olivia Dixon, 'Corporate Criminal Liability: The Influence of Corporate Culture', in Justin O'Brien and George Gilligan (eds.), *Integrity, Risk and Accountability in Capital Markets: Regulating*

Part 2.5 of the Criminal Code provides that corporate fault for an offence can be established if the corporation 'expressly, tacitly or impliedly authorised or permitted the commission of the offence'.[136] It then lists several non-exclusive methods by which such organizational consent can be established.[137] Some of these methods rely directly on corporate culture.[138] The relevant provisions state that a corporation is taken to have 'authorised or permitted' the offence, if it is proved that a corporate culture existed, which either encouraged or tolerated non-compliance[139] or failed to promote compliance.[140] These provisions effectively permit the court to examine the 'mindset' of the entity, to determine the extent to which its practices and procedures contributed to the offence.[141] The provisions also permit an examination of the company's 'unwritten rules' and whether those unwritten rules demonstrate a genuine commitment to compliance.[142] This is critical because policies of non-compliance are usually tacit or implied, rather than explicitly authorized.[143]

Culture (Oxford, Hart Publishing, 2013), 251; Simon Longstaff AO, 'Corporate Culture and the Duties of Directors', *The Ethics Centre*, Sydney, Australia (2016), 5-8.

136 *See* s. 12.3(1) *Criminal Code*. See Ian D. Leader-Elliott, *The Commonwealth Criminal Code: A Guide for Practitioners* (March 2002), 306*ff*.

137 See s. 12.3(2) *Criminal* Code.

138 See ss. 12.3(2)(c) and 12.3(2)(d) *Criminal Code*.

139 See s. 12.3(2)(c) *Criminal Code*.

140 See s 12.3(2)(d) *Criminal Code*. The statute defines 'corporate culture' to mean '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 take place (s. 12.3(6) *Criminal Code*).

141 See generally Note, 'Developments in the Law: Corporate Crime: Regulating Corporate Behavior through Criminal Sanctions' (1979) 92 *Harv. L. Rev.* 1227, 1243 (discussing the possible link between corporate processes and practices and organizational blameworthiness).

142 See Olivia Dixon, 'Corporate Criminal Liability: The Influence of Corporate Culture', in Justin O'Brien and George Gilligan (eds.), *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Oxford, Hart Publishing, 2013), 251, 261.

143 Olivia Dixon, 'Corporate Criminal Liability: The Influence of Corporate Culture', in Justin O'Brien and George Gilligan (eds.), *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Oxford, Hart Publishing, 2013), 251, 261; Ian Leader-Elliott, *The Commonwealth Criminal Code: A Guide for Practitioners* (March 2002), 319. The unwritten rules of an organization may, admittedly, be difficult to prove, though internal emails may be helpful to prosecutors in this regard. See Tahnee Woolf, 'The Criminal Code Act 1995 (Cth) – Towards a Realist Vision of Corporate Criminal Liability' (1997) 21 *Crim L.J.* 257, 264; William S. Laufer, 'Corporate Bodies and Guilty Minds' (1994) 43 *Emory L.J.* 647, 664.

Part 2.5 of the *Criminal Code* has been described as 'arguably the most sophisticated model of corporate criminal liability in the world'.[144] It provides directors and managers, in theory at least, with strong incentives to self-monitor and to introduce effective compliance programs to address defective corporate culture.[145]

Nonetheless, the potential for entity accountability offered by Part 2.5 has remained largely unfulfilled in Australia. This is because some of the most significant federal statutes relating to organizational wrongdoing explicitly exclude the operation of Part 2.5,[146] thereby undermining the relevance of the corporate culture provisions.

Despite this statutory marginalization, discussion of the corporate culture provisions re-emerged in 2015, when ASIC announced a plan to extend the operation of the culture provisions in Part 2.5 to include key financial services and markets rules in the *Corporations Act* 2001 (Cth) ('*Corporations Act*').[147] ASIC also suggested the possibility of extending these provisions to impose criminal liability company directors and officers.[148] Although these proposals did not eventuate, they brought the corporate culture provisions of the Criminal Code to the forefront of policy debate in Australia.

6. Targeting Individuals – Liability of Directors and Officers for Wrongs Arising from Flawed Corporate Cultures

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144 See Olivia Dixon, 'Corporate Criminal Liability: The Influence of Corporate Culture', in Justin O'Brien and George Gilligan (eds.), *Integrity, Risk and Accountability in Capital Markets: Regulating Culture* (Oxford, Hart Publishing, 2013), 251, 252 (citing Jonathan Clough and Carmel Mulhern, *The Prosecution of Corporations* (Melbourne, Oxford University Press, 2002), 138).

145 *See* Jennifer Hill, 'The Transformation of Corporate Ethics into Risk Management', *Keeping Good Companies*, February 2001, 26.

146 These statutes include the *Corporations Act* 2001(Cth) ('*Corporations Act*') and *Competition and Consumer Act* 2010. See, for example, s. 769A *Corporations Act* (stating that Part 2.5 of the *Criminal Code* does not apply to any offence under Chapter 7 of the Act, which deals with financial services and markets); s. 6AA(2) *Competition and Consumer Act* 2010 (stating that Part 2.5 of the *Criminal Code* does not apply to certain offences under the Act).

147 See Commonwealth of Australia, Official Committee Hansard, Parliamentary Joint Committee on Corporations and Financial Services, *Oversight of the Australian Securities and Investments Commission*, Oct. 16, 2015, 15 (where then-Chair of ASIC, Greg Medcraft, stated '[w]hat we have suggested…is that perhaps [Part 2.5 of the *Criminal Code*] should extend through to chapter 7, 'Financial products and markets' of the Corporations Law'.)

148 *Ibid*.

Individuals who intentionally commit criminal acts in the corporate setting can, of course, be prosecuted for that conduct. However, to what extent can those in the upper echelons of the corporate hierarchy, who did not themselves engage in the wrongdoing, but may have benefited financially from it, be held accountable?

No-one who has seen Senator Elizabeth Warren's questioning the former CEO of Wells Fargo, John Stumpf, at a 2016 US Senate Committee[149] hearing,[150] could doubt that she regarded the bank's senior managers, as personally responsible for the culture, and resulting misconduct, at Wells Fargo. During this hearing, Senator Warren stated that there would be no real accountability until executives such as Mr Stumpf, who had personally benefited from the fraud,[151] faced the possibility of criminal charges and prison sentences.[152] Senator Warren is not alone in asking '[w]hy isn't Wall Street in jail?'[153]

The difficulty with this proposal lies in the limitations of criminal law itself. Although directors and senior officers may be responsible for creating, or failing to monitor the corporation's culture, this will usually fall outside established principles of criminal liability, which requires *mens rea* and has limited applicability to omissions.[154] This legal mismatch has been labelled the 'responsibility gap'.[155]

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149 United States Senate Committee on Banking, Housing, And Urban Affairs (https://www.banking.senate.gov/).

150 See 'Senator Elizabeth Warren Questions Wells Fargo CEO John Stumpf at Banking Committee Hearing', 20 September 2016 (https://www.youtube.com/watch?v=xJhkX74D10M).

151 According to Senator Warren, Mr Stumpf held 6.75 million shares in Wells Fargo, which, as a result of cross-selling of retail accounts, appreciated in value by $30 per share, leading to $200 million in gains for Mr Stumpf personally. *Ibid.*

152 *Ibid*.

153 See Matt Taibbi, 'Why Isn't Wall Street in Jail?', *Rolling Stone*, Feb. 16, 2011. See also Jean Eaglesham and Anupreeta Das, 'Wall Street Crime: 7 Years, 156 Cases and Few Convictions', *Wall St J*, May 27, 2016 (showing that proceedings against bank employees are rare, usually brought against mid-level or junior employees, and generally unsuccessful).

154 See Samuel W. Buell, 'The Responsibility Gap in Corporate Crime' (2018) 12 *Crim. L. and Phil.* 471; Otto Kirchheimer, 'Criminal Omissions' (1942) 55 *Harv. L. Rev.* 615; Graham Hughes, 'Criminal Omissions' (1958) 67 *Yale L. J.* 590. *Cf,* however, Liz Campbell, 'Corporate Liability and the Criminalisation of Failure' (2018) 12 *Law and Financial Markets Review* 57 (discussing a UK legislative trend, which constitutes an indirect form of omissions liability, toward criminalizing failure to prevent certain crimes, including bribery and tax evasion).

155 See Samuel W. Buell, 'The Responsibility Gap in Corporate Crime' (2018) 12 *Crim. L. and Phil.* 471.

In 2015, the Australian regulator, ASIC, suggested reforms that would have increased the potential for criminal prosecution against directors and officers in these circumstances. As noted previously, ASIC suggested extending Part 2.5 of the *Criminal Code* to include individual criminal liability of directors and officers, who manage corporations with defective cultures.[156] Not surprisingly, this proposal provoked an extremely negative reaction in the business community, and has not been implemented.[157]

However, another potential type of liability, which could apply to those overseeing companies with defective corporate cultures, is civil liability for breach of directors' duties. To what extent can directors and corporate officers be liable for breach of their duty of oversight and care in failing to recognize, and address, ethical risks, which arise from a flawed culture and result in corporate wrongdoing? At least superficially, there is a major divergence between US, UK and Australian law in this regard.[158]

Under US state law, the most significant of which is Delaware law, directors face virtually no liability risk with respect to their duty of oversight, unless it can proved that they had actual knowledge of the wrongdoing. The leading modern US case on the duty of oversight is the landmark 1996 decision, *In re Caremark International Inc. Derivative Litigation* ('*Caremark*').[159] This case, bolstered by later important decisions, such as *Stone v Ritter*[160] and *In re Citigroup Shareholder Derivative Litigation*,[161] demonstrated that directors will generally be protected from liability in all but extreme circumstances. Mere negligence is insufficient,

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156 Commonwealth of Australia, Official Committee Hansard, Parliamentary Joint Committee on Corporations and Financial Services, *Oversight of the Australian Securities and Investments Commission*, Oct. 16, 2015, 15 (evidence of Greg Medcraft, responding to Senator Ketter).

157 See, for example, John H.C. Colvin and James Argent, 'Corporate and Personal Liability for "Culture" in Corporations?' (2016) 34 *Co. & Sec L.J.* 30 (arguing that culture cannot and should not be regulated, and that ASIC's proposal would place an unreasonable burden on corporations, directors and officers).

158 See generally Jennifer G. Hill and Matthew Conaglen, 'Directors' Duties and Legal Safe Harbours: A Comparative Analysis' in D. Gordon Smith and Andrew S. Gold (eds), *Research Handbook on Fiduciary Law* (Cheltenham, Edward Elgar Publishing Ltd, 2018), 305.

159 698 A.2d 959 (Del. Ch., 1996). For detailed background to the *Caremark* case, see Jennifer Arlen, 'The Story of *Allis-Chalmers*, *Caremark*, and *Stone:* Directors' Evolving Duty to Monitor', in John M. Ramseyer (ed.), *Corporate Law Stories* (Foundation Press, 2009), 323.

160 *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).

161 *In re Citigroup Inc. Shareholder Derivative Litigation*, 964 A.2d 106 (Del. 2009).

given the capacious protection of the business judgment rule.[162] Nor does gross negligence suffice, due to the ubiquitous presence of exculpation clauses in corporate charters.[163]

The *Caremark* case showed that a director will only be liable for 'bad faith' breaches of oversight responsibility, falling within the more stringent duty of loyalty.[164] The court stated that to establish lack of good faith, the plaintiff must show 'a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists'.[165] Dicta in the *Disney* litigation and *Stone v Ritter* went even further, requiring, as a precondition to liability, *intentional* infliction of harm or *conscious* dereliction of duty by a director.[166]

The practical effect of these decisions is to render the US duty of oversight aspirational only. The narrow contours of the duty has led some commentators to question whether investors are, in fact, provided with any 'meaningful oversight protection'.[167] Although often justified on policy grounds, this legal regime has been challenged in recent times.[168]

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162 See E. Norman Veasey, 'An Economic Rationale for Judicial Decisionmaking in Corporate Law', 53 *Bus. Law.* 681, 690 (1998) (stating that although '[s]trictly speaking', the business judgment rule does not apply to directors' oversight responsibilities, there are nonetheless, judgment aspects to monitoring those oversight responsibilities).

163 See *Malpiede v. Townson*, 780 A.2d 1075 (2001).

164 See Louis J. Bevilacqua, 'Monitoring the Duty to Monitor', *N.Y. L.J.*, 28 November 2011(stating that, in the absence of evidence of self-dealing by a director, 'bad faith is a rarely met threshold'). See also E. Norman Veasey, 'An Economic Rationale for Judicial Decisionmaking in Corporate Law', 53 *Bus. Law.* 681, 691-92 (1998); Hilary A. Sale, 'Good Faith's Procedure and Substance, *In re Caremark International Inc., Derivative Litigation'*, in Jonathan R. Macey (ed.), *The Iconic Cases in Corporate Law* (West/Thomson, 2008); Jennifer G. Hill and Matthew Conaglen, 'Directors' Duties and Legal Safe Harbours: A Comparative Analysis' in D. Gordon Smith and Andrew S. Gold (eds), *Research Handbook on Fiduciary Law* (Cheltenham, Edward Elgar Publishing Ltd, 2018), 305.

165 *In re Caremark Int'l Inc. Deriv. Litig.,* 698 A.2d, 959 at 971 (Del. Ch. 1996).

166 See *Disney*, 906 A.2d 27, 66-7 (Del. 2006). See also *Stone v Ritter*, 911 A.2d 362, 370 (Del. 2006).

167 Louis J. Bevilacqua, 'Monitoring the Duty to Monitor', *N.Y. L.J.*, Nov. 28, 2011. See also Ron Barusch, 'CBS and the Need to Hold Directors Accountable', *Wall St. J.*, Sept. 17, 2018.

168 The high level of protection provided to US directors in in relation to the duty of care has sometimes been justified on the basis of the 'stupefying disjunction between risk and reward', which could apply if directors were liable for negligence. See *Gagliardi v Trifoods International, Inc*, 683 A. 2d 1049, 1052-53 (Del. Ch. 1996). *Cf*, however, Holger Spamann, 'Monetary Liability for Breach of the Duty of Care?' (2016) 8 *J. Leg. Anal.* 337 (arguing that a complete exclusion of liability is not necessarily justified by standard policy rationales).

One recent Delaware Supreme Court decision, *City of Birmingham Retirement and Relief System v Good*[169] highlights the traditionally narrow scope of US *Caremark*-style claims, yet at the same time demonstrates that change may be in wind. This 2017 demand futility case related to a claim that the directors of Duke Energy Corp. had breached their duty of oversight when the company discharged highly toxic coal ash and waste water into a North Carolina river. The majority judgment affirmed the Court of Chancery's decision that the plaintiffs had failed to show that the directors acted in 'bad faith', which is a necessary condition for *Caremark*-style oversight liability.[170] The dissenting judgment of Chief Justice Strine may, however, be a harbinger of shifting *Caremark* boundaries in the context of flawed corporate culture. In Strine CJ's view, the plaintiffs had established the basis for a *Caremark* claim, because:

'it was the business strategy of Duke Energy, accepted and supported by its board of directors, to run the company in a manner that purposely skirted, and in many ways consciously violated, important environmental laws... Duke's executives, advisors, and directors used all the tools in their large box to cause Duke to flout its environmental responsibilities, thereby reduce its costs of operations, and by that means, increase its profitability. This, fiduciaries of a Delaware corporation, may not do'.[171]

At first sight, the position in the United Kingdom appears to be quite different from the narrow contours of traditional US *Caremark*-style liability. UK directors have been have been subject to a clear oversight responsibility for financial mismanagement as part of their duty of care and diligence ('duty of care') since the landmark 1925 decision in *In re City Equitable Fire Insurance Co*.[172] The standard for this duty, originally one of gross negligence, rose significantly during the 1990s.[173] Also, UK corporate law does not include a formal business judgment rule and, moreover, prohibits exculpation for breach of the directors' duties,

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169 C.A. No. 9682-VCG (Del. S.C., Dec. 15, 2017).

170 See *id*, 4, 13 (per Seitz J.).

171 *Id*, 32. See also *In re Massey Energy Co.,* C.A. No. 5430-VCS, 2011 WL 2176479, at *6, *20 (Del. Ch., May 31, 2011); *In re Massey Energy Company Derivative and Class Action Litigation*, C.A. No. 5430-CB (Del. Ch., May 4, 2017) (where similar issues arose in the context of worker safety).

172 [1925] Ch 407.

173 UK cases, such as *Re D'Jan of London Ltd* [1993] BCC 646 and *Norman Theodore Goddard* [1992] BCC 14 adopted a more demanding objective test for directors' duties than the test that previously applied in *In re City Equitable Fire Insurance Co* [1925] Ch 407. This objective test is now reflected in s 174 of the UK *Companies Act* 2006.

including the duty of care.[174] UK case law also suggests that directors have a responsibility to monitor, from both a competence and an integrity perspective, any functions that they have delegated to other persons in the organization.[175] UK directors are required to consider a range of stakeholder interests in fulfilling their statutory duty under s 172(1) of the Companies Act 2006, and the 2018 UK CG Code states that they 'must act with integrity, lead by example and promote the desired culture'.[176]

It appears, therefore, that UK directors, who oversee companies with defective corporate cultures that engender or tolerate wrongdoing, might face a considerably higher risk of liability than US directors. In fact, that is not the case.[177] Directors of UK public companies still run virtually no risk of being sued for damages for breach of their duty of care,[178] even in the wake of the global financial crisis, where blame could often be traced to board policies.[179] The

174 See s 232(1) *Companies Act* 2006 (UK).

175 See *Re Barings Plc (No 5); Secretary of State for Trade and Industry v Baker (No. 5)* [2000] 1 BCLC 523. See generally, Joan Loughrey, 'The Director's Duty of Care and Skill and the Financial Crisis' in Joan Loughrey (ed.), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar Publishing, 2013), 12, 17; Paul L. Davies and Sarah Worthington, Gower & Davies Principles of Modern Company Law (10th ed., Sweet & Maxwell, 2016), [10-10].

176 UK Corporate Governance Code 2018, p 4, Principle B.

177 It should be noted, however, that director disqualification orders, including for recklessness and incompetence are relatively common in the United Kingdom. See generally Paul L. Davies and Sarah Worthington, Gower & Davies Principles of Modern Company Law (10th ed., Sweet & Maxwell, 2016), [10-2], [10-10].

178 John Armour, Bernard S. Black, Brian R. Cheffins and Richard Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States' (2009) 6 *J Empirical Legal Studies* 687, 687, 690, 699-700, 710.

179 For example, the UK House of Commons Treasury Committee considered that the board of Northern Rock was directly responsible for the liquidity crisis that ultimately led to the bank's nationalization and massive investor losses. According to the committee, the board had 'pursued a reckless business model', by relying excessively on wholesale funding. See the House of Commons Treasury Committee, *The Run on the Rock* (HC 56-1) (January 2008), 3. In spite of this finding, no actions for breach of duty of care were ever commenced against the directors by either the bank's new board or its shareholders. See Joan Loughrey, 'The Director's Duty of Care and Skill and the Financial Crisis' in Joan Loughrey (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar Publishing, 2013), 12, at 12-13. Two of the directors were, however, banned by the Financial Services Authority from working in the City of London. See Chris Tigh, 'What Happened to Northern Rock's 12 Directors?', *Financial Times*, Sept. 14, 2017.

reasons for this dearth of litigation are mainly procedural,[180] yet they create what has been described as 'an accountability firewall'.[181]

One post-crisis UK regulatory development, which has sought to bypass this firewall and expand individual accountability in the banking area, is the adoption of a senior managers regime ('SMR').[182] The goal of the regime is to provide a clearer roadmap of responsibilities within financial institutions, coupled with enhanced enforcement powers.[183] The Director of Enforcement and Oversight at the Financial Conduct Authority has stated that the regime helps to align the responsibilities of senior managers with the responsibilities owed by the firm 'to the whole community'.[184]

This highly prescriptive UK regime[185] has provided the blueprint for an analogous regime in Australia, the Banking Executive Accountability Regime ('BEAR'),[186] and a similar regime has

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180 Procedural reasons for the negligible UK caselaw on breach of the duty of care include the absence of class actions and the loser-pays litigation system. See generally Marc T. Moore, 'Redressing Risk Oversight Failure in UK and US Listed Companies: Lessons from the *RBS* and *Citigroup* Litigation' (2017) 18 *Eur. Bus. Org. L. Rev.* 733; John Armour, Bernard S. Black, Brian R. Cheffins and Richard Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States' (2009) 6 *J Empirical Legal Studies* 687; Jennifer G. Hill and Matthew Conaglen, 'Directors' Duties and Legal Safe Harbours: A Comparative Analysis' in D. Gordon Smith and Andrew S. Gold (eds), *Research Handbook on Fiduciary Law* (Cheltenham, Edward Elgar Publishing Ltd, 2018), 305.

181 See Joan Loughrey, 'Breaching the Accountability Firewall: Market Norms and the Reasonable Director' (2014) 37 *Seattle U.L. Rev.* 989, 989 (citing UK Parliamentary Commission on Banking Standards, *Changing Banking for Good*, Vol. 1. 2013-14, H.L. 27-1, H.C. 175-1, at 10).

182 The SMR was established by the *Financial Services (Banking Reform) Act* (2013). See generally Jay Cullen, 'A Culture Beyond Repair? The Nexus Between Ethics and Sanctions in Finance' in Lisa Herzog (ed.), *Just Financial Markets: Finance in a Just Society* (Oxford, Oxford University Press, 2017), 154, 176-78 (discussing the contours of the SMR). The SMR proposal originated from the final report of the UK Parliamentary Commission on Banking Standards, which was established in the United Kingdom in 2012, following the Libor scandal. See *id*, [538] *ff*; UK Parliament, Joint Select Committee, *Banking Committee publishes report on changing banking for good*, June 19, 2013.

183 See generally Speech by Mark Steward, Director of Enforcement and Market Oversight at the FCA delivered at the New York University Program on Corporate Compliance and Enforcement, *The Expanding Scope of Individual Accountability for Corporate Misconduct*, Apr. 3, 2017.

184 *Ibid*.

185 Jay Cullen, 'A Culture Beyond Repair? The Nexus Between Ethics and Sanctions in Finance' in Lisa Herzog (ed.), *Just Financial Markets: Finance in a Just Society* (Oxford, Oxford University Press, 2017), 154, 176.

186 See Australian Government, Banking Executive Accountability Regime, Consultation Paper, July 2017, 3 (noting that the design of BEAR draws on elements of the SMR, as well as the Managers-in-Charge regime in Hong Kong). Australia introduced the Banking Executive Accountability Regime in February 2018. See APRA, *Information Paper: Implementing the Banking Executive Accountability Regime*, Oct. 17, 2018.

been proposed by the Central Bank of Ireland.[187] It is as yet too early to predict the effect of these regimes in the banking sector.

In the area of directors' duties, although Australian law resembles US and UK law in a number of ways, it operates quite differently in practice.[188] Australian directors and officers are subject, not only to general law (i.e. common law and equitable) duties, but also to statutory duties under the *Corporations Act*.[189] These statutory duties, which include the duty of care under s 180(1) of the *Corporations Act* form part of a broader civil penalty enforcement regime.[190] There has recently been a huge increase in the sanctions available under this regime.[191]

During the 1990s, Australian judges, like their UK counterparts, adopted a significantly more demanding standard for the duty of care.[192] A pivotal case in this regard was *Daniels v Anderson*,[193] which has been described as representing 'a quantum shift' in the legal expectations regarding the duty of care for directors and officers in Australia.[194]

In contrast to the strong private/contractual interpretation of corporate law under contemporary Delaware case law,[195] the Australian courts have also increasingly viewed directors' statutory

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187 See Central Bank of Ireland, *Behaviour and Culture of the Irish Retail Banks* (2018), 36-37; Shane Kelleher, 'Whodunnit? Individual Accountability on Way for Banks and Regulated Firms', *Business Irish*, Nov. 12, 2018.

188 See generally Jennifer G. Hill and Matthew Conaglen, 'Directors' Duties and Legal Safe Harbours: A Comparative Analysis' in D. Gordon Smith and Andrew S. Gold (eds), *Research Handbook on Fiduciary Law* (Cheltenham, Edward Elgar Publishing Ltd, 2018), 305.

189 See *Corporations Act* 2001 (Aust), ss 180-184.

190 See *Corporations Act* 2001 (Aust), Part 9.4B; s 1317E(1). See generally Jennifer G. Hill and Matthew Conaglen, 'Directors' Duties and Legal Safe Harbours: A Comparative Analysis' in D. Gordon Smith and Andrew S. Gold (eds), *Research Handbook on Fiduciary Law* (Cheltenham, Edward Elgar Publishing Ltd, 2018), 305.

191 See *Treasury Law Amendment (Strengthening Corporate and Financial Sector Penalties) Act* 2019; Australian Securities and Investments Commission, Media Release 19-032, *ASIC to pursue harsher penalties after laws passed by Senate*, Feb. 15, 2019.

192 For concise summaries of the legal content of the duty of care under modern Australian law, see Greg Golding, 'Tightening the Screws on Directors: Care, Delegation and Reliance' (2012) 35 *UNSW L.J.* 266, 270-271; *ASIC v Adler* (2002) 168 FLR 253, [372].

193 (1995) 37 NSWLR 438.

194 Greg Golding, 'Tightening the Screws on Directors: Care, Delegation and Reliance' (2012) 35 *UNSW LJ* 266, 268.

195 See, for example, *Boilermakers Local 154 Retirement Fund v Chevron*, 73 A. 3d 934 (Del Ch 2013) and *ATP Tour, Inc v Deustcher Tennis Bund*, 91 A. 3d 554 (Del 2014). See also James D. Cox, 'Whose Law

duties as public obligations, which have an important social function.[196] According to the 2011 decision, *ASIC v Healey*,[197] '[t]he role of a director is significant as their actions may have a profound effect on the community, and not just shareholders, employees and creditors'.[198]

Australian case law also accepts that directors have an obligation to oversee and monitor the activities of their company,[199] and that failure to ensure that the company has proper control systems in place to enable directors to fulfil their monitoring responsibilities can constitute breach of the duty of care.[200]

Furthermore, directors' oversight responsibilities may, in certain circumstances, implicate matters traditionally associated with corporate social responsibility. For example, a Memorandum of Opinion, co-authored by a senior corporate law barrister, argued that Australian directors who disregard the risks to their business associated with climate change could potentially face liability under the statutory duty of care.[201]

Although Australian law appeared to move closer to US law in 2000, when it adopted a statutory business judgment rule,[202] the protection offered by the Australian version of the rule

Is It? Battling over Turf in Shareholder Litigation' in Jennifer G. Hill and Randall S. Thomas, (eds), *Research Handbook on Shareholder Power* (Edward Elgar, 2015), 333.

196 See Michelle Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' (2014) 42 *Federal Law Review* 217, 223-228; Jason Harris, Anil Hargovan and Janet Austin, 'Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?' (2008) 26 *Co. & Sec. L.J.* 355.

197 [2011] FCA 717. See generally, Jennifer G. Hill, 'Centro and the Monitoring Board – Legal Duties Versus Aspirational Ideals in Corporate Governance' (2012) 35 *UNSW L.J.* 341; John Lowry, 'The Irreducible Core of the Duty of Care, Skill and Diligence of Company Directors: *Australian Securities and Investments Commission v Healey*' (2012) 75 *Mod. L. Rev.* 249.

198 *ASIC v Healey* [2011] FCA 717, [14].

199 See *Daniels v Anderson* (1995) 37 NSWLR 438, 503-504; *ASIC v Adler* (2002) 168 FLR 253, [372], (8).

200 *ASIC v Adler* (2002) 168 FLR 253, [372], (13).

201 See The Centre for Policy Development and the Future Business Council, 'Climate Change and Directors' Duties', Memorandum of Opinion (Mr Noel Hutley SC and Mr Sebastian Hartford Davis', Oct. 7, 2016. The authors issued an updated memorandum of opinion in 2019, in which they concluded that 'the exposure of individual directors to "climate change litigation" is increasing, probably exponentially, with time'. The Centre for Policy Development and the Future Business Council, 'Climate Change and Directors' Duties', Supplementary Memorandum of Opinion (Mr Noel Hutley SC and Mr Sebastian Hartford Davis', Mar. 26, 2019, 9.

202 *Corporations Act* 2001 (Aust), s 180(2).

is far narrower than its US counterpart[203] and it has been suggested that this does not encompass board oversight failure, such as failure to respond to a business crisis or to monitor the business adequately.[204]

Finally, in contrast to both the United States and the United Kingdom,[205] Australia relies on a predominantly public, rather than private, enforcement model,[206] as a result of its civil penalty regime.[207] The 2016 decision, *ASIC v Cassimatis (No 8)*[208] accepted that breach of the statutory duty of care is not only a private, but also a public, wrong, and that there is a public interest in the enforcement of directors' duties in Australia.[209] Under this public enforcement regime, actions for breach of directors' duties are usually brought by ASIC, and the regulator has an extremely high success rate in such actions.[210]

An increasing number of ASIC's civil penalty applications involve so-called 'stepping stone' liability.[211] This developing form of liability involves a two-step process, whereby directors and officers may be personally liable for failure to prevent contraventions of the law by their

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203 A 'business judgment' is defined to mean 'any decision to take or not take action in respect of a matter relevant to the business operations of the corporation'. *Corporations Act* 2001 (Aust), s 180(3).

204 See *Corporate Law Economic Reform Program Bill*, Explanatory Memorandum, [6.8].

205 See John Armour, Bernard S. Black, Brian R. Cheffins and Richard Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States' (2009) 6 *J. Empirical Legal Stud.* 687. There are, however, some aspects of public enforcement in the United Kingdom. *Id*, 716-17.

206 For a comparison of the US and Australian enforcement models relating to directors' duties, see Renee M. Jones and Michelle Welsh, 'Toward a Public Enforcement Model for Directors' Duty of Oversight' (2012) 45 *Vand. J. Transnat'l L.* 343.

207 *Corporations Act* 2001 (Aust), Part 9.4B; s 1317E(1).

208 *ASIC v Cassimatis (No 8)* [2016] FCA 1023.

209 See *id*, [455] [461], [496]*ff*, [503].

210 See Ian M. Ramsay and Benjamin B. Saunders, 'An Analysis of the Enforcement of the Statutory Duty of Care by ASIC' (2019) 36 *Co. & Sec. L.J.* 497, 510-11; Greg Golding, 'Tightening the Screws on Directors: Care, Delegation and Reliance' (2012) 35 *UNSW LJ* 266, 273-74. See also Michelle Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' (2014) 42 *Fed. L. Rev.* 217, 233*ff*; Jasper Hedges and Ian M. Ramsay, 'Has the Introduction of Civil Penalties Increased the Speed and Success Rate of Directors' Duties Cases?' (2016) 34 *Co. & Sec. L.J.* 549, 552-553; Belinda Gibson and Diane Brown, 'ASIC's Expectations of Directors' (2012) 35 *UNSW L.J.* 254.

211 On the evolution of 'stepping stone' liability, see Abe Herzberg and Helen Anderson, 'Stepping Stones - From Corporate Fault to Directors' Personal Civil Liability' (2012) 40 *Fed. L. Rev.* 181; Tim Bednall and Pamela Hanrahan, 'Officers' Liability for Mandatory Disclosure: Two Paths, Two Destinations'? (2013) 31 *Co. & Sec. L.J.* 474.

corporation.[212] In recent stepping stone liability cases, ASIC has argued that directors breached their statutory duty of care by allowing the corporation to contravene another provision of the *Corporations Act*, thereby jeopardizing the corporation's interests by exposing it to a penalty.[213] Stepping stone liability is particularly well-suited to the kind of misconduct that often arises from flawed corporate cultures, and potentially increases the liability risks for directors and officers, who oversee the activities of companies with such cultures.

6. Conclusion

A number of recent corporate law scandals demonstrate that flawed corporate cultures can inflict damage on stakeholders, communities and society as a whole. The aim of this study is to explore, from a theoretical and comparative perspective, the issue of accountability for misconduct arising from defective corporate cultures.

The study examines two specific types of liability which may be relevant in the context of misconduct arising from flawed corporate cultures – (i) entity criminal liability and (ii) personal liability of directors and officers for breach of duty to their company. The study compares these forms of liability in the United States, the United Kingdom and Australia, to assess the extent to which they are well-suited to providing accountability for misconduct arising from flawed corporate cultures. As this comparative analysis shows, there are significant jurisdictional differences in these areas of law, which, in some cases, make these forms of liability ill-suited to achieve such accountability.

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212 See Alice Zhou, 'A Step Too Far? Rethinking the Stepping Stone Approach to Officers' Liability' (2019) 47 *Fed. L. Rev.* 151.

213 See, for example, *ASIC v Maxwell* (2006) 59 ACSR 373; [2006] NSWSC 1052, [104]–[106]. See generally Jason Harris, Anil Hargovan and Janet Austin, 'Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?' (2008) 26 *Co. & Sec. L.J.* 355. Although some judges have expressed concern about stepping stone liability being used as a back-door means of imposing accessorial liability on directors, this type of liability has been successful in a number of recent Australian cases. See, for example, *ASIC, in re Sino Australia Oil and Gas Ltd (in liq) v Sino Australia Oil and Gas Ltd (in liq)* [2016] FCA 934, [85]-[86]; *ASIC v Cassimatis (No 8)* [2016] FCA 1023. See Ian M. Ramsay and Benjamin B. Saunders, 'An Analysis of the Enforcement of the Statutory Duty of Care by ASIC' (2019) 36 *Co. & Sec. L.J.* 497, 519.