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SYDNEY UNIVERSITY LAW SCHOOL

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INSTITUTE OF CRIMINOLOGY
SYDNEY UNIVERSITY LAW SCHOOL

Proceedings of a Seminar on

POLICING CORPORATE CRIME

Convenors: The Honourable Mr Justice R. N. Purvis, Family Court of Australia, and Professor Brent Fisse, Director, Institute of Criminology

CHAIRMAN

The Honourable Mr Justice J. A. Lee, Supreme Court, N.S.W.

16th September 1987

State Office Block, Sydney

TABLE OF CONTENTS

FOREWORD

The Honourable Mr Justice R. N. J. Purvis,
Family Court of Australia,
Presidential Member of the Administrative Appeals Tribunal

A policeman on patrol duty who sees a person in the course of committing an offence can act then and there, arrest the suspect, and have him charged at the nearest police station. The suspect is speedily brought before a magistrate preparatory to the trial process being implemented. Not so with the corporate suspect criminal. He will not be seen to be in the course of committing an offence, an arrest as such is the exception rather than the rule, and if, and when, an arrest and/or charge does take place it will only follow an extensive and time consuming investigation. The prospect of conviction is not high.

On the assumption that corporate crime, both by and against companies and their shareholders, creditors, or other interested persons is increasing—and this all statistics seek to affirm—what steps can then be taken to restrain, let alone contain, this form of criminality?

Following on an examination of various areas of corporate crime as considered in previous seminars of the Institute of Criminology—including crime and the medical, legal and accounting professions—it was thought appropriate for there to be an opportunity afforded to those involved in prosecuting corporate crime, commenting upon it, detecting its occurence or prospective occurence, implementing guidelines for self-regulation and enforcing the same, to come together and discuss their experience in overseeing and policing this challenging field of human digression.

The discussion paper of the Federal Law Reform Commission on 'Sentencing: Penalties' drew, at paragraph 286, a distinction between investigation of corporate crime and enforcement of sanctions by regulatory bodies rather than by the police. There is an apparent trend towards reliance upon civil remedies and self-regulation rather than resort to criminal prosecution. Reasons there advanced for this tendency included:

- a strong belief in, and reliance upon, self-regulation as a strategy;
- the availability of stronger and more effective civil than criminal sanctions;
- the perceived unwillingness of sentencing authorities to use the sanctions already available;
- insufficient staff and financial resources;
- the political power and superior resources of corporations and their executives;
- general discomfort with the criminal law and the belief that persuasion rather than punishment is a more effective strategy to get compliance;
- complexity of cases compared with the prosecution of individual offenders, both legally and in terms of the amount of forensic activity required.

The general theme of the papers and comments given by participants at the seminar on 'Policing Corporate Crime' are supportive of the perceived trend noted in the discussion paper of the Law Reform Commission. The difficulty experienced in attempting to contain corporate mal-practice within the constraints of the prosecution procedure was illustrated by reference to recent instances where there had been massive avoidance of taxation and where there had been large amounts of money lost by creditors of companies consequent upon alleged criminal negligence by officers of such companies. In some cases the complexity compounded by an insufficiency of resources resulted in the system being unable to cope and proceedings then terminated. But, it was said that with the education of those who dictate policy consequent upon a demand for action by those who have suffered harm and/or perceived a need for change, it should be competent, if considered appropriate, to arrest this trend.

Recent developments illustrative of an industry endeavouring to contain its own transgressors were outlined in the papers on trading in securities and on futures. The obtaining of confidential information and its use by a recipient for that persons own benefit in maximising a profit or minimising a loss and its being detrimental to another, was instanced as was the practice of leverage currency dealers taking a principal position against their clients, the same resulting in a loss to the client being a profit to the dealer. A dealer might let losses mount and then close out the client's contracts while the client was in a loss situation. Profitable contracts could be rolled over into new contracts with the anticipation on the part of the dealer that a loss will result—matters for the internal control and discipline or police action?

Self-regulation and the introduction and implementation of industry codes of conduct can be of benefit, but only if a regulatory agency whether governmental or private, is sufficiently able to investigate breaches and impose appropriate sanctions. The extent to which persuasion rather than punishment is effective as a strategy to obtain compliance, whilst illustrated by the measured success achieved by the National Companies and Securities Commission, is dependent upon its acceptance by the members of an industry and a perception of the consequences arising from non-adherence to the tenants of such code.

If self-regulation whether in industry, the professions, or commerce is not effective as a policeman in containing corporate crime, then the criminal process altered by procedure and substantive law to cope with the complexities of the factual circumstances and the sophistication of the alleged perpetrator, will be, if not the sole, then the prime instrument of enforcement.

PROBLEMS OF PROSECUTING CORPORATE CRIME
RESOUNDINGS FROM THE BOTTOM OF THE HARBOUR

Terry Griffin and Bryan Rowe,
Griffin Rowe and Associates

We would like to thank the Institute of Criminology and in particular Professor Fisse, for their continuing commitment to full discussion of contentious legal issues.

We have interpreted the topic somewhat liberally and have taken the work 'prosecuting' to include investigation, preparation and actual presentation. The paper is mainly centred around the experience we gained when employed by the Special Prosecutor's Office and Federal Director of Public Prosecutions Office. It should not be assumed that our comments are only of relevance to the federal sphere or, indeed, that they are limited to corporate crime and the public sector. It is our belief that corporate crime is as active, if not more so, in the private arena. Large public companies, including banks and other finance houses, insurance companies, credit card agencies and the like are extremely attractive and, according to our research, vulnerable targets. Our commments apply equally to civil and criminal litigation.

There can be little doubt that there is constant stream of frauds being perpetrated in our society. Many of these frauds are unexceptional, at least in the legal sense and are adequately dealt with by the criminal justice system. Equally there are obviously many large, complex matters that seem to be beyound the capabilities of the system.

We have seen figures that suggest that the cost of organised fraud in the federal sphere is somewhere between $11 and $87 per week to every tax payer. Whatever the amount is, it is not some book entry, but the amount each taxpayer is actually out of pocket, and those figures only take into account the recognised trouble areas like Social Security, the Tax Office and Customs. You don't have to be Einstein to realise that there must be unidentified fraud in major federal departments like Defence, in State Government departments, Local Government areas, stock exchanges and commerce generally. It is amazing that to date no-one has been able to provide an accurate estimate. But whatever the final figure is, the real cost must be absolutely staggering!

If these frauds exist, and we don't think there is room for debate about that, then they must be massive and complex (even if only the known figures are used as a guide). In our view there is only one long term solution to the problems created by major fraud but that is lateral one. Of course, there are areas where law reforms can assist. Things like full disclosure of brief, trial without committal, compulsory pre-trial conferences, trial by a judge without jury and/or with expert assistance have been mooted. It behoves us all to do what we can to ensure that useful reforms are achieved but in any given matter we have to take the law as we find it, accordingly, in the short term we have to be most concerned with finding solutions within the present structures.

The management of really large criminal cases has always been a headache for all involved. Almost invariably these cases have been fraud related document matters. Investigators have ranged their very limited resources against seemingly impossible tasks, prosecutors have strained to push the cases into

traditional and recognisable shapes, defence lawyers have railed at the difficulties presented to them and the courts have attempted to do the impossible and handle the cases promptly within the existing frameworks.

In civil cases the problems have been similar but economic considerations take on much greater importance. Major complex litigation can cost hundreds of thousands of dollars in all, or any of, investigation, preparation and presentation. Efficient management is crucial. Many organisations cannot afford major litigation and some are obviously not convinced of the cost effectiveness of legal action. A survey conducted in Victoria in 1986 found that two out of three companies that had experienced fraud took no legal action. It has been suggested that it is sounder commercially to pay criminals to stay away from an enterprise than it is to take security measures and use the legal system if they fail. We have some difficulty with the morality of such an approach but, more importantly, we don't accept that it represents good commercial sense in today's environment. We are sure the N.R.M.A. for instance will tell you that every fraudulent claim paid will generate at least another five similar claims.

Whilst there were only a handful of really large cases every couple of years the administration of justice did not suffer too much. No doubt individuals from all sides suffered a great deal but the system coped, even though you could be excused for wondering how many major cases were left in the too hard basket.

However, times have changed. Society generally is becoming more sophisticated and electronics have revolutionised the handling of information. Both the quality and the quantity of information available to the public has reached staggering proportions. The technology has not been totally ignored by either law enforcement agencies or their quarry. Indeed, it is relatively common for major cases to have electronic assistance.

The end result of all this is, in our opinion, that the system is breaking down. Even where investigators, prosecutors and the courts act with all possible speed, in some cases citizens accused of offences are being asked to defend themselves years after the commission of the alleged offence/s. In a few notable cases delays of over a decade have occured.

Clearly long delays are unfair to those accused of offences and unacceptable to those charged with the administration of justice. The courts have provided part of the solution by deciding that they will stay proceedings where there has been unjustifiable delay. Delay can constitute harsh and oppressive conduct such as to render proceedings an abuse of process. As a byproduct of the courts' move to protect the basic rights of defendants they have created, perhaps inadvertantly, a situation where all agencies will have to re-evaluate their old matters; and they will have to be very carefully examined indeed. Many should never see the light of day. That is not to say that these cases should be buried away in bottom drawers. They should be analysed, where necessary by independent experts and final, public decisions taken about their fate.

The importance of several recent cases cannot be underestimated. Of course, we are speaking about *Gill* v. *McGregor* and *Herron* v. *McGregor* which together are commonly known as the *Chelmsford Hospital* case and *Whitbread* v. *Cooke* and *Purcell* v. *Cooke* which are known as the *Cambridge Credit* case. The decisions in these landmark cases were handed down in the later part of last year and the principals established have been applied in several notable cases since.

Although both matters are no doubt becoming well known, it will not hurt to touch on the facts and summarize the practical effect of the authorities—

> The *Chelmsford Hospital* case arose out of the much publicised deep sleep therapy disciplinary proceedings undertaken by the Disciplinary Tribunal constituted under the *Medical Practitioners Act* 1928 against some of the doctors involved in the treatment.

The allegations of misconduct depended on proof of acts and omissions which allegedly occurred in the years 1973, 1976 and 1978. Complaints were laid in 1982, 1983, 1985 and 1986. The investigating committee set up under the Act found that a *prima facie* case had been made out on all complaints on 11 March 1986.

In reaching the conclusion that the delay had been such as to support a stay of proceedings the Court found *inter alia*—

> Once knowledge of the facts exist, one cannot stand by and allow time to pass.
>
> 'The public interest requires that complaints be lodged and dealt with as expeditiously as possible'

The case also supports the view that delay is to be judged objectively, and that the total delay between discovery of the facts and final disposition is the relevant delay.

The *Cambridge Credit* case reinforced and extended the principles set out in the Chelmsford Hospital matter. Briefly the facts in the matter were as follows; From 1966 to 1974 Cambridge Credit Corporation grew to a massive conglomerate with seventy-five subsidiary companies and a wide range of business activities across Australia. In September 1974 a Receiver was appointed and in February 1975 the Attorney General appointed a C.A.C. inspector to investigate the matter. The final report was delivered in 1980 and steps then began to prepare a prosecution case. Charges were laid in 1985 and the hearing began in 1986.

It should be clear that this was a big case. One C.A.C. officer described it thus—

> the collapse of Cambridge was so big an event and the elements leading to its collapse so multifarious that those involved in the conduct of the prosecution have been simply bemused by the size of the thing. My own perception of the matter which took about 4 weeks to form, was that the thing was the size of an elephant and I was like a small boy wandering around it wondering where I should begin to take hold.

That, of course, is a very understandable reaction, but we suggest that there are ways to avoid the problems created by such a limited perspective. At least, in the first instance, all large and dangerous things are best observed from a reasonable distance, otherwise panic and thoughts of self preservation are want to set in.

I will mention some of the facts that emerged from the case that contributed to the delay and eventual downfall of the matter. None of these will be novel to those of you who have had the resposibility for managing large litigation—

> Investigators resigned and were not replaced for several months, they then had to familiarize themselves with the matter.

Officers could not be devoted solely to the one case.

Counsel changed, took silk, etc., and had to be replaced.

Counsel requested expert opinion on aspects of the matter.

Counsel took many months to provide advice.

Requests for additional staff were made but not met.

Inadequate word processing facilities were available.

Photocopying resources were inadequate.

General financial restrictions were in place.

Clerical support was inadequate.

From the current authorities it is possible to make the following points in summary form:

The Supreme Court has inherent power to prevent an abuse of process in both civil and criminal cases.

The court will investigate circumstances leading to the institution of proceedings regardless of bonafides.

Delay in instituting or prosecuting a matter can constitute harsh and oppressive conduct and can render such proceedings an abuse of process.

In Australia at the moment long delay *per se* is probably not enough to bar action but it will certainly base enquiry into cause. The prosecution can attempt to justify delay but justification is not the same as explanation. The following are unlikely to be considered justification:

Delay caused by an overcrowded court system. This includes delays caused by lack of courts or transcript.

Inefficiency of the prosecution team. Including inefficiencies beyond the control of the person or authority ostensibly in charge of the case.

Complexity of the inquiry and preparation of the case even where proper attention is given to the inquiry. (The proper question is unfairness to the accused.)

Co-accused involved in other proceedings.

The court will look objectively at the facts and will not accept the prosecutors subjective view of proper expedition in a matter.

Even where unavoidable delay in bringing on the hearing can be foreseen, proceedings should be instituted promptly.

Earlier we suggested that by their attitude to delay, the courts had provided part of the solution. Old and mismanaged cases will not be heard. At least as far as the citizen is concerned the court's approach ensures some justice. But the solution creates great pressure on the law enforcement agencies. Without massive injection of resources, which seems unlikely in the short term, or a highly streamlined approach it is possible the only way most major cases will end is with an application to stay proceedings.

Investigators, prosecutors and administrators, require a much less dramatic solution. There is a real need for those persons who are prepared to flout the criminal law on a major scale to be brought to book. Equally there is a need for those civilly wronged to be able to obtain redress. No society that can deal with petty offenders against its rules but cannot effectively handle major transgressors can expect to prosper. Not very long ago we heard a popular

rumour to the effect that to avoid prosecution, if not detection, criminals only had to operate on a sufficiently large scale. The artificially created paper chase is a well known device of both the criminal and commercial world, we have to have systems that can render it ineffectual where necessary. It will not benefit any one of us in the long run if that rumor becomes fact.

What then is to be done

We suggest that there are short term solutions. Not universal solutions and not absolute solutions but methods and attitudes and applications of current technology that can overcome many of the problems.

Before advances are able to be made, many, if not all, preconceived ideas have to be forgotten. The methods we all developed over the last decade or so to deal with the harder cases have to be revised—

> Firstly we must look at the use of resources. Resources are difficult to obtain in most areas but they are completely wasted if they are inadequate for the task in hand. In these troubled times, half a job, three-quarters of a job, or even nine-tenths of a job is not better than none.
>
> Secondly it is important to reappraise the traditional approach taken to the gathering of evidence. It is not vital that every available piece of evidence is collected, collated and evaluated . . . not every witness has to be proofed, spoken to or even identified. Quite clearly if that is attempted, even a merely large case, will soon become out of control and worse, uncontrollable.
>
> Thirdly not every criminal has to be caught and charged and there is no obligation to throw the proverbial book at those who are charged. It is of little value to the community if all the players in a fraud are investigated, arrested and charged but the system is unable to handle the additional steps necessary to obtain convictions.

Our experience with major case management involving corporate crime was gained from the time we joined Roger Gyles in late 1982. It continued unabated until we resigned from the office of the Director of Public Prosecutions in early 1987. We have experienced the 'pre-Gyles' era, the 'Gyles' era and the 'post-Gyles' era.

The office of Special Prosecutor to which Roger Gyles was appointed in September 1982 was established to investigate and prosecute those involved in the tax avoidance schemes colloquially known as the 'bottom of the harbour' schemes. After initial problems, the resources available to that office were quite remarkable, at least by comparison to those that had hitherto been available in the federal sphere and in law enforcement agencies generally. We do not believe that the reasons for this commitment are open to debate; there was strong political commitment. many will remember the lead up to the federal election which saw Robert Hawke become Prime Minister and recall—

> The McCabe/Lanfranchi report;
>
> The black box sales tax scheme;
>
> The allegations, by both the media and the opposition, of government inactivity;
>
> The Government response; and
>
> The Costigan revelations.

Political parties went out of their way to promise action and commitment, and why wouldn't they? The bottom of the harbour schemes alone involved over 6 000 companies and about $800–$900 million in fraud on the Commonwealth. From humble, tentative beginnings in the early 1970's it had become probably one of the largest growth industries by the end of the decade. The media kept tax avoidance an issue and although not pursued as rigorously these days, the topic is still revived from time to time. It should not be forgotten that the bottom of the harbour schemes were not the only ones around at the time. It would be naive to think, that because there is no current hue and cry, organised tax avoidance/evasion has ceased or is on the decline.

The Special Prosecutors Office provided an opportunity for those involved to investigate and prosecute massive documentary cases without the crippling effect of completely inadequate resources. Over 500 search warrants were executed and literally millions of documents were seized or otherwise obtained. The office operated on a multi-discipline team approach; combining lawyers, police officers, taxation officers, financial investigators and clerical support staff in operational groups. A management committee comprising the Special Prosecutor, two senior lawyers, the senior police officer, the senior taxation officer, the executive officer and counsel assisting was established and met frequently. The marriage of the assorted disciplines worked quite well although it was necessary to devise procedures to assist the resolution of disputes between the teams, members of the teams and various disciplines.

In our experience the most difficult dilemma arises out of the need to make the right legal/management decisions. They are the key to major case management and the importance of having the best possible operators making these decisions cannot be overstated. They take experience, practice and often a lot of intestinal fortitude.

However, once those decisions have been made, and remain to be implemented, we believe the single most useful weapon available to attack major investigation and litigation work is the computer. Used only like a card index a computer can provide significant support, used properly it can be formidable. Even the smallest personal computers can be useful but a moderately powerful machine with a reasonable data base and a well structured retrieval system can save a massive amount of effort. And effort is time . . . and time is very much of the essence.

As a federal office we had free access to a very large FACOM computer located in the Attorney General's Department in Canberra. The system that was originally installed operated on a full text retrieval system called STATUS which is very similar to the STAIRS software developed by I.B.M. and used fairly commonly around Sydney. We set up a series of data bases designed to compartmentalise the information we had, or hoped to get. The idea was that these data bases were to be loaded on a full text basis with all the documents we obtained during the investigation. We used multiple word processing terminals to capture data, running double shifts of twenty-five operators in Sydney for most of the 2-year term, and relayed the information to the mainframe in Canberra electronically every night.

Clearly there are difficulties with using computers, everyone is aware of the horror stories, many have had an unwanted role in them. However, we believe the incredible technical progress and the learning process of the last few years make them mandatory equipment. When we were in the Special

Prosecutors Office we were told we had a perfect system. We believed all we had to do was enter our data, shuffle it around and then press the print button and out would come the answers to all our questions. Ignorance was bliss—of course, it didn't work. We fell into a lot of traps, some we knew about, like the need to ensure data integrity, but didn't then know what steps were necessary to achieve satisfactory accuracy. Others were less obvious but equally basic. For example we accepted a system with full text retrieval, it was enormously powerful but we had such a mass of material that it was not possible to capture it all, despite the fact we had 25 data entry operators working on shifts. One afternoon we made a decision not to attempt to put in the material seized in one police operation. We worked out that the decision saved 80 years input time. That was fairly important, the Special Prosecutor's commission was only for 2 years.

One of the most difficult questions facing those about to construct a data base to support major litigation is what form should the retrieval system take. In some matters you may want to be able to recover all or any of the information entered in to the system in a variety of ways, some not even thought of. A full text retrieval system like STATUS where every piece of information has its own 'address' can be manipulated in almost limitless ways. The I.B.M. STAIRS program has similar capacity. Equally you may only want a limited number of identifiable reports with nothing more than an alpha sort. In this case most of the good word processing programs would suffice. You have to consider time and resources . . . its no good attempting to set up a huge unstructured data base which requires skilful searching if there is not time to get the material into the system, or perhaps, to train staff in searching techniques. That may sound obvious but it is difficult to obtain reliable advice about the capacity of any system. By the same token the strictly formatted approach requires much greater intellectual input at the initial data capture stage but it makes for much easier retrieval. One of the great debates in this area went on between Mr Costigan Q.C. and Mr Gyles Q.C. and their staff. Mr Costigan (or at least Douglas Meagher Q.C.) strongly advocated the use of formatted material. Although oversimplified to make the point, the approach was something like this: his officers examined documents, made judgements about the contents and where appropriate provided summaries for capture. Only a small proportion of the available material was held on the computer. From an investigator's point of view the primary objection to the approach was that at the early stages when the officers were looking at the documents they didn't necessarily know enough to recognise all important information and once summarised it was unlikely to see the light of day again. Of course, there were also problems guaranteeing consistency between the various officers. A major objection from the information management point of view was the restriction on information retrieval.

The approach taken by Special Prosecutor Gyles was diametrically opposite. All the information was put into a very powerful system in a raw form. The idea being that it would be available at all stages of the investigation, the intellectual input would come in towards the end of the investigation when sophisticated search techniques would be used to retrieve required information in a useful form. Whilst the approach answered the objections to the previous system, as we said earlier it was unworkable because of the volume of material on hand and unrealistic expectations about input rates. Recent studies on full text retrieval systems have concluded that, at least, when dealing with major cases, the effective retrieval rate is about 25 per cent. Suffice to say that a

compromise between the two provides a satisfactory starting point for most designs, but because of the importance of the question and the horrendous consequences if an inapt approach is used, the problem has to be carefully considered.

The bottom of the harbour work commenced by Roger Gyles Q.C., was carried on by the newly appointed Director of Public Prosecutions, Mr Ian Temby Q.C., when Mr Gyles' term expired in 1984. The balance of our experience with computers in the public sector occurred in the Sydney office of the Director of Public Prosecutions (D.P.P.) where we spent most of our time post-Gyles. The D.P.P. in Sydney, now an office of around 150 people, operated out of the premises previously occupied by the Special Prosecutor, so the automated Litigation Support System (L.S.S.) developed in the S.P.O. was already in place. When the D.P.P. assumed responsibility for the mass of prosecution work previously carried on by the Attorney General's Department we decided to use some of our data processing capacity to handle file management. As a result of a lot of hard work by some of the staff and cautionary tales from those of us who had survived the Gyles experiments the system now in place is an excellent advertisement for A.D.P. systems as management tools. For completeness I should say the D.P.P. also uses several small structured packages to provide assistance with revenue fraud matters and in the civil remedies area.

It is our view that the introduction of automated data processing into the law generally and L.S.S. particularly is inevitable. There are a plethora of reasons why this should be so, but if any of you doubt it, ponder the history of the workhorse of the office photocopier. Today they are common place, taken for granted, yet when they were first introduced into commercial use they met with tremendous resistance, they were labelled unreliable, uneconomic and generally untrustworthy—a familiar cry. The same probably applies to calculators, dictaphones, word processing machines and commander telephones.

The sheer volume of documentation in major fraud cases is such that without automated assistance these cases would be under investigation and preparation for inordinately long periods of time. Many matters would be stayed as a result of the principles enunciated in cases like Cambridge Credit. In short, without automated assistance these matters probably cannot be dealt with in an efficient, effective and appropriate manner.

The following summary of the development of computer support systems in cases we have been involved in may be of some assistance to others faced with similar tasks in the future. Originally we identified the tasks to be performed as:

(1) record property and identify relevant document types;

(2) analyse documents;

(3) present a subset of the documents as a 'brief' of evidence to court.

The approach initially taken, to perform these tasks, with necessary variations from case to case, was basically as follows:

(1) Document lists (prepared by Word Processing) were produced. These lists contained information such as the document number, type, name and some textual data. This was usually followed by . . .

(2) Where appropriate, documents were entered in either a structured or full text form into specially designed data bases in the STATUS system. STATUS was then used for searching purposes. The following difficulties occurred: (a) where more than one document detailing similar information had been input and misspelling of names had taken place; (b) where (due to inflexibility of STATUS) it became necessary to update data and generate reports; (c) because the recall rates for large textual systems are low.

However, as we gained more experience and refined the systems the need for full text searching became less and less and occupied only a minor percentage of time taken on overall searching. The later cases adopted a more flexible approach and thereby avoided many of the problems previously encountered. The S.P.O had a powerful Wang system and catalogue and reference information about the documents were held on this system. The document content itself, however, was still kept in textual form and transferred from the Wang to STATUS for searching purposes. This approach was refined even further as time went by. The catalogue and reference information support was extended to incorporate data validation, reporting, enquiries and generation of exhibit lists. Also the information kept on STATUS became more structured according to document type, the case and the data subject. In STATUS, each article (usually corresponding to a physical document) was consistently input into structured data bases. The use of 'key' fields (which further structured the data) also made it easier for searching, sorting and generating spreadsheets of selected information. This was about the stage of litigation support in 1986 and it probably represented the state of the art at that time.

However, we realised that even this approach had some problems. The Wang utilities whilst better than STATUS were still very limited. It was still difficult to validate data, link data from seperate files, add or delete fields and generate all the types of reports investigators, lawyers and management required. The STATUS data bases are perhaps as good as they can be. However, they have limitations. The most obvious being their inability to handle structured data. For example, some documents repesent information in a very formalised way, e.g., Corporate Affairs Commission [C.A.C]. documents show the name, capacity and relevant dates for people involved in companies. STATUS does not take advantage of this structure and relatively, or what should be relatively, straightfoward information cannot be as expeditiously retrieved as is possible. Obviously this does not unduly concern the skilled users but it does necessitate training and practise.

In summary, at the beginning all information was stored as free text (a form of 'photocopying' the documents into the computer data bases) because there was little indication, at that stage of the cases, what the documents contained or what facts would be of interest or revelance later. As the matters became more clearly defined, the data bases were structured to an increased extent to facilitate searching of relevant facts and to save on input time. It became quite apparent relatively early that many lengthy documents (e.g., sale agreements) were highly repetitive and that only select data was of interest (e.g. date, consideration, parties, etc.). However, STATUS was still being used to handle what was essentially structured databases. This allowed the DPP to take advantage of all the facilities that a structured database system possesses while retaining the enormous flexibility of searching on STATUS.

When time permitted a review of the system was undertaken and new techniques applied. The need to review was made more important when the D.P.P. became active in the area of Civil Remedies and consideration was being given to using the power of the machines to assist in locating, freezing and ultimately forfeiting the proceeds of crime. The techniques now involved rely more heavily on analysis of the content of each document and class of document. Information is predominantly entered in structured form rather than full text. This is possible because a lot of the work now performed by the D.P.P. involves documents of a formalised kind (i.e., they convey specific facts in a standard form, e.g., bank statements, cheques, C.A.C. documents, memoranda of transfer, etc.). The office also acquired a development tool called SPEED 11 which improved the linking facilities and made data validation, report generation, maintenance and modification easier. This has made the search, link and relate capabilities of the L.S.S. even more powerful particularly in analytical and investigative work. STATUS still retains a strong role because some data demands full text entry, the majority of the staff are experienced in using STATUS and competent with full text retrieval systems and STATUS is available nationally, whereas the Wangs are not yet networked. For these reasons the system is 'backed up' by reproduction of all material, both structured and free text data on STATUS. Users can then search on either STATUS or through the local Wang system.

Our enquiries have not revealed a more effective system to assist prosecutors and although that covers an admittedly small field, our experience during the developmental stages should prove useful to all players in any major litigation. The power in the system is not just the function of having all the information in an easily retrievable form, it comes from the ways in which the information can be shuffled around and cross matched.

Computers would clearly assist the investigation and prosecution of those involved in corporate crime in at least the following areas:

pre court document control;
records of exhibit/M.F.I.s;
witness control;
transcript;
case management; and
current awareness.

1. *Pre court document control*

The foundation of any major case involving masses of paper is the control of that paper. If you do not have an effective control system you will end up in a mess. We found that there is a need to ensure as far as possible that investigation support systems are designed with litigation in mind, even things as basic as ensuring compatibililty between systems. Until quite recently it was a fact that the three major law enforcement agencies in the federal sphere, the Australian Federal Police, the National Crime Authority and the Director of Public Prosecutions Office all used different computer support. Whilst data bases used for investigation will usually contain far more information than is required for a L.S.S., much of the information will be common. Statements from witnesses and relevant details like addresses, availability, etc., will be recorded. Documents, their contents, pedigree and source will be recorded, details of activities conducted under statutory authority (search warrants/listening device warrants, etc.) could be included. In short all the briefing material will be held in a machine readable form.

If that material can be simply lifted off the investigators' computer and read by the prosecutor's litigation support system there is an enormous saving in both time and money—if a conversion program has to be written it will take around 4 to 6 weeks even if all goes well, and all rarely goes well, especially if there is a panic on.

A little less obvious is the need to capture the data in a form that will facilitate dual use. For example, the system adopted by the investigators for recording document source and continuity has to be adaptable to the later requirements of prosecutors and courts or all the information will have to be rekeyed.

It is the need to control documents during all the pre-court shuffling that makes the use of the litigation support systems important. In major document handling exercises in the D.P.P. where no other system is in place, each document is given a computer generated number. This number is keyed into the data base and is used to record the source and all movements of the document. It also forms the basis of a code within the L.S.S. for identifying the relevance and importance of the particular document as the understanding of the case develops.

2. *Exhibits/MFIs*

This is an area where the infallible memory of the machine is best demonstrated and because of the heavily structured nature of the data, problems of retrieval that are apparent in full text systems, are not or should not be apparent. Even so there are several matters that have to be addressed. The prosecution has to be prepared to provide lists to the court and the defence, accordingly the lists have to be absolutely accurate. The courts have to be flexible enough to allow for prepared exhibit lists that do not necessarily follow the course of the evidence, and will often contain multi-lettered codes for each article. These codes will often only be meaningful to investigators or prosecutors but they have no sinister or unreasonable purpose. Although irrelevant, they should be explicable. Usually consisting of numbers and letters that identify for example—source, date, data capture, relevant charge, etc.

3. *Witnesses*

Obviously if you are using a L.S.S. all witnesses will be entered. The L.S.S. enables the details to be resorted in various ways to assist in whatever planning is deemed necessary. It can provide check lists for subpoenae, write a diary of available dates and sort them against court days, it can sort against charges, record effectiveness or departure from proof, list all relevant documents for a given witness, check all expenses have been paid. In short a properly set up L.S.S. can assist with all the little things that have to be done before during and after a case—but it can do it all without error or overtime.

4. *Transcript*

There is room for considerable debate about the capture of transcript in L.S.S. To date the only transcript we have seen on L.S.S. has been typed or captured by optical scanners after the court transcript has become available in hard copy. The evidence has been taken, reduced to writing, reiterated in court—often the statements are produced, taken down either in shorthand or by typewriter, reproduced and disseminated. THEN it is rekeyed into a L.S.S.

There's a lot of double handling. Personally we favour a system where the courts key directly into a system that provides the material in a common machine readable form. However, we saw little enthusiasm for any change within the courts' system. We could understand such an attitude if the transcription services were effective, but there are many cases being held up for substantial periods just because transcript is not available. Recently we were told that to obtain a transcript in writing of the entry of default judgment would take 12 months. We find such an obvious saving in time and materials in having the court reporter typing straight onto a word processing machine that can provide parties with the material in electronic form almost immediately, that we see little arguments of merit that can be advanced by the detractors of the idea. Such a system could be instituted without addressing the L.S.S. question. If the transcript is to be taken in such a form that a L.S.S. could load it directly onto a data base some thought has to be given to the structure. For example, if the usual heading showing the parties is used on each page of the transcript it is difficult to sensibly search the data using one of those names. Likewise it is necessary to provide key fields to allow simple searches for things like exhibits and articles marked for identification.

Proper handling of documents in court has always been a problem in large cases. In some of the 'bottom of the harbour' cases we used overhead projectors and large screens to display the documents to the juries. All the relevant documents has been photocopied onto transparencies and were displayed at appropriate times during the case. There is little doubt that this sort of presentation speeds up hearings and enhances the understanding of the jury. However it is expensive and labour intensive. What is requried is a system whereby documents held in a L.S.S. data base can be identified and displayed by use of a terminal in court. It is now relatively easy to generate a visual image of any document held in a data base—in other words the technology is available and whereas it was extremely expensive a couple of years ago there are now small effective and cheap units on the market. One thing we should mention is that it is possible to separate data bases within a L.S.S. thus enabling a single system to be used for multiple purposes; for example in a case in Queensland where the Supreme Court proved fairly receptive to computer assistance the judge was provided with a terminal which had access to the S.P.O./D.P.P. L.S.S. He had access to the transcript and to the exhibits/M.F.I.'s but all the investigative material was locked off.

5. *Case Matter Management Systems*

Basically these systems are structured data bases that can be used for daily management and control of files. Typically they can generate reports and statistics in a variety of forms. They are excellent devices for preparation of information in an arranged form, in a legal administration area things like Parliamentary reports and comparative sentencing figures come to mind. (It could easily incorporate any other statistics you may need in your particular practice—e.g., verdicts, number of trials, number of fraud cases, amount of fraud, length of hearings, etc.) A good system acts as a file tracking device. It enables you to find out the current position of a matter. It also allows for exception reporting on any number of matters including for example, matters that have not been actioned for a period of time, court hearings that have not been allocated or briefed and are pending, etc. It is a relatively simple system to establish provided the proper staff are put on the task to ensure the fields of

relevance to your particular type of work are identified and provided for. There will be differences of emphasis between your requirements and those of another office organisation, court, etc. You must ensure that your fields are unambiguous and clearly understood by your input operators.

These simply structured systems can be used to assist in many areas for example: post-court procedures and diaries. If the system has been properly structured and maintained, things like returning exhibits, paying witnesses, and generating reports can all be done by the push of a button, If not done the machine can alert you. Diaries are another area. It is easily possible for a computer to organise your own or the court's diary. All dates can be accessible via terminals so parties can access the courts terminal and settle dates. The court lists can be generated and maintained very effectively by machine.

There are other areas where the power of these machines could be very useful; things like preparation of appeal books, compilation of sentencing statistics and extraction of common material from a variety of cases come to mind.

6. *Current Awareness System*

By this we mean a system to cope with specialist data along the lines of CLIRS. We believe CLIRS is a valuable concept but at the moment it is going through some teething problems. It may be that these problems will not be overcome or that they will not be overcome before many users and potential users have been turned off sufficiently never to return. One apparent problem is the effectiveness (or lack of it) of retrieval in full text systems. Another is that it may be too broad or cluttered for most users' needs. Many lawyers operate in specialist areas of practice. They do not need the enormous amount of information that is stored in CLIRS and, indeed, it is probably not efficient in either cost or time for inexperienced operators to search through mountains of material. What many of those involved in pursuing corporate crime want is a subset of information relevant to their particular specialty. The on-going development work by those behind CLIRS into such assistance tools as IQ and RANKING of answers may assist but until the techniques are perfected and verified and the cost is more affordable (currently we believe about $20,000) you may consider the establishment of in-house data bases using experienced lawyers to select matters for input and to preside over quality control. These systems could be textual, structured or mere indexes leading to hard copies stored in another area (e.g. the library). They could include such material as advices, unreported judgments, office policies/directions, precedents pleadings, material on obscure topics that are unlikely to feature in textbooks or authorised reports. It may be that some people are involved in a developing area of the law such that reports, text books may not catch up with developments for a while and the most effective way to keep abreast or ahead of the pack is to establish a specialised data base at least until matters stabilise (e.g., Mareva injuctions, proceeds of crime, etc.).

One matter that must be addressed and constantly borne in mind is security. To date security is a major problem which has not received the consideration it deserves. This neglect has made all systems vulnerable and extremely expensive to protect to any reasonable degree. The phenomena of hackers is well known. But the problems have been recognised within the industry and it is likely the machines will soon be able to recognise intrusions and deal with them at least to the extent that the data is protected and the attempted breach is recorded.

In relation to computer support we caution against investigators and lawyers being at the leading edge. There are many dangers in being at the forefront of technology. We also do not believe that systems should be developed in isolation. In some respects there appears to be a competition going on. In this area a united front and shared ideas are essential.

In this paper we have outlined some of our experiences and ideas for the conduct of major fraud work. Hopefully, it provides some ideas for investigators, prosecutors and others involved in this area. In case we have given the impression that we believe A.D.P. systems provide most of the answers to the problems of handling corporate crime; that is not the case. In the short term, policy and legal management decisions are the most important. They have to be right or everything else will be an exercise in futility.

However, we believe that in the long term, EDUCATION is the only solution. Whatever label you apply to the problem be it corporate crime, organised crime or economic crime, the only effective answer lies in ensuring the public are fully aware of the facts. For what it is worth we believe the media have the power and a responsibility to provide those facts.

Today an objective observer, noting the tremendous harm organised criminal enterprise is doing to the economy and the people of Australia could be forgiven for thinking either that there were no weapons available to fight these crimes or that there was no interest in deploying them. Clearly law enforcement agencies are having only a limited effect—and without some dramatic changes they will never be really effective. In practical terms the available resources are completely inadequate, and some of the heralded improvements provide nothing more than window dressing, it also seems clear that there are people in authority who have no interest in deploying the weapons and don't care whether or not they are effective.

There are two very important questions that follow from the above; firstly is it possible to establish effective measures against organised crime? and secondly if it is possible why aren't these measures in place and operating successfully?

As to the first point there is little doubt that adequate measures to combat organised crime could be established. There would need to be a greater commitment to modern devices, things like motor cars, telephone systems and computers. Of course time and resources would have to be devoted especially in relation to the introduction and programming of computers. Criminals are using computers and engaging experts to advise them on programming and the like. Attention must be given to compatibility and that the right systems are put in place. People must be employed or used who understand law enforcement and appreciate the requirements. It would require greater funding than is now given and would be honestly unpalatable to some. The measures would certainly receive a lot of attention from various special interest groups but there is nothing new or mysterious about them. This country certainly has sufficient people with the standing and expertise to design the powers and procedures that would be necessary. Whether everyone would be happy or even prepared to see the powers implemented is yet another question.

One thing that has amazed commentators in America is the public apathy about the organised crime problem. Australians appear no less apathetic to the problem. Yet even assuming that this apathy may be related to the so called victimless nature of organised crime and, in our case, to the notoriously

relaxed attitude attributed to many Australians, the degree to which this community ignores organised crime is fascinating. There has been no shortage of warnings. Royal Commissioners, judges, senior law enforcement officers, academics, and many others have attempted to get across the message that ORGANISED CRIME HAS OR WILL INFILTRATE EVERY ASPECT OF LIFE IN THIS COUNTRY UNLESS DRAMATIC STEPS ARE TAKEN TO ERADICATE IT. Overseas experience points to this and most knowledgable observers have confirmed the trend. But no one, outside a small group, seems to care. Why not? How can anything so serious be ignored. It can only be because the public do not appreciate the extent to which they have become victims of these victimless crimes. Therefore it must be part of the solution to educate the masses. EDUCATION of the public is fundamental to any attack on organised crime, starting with adult tax payers; once they accept that major crime has an economic effect that they are paying for the lifestyle of the criminals by tolerating a lower standard of living for themselves, perhaps then their attitude will change.

Action from the citizens has to be translated into action from the politicians, but until public concern reaches the point where politicians believe their very existence depends on a proper approach to this problem it is unlikely anything really effective will be done. Organised crime relies on corruption of those in power to further its ends. Quite obviously exposure of corrupt officials or members of a government can cause serious embarrassment. Accordingly it is unlikely a government of any persuasion is going to welcome procedures that probe too deeply. If it is possible to get away with it the best political answer is to create the impression that something is being done without actually risking votes—to lull the voters into a false sence of security. It is of course pathetically easy to appear to be doing a great deal without achieving anything. One classic method is to create a body to deal with a particular problem; shout about the creation from the roof tops and then quietly let the body die from lack of nourishment. Another old favourite is to establish a Royal Commission. Such bodies always provide a mantle of respectability and, while they are current, provided a convenient gag or cop-out. One can always say that the Royal Commission is looking at that matter and that is the appropriate forum for it. If a commission makes any serious recommendations it is always possible to simply shelve them until a later stage when the debate has run its course.

We say that the first step in the fight against organised crime is the reversal of the TANVIC principle. We coined the term TANVIC at a recent seminar conducted by the Commonwealth Secretariat in a light hearted attempt to get across a very serious message—that at present there are no votes in crime. Many people may not realise this. Indeed when we were with Roger Gyles and later with the D.P.P. we presumed that the issue of corporate crime was of great importance to the public, that it swayed politicians, that it counted in elections. All of our colleagues felt the same. We were wrong! Organised crime was not an issue in the last Federal election despite some attempt by, at least, one group to make it one. I believe that there is a tendency amongst most of us who know the importance of the fight against organised crime, who are part of the fight and who are therefore concerned about it—to believe that the community shares our views and echoes our concerns. They certainly should! It is even probable that they would—if the facts were fully and properly before them and if they were kept in front of them. Once the reality is out, once everyone realises that we are not dealing with modern day Robin Hoods but with cold, hard, calculating and ruthless criminals—then and only then—will the POLITICIANS

have to do something other than pay lip service to the problem. However, we are not saying that if by some miracle a successful education program creates a community of informed and concerned citizens that the fight is over. That is really only a necessary preliminary.

What has to follow is the implementation of a comprehensive strategy that can be effective NATIONALLY. Like others we have given considerable thought to the design of a proper strategy. However, there is little point in pursuing any of these ideas until there is demonstrable political will and unity. Promises of action, assertions that matters are being considered or suggestions that we are getting on top of the problem will only serve to prolong the present agony.

This quotation from Alice in Wonderland is apt:

"If seven maids, with seven mops
Swept it for half a year
Do you suppose," the Walrus said
"That they could get it clear?"
"I doubt it" said the carpenter
and shed a bitter tear.

PRESENTATION OF PAPER

Bryan Rowe

It may seem a little unusual for a solicitor from private practice to stand up here and address you on this topic. I should perhaps explain for those of you who know nothing more than that I am a partner in Griffin Rowe & Associates and am perhaps wondering why I am here. Let me provide a little bit of background before I go into my speech.

Prior to the recent establishment of our practice I was a Senior Assistant Director of Pubic Prosecutions in Ian Temby's Sydney office. My partner Terry Griffin was a Deputy Director in that office and we both had been federal prosecutors for some time. We also came to the D.P.P. from the office of the Special Prosecutor, Roger Gyles Q.C., where we had been dealing with the bottom of the harbour tax avoidance cases. So I do have some credentials to be here. Until the most recent *Times on Sunday* article I thought the one area that was common to all commentators on commercial crime was that it constituted a massive and a growing problem. If Ian Temby Q.C. was correctly quoted in that newspaper he does not share this view, at least insofar as the federal arena is conerned. If he is right in his assessment that he is on top of the problem, and it would be great if he is, it is very comforting. It clearly reduces the areas we all have to be concerned about. But despite that publicity and some impressive recent coups by various law enforcement agencies we still believe that there is a great deal of major commercial fraud around. However, it seems that the amount of fraud and its cost to the community, are difficult to quantify. Funnily enough we were recently taken to task for repeating as a possible guide a range of figures we had extracted from the Parliamentary debates on the Australia card. The figures we used were much starker and more informative that those used in that debate because we translated them into dollars per week. We found that percentages of Gross National Product are apt to be a wee bit confusing but then we were told that 'no one knows how much fraud is costing'. If that was not so serious it would almost be funny.

Of course, cost is only one of the unknowns about commercial crime and that leads me to what we see as the long term solution and that is *education.* We believe that informed debate is a necessary adjunct to the fight against crime generally. It is a matter of some regret that many who know what is happening in this area are not prepared to speak out. Perhaps they are concerned about the possible repercussions. Public servants are vulnerable, Costigan was roundly criticised, Roger Gyles had some monumental brawls, and even investigative journalists seem to suffer. It is strange that in this society commentators that publicly express concern about crime of any nature and suggest that more should be done are immediately branded as 'nutters', 'zealots', 'cynics', 'whistleblowers', or just plain uninformed. This seems to be particularly so if the commentator has just left a job as a Royal commissioner, or as a judge, or as a senior law enforcement officer. Hopefully I will have time to touch on the long term importance of education and informed debate before I close.

But first to the short term. The problems facing those charged with policing corporate crime are myriad and complex. Although there are special difficulties in many areas there are also problems that are common to most agencies. Things like limited inter-agency co-operation, poor case management, and woefully inadequate resources seem to recur with monotonous regularity as do ineffectual legislation and artificial boundaries. It would be simplistic to

suggest that all or any of the problems can be solved by streamlining procedures yet there are many areas where experience and careful planning can save both time and money.

When we first went to work with Roger Gyles Q.C. who was appointed a Special Prosecutor to investigate and prosecute the tax avoidance schemes commonly known as 'bottom of the harbour' matters we were almost overwhelmed by the magnitude of the problems we faced. It is no secret that the resources eventually available to his office were remarkable. At least in comparison to other law enforcement agencies at that time. But in the early days we had little to work with and a great deal to learn.

Much of the credit for the final successes of the prosecutions must go to Mr Gyles, but, as an aside, without political will, even he could not have achieved much. The fact was that the tax avoidance schemes had become a public issue, media generated awareness created a situation where the Special Prosecutor's Office had priority and throughout his term Mr Gyles maintained quite a high media profile.

For those involved his office provided an opportunity to investigate and prosecute massive documentary cases without the crippling effect of completely inadequate resources. A rare luxury that presented an unique learning experience. During its 2 years of operations the Special Prosecutor's Office developed a highly specialised team of major case managers. Techniques for employing multi-discipline teams in handling the masses of documents and complex litigation were developed, refined, and polished. Automated data processing systems were designed and widely employed and I am happy to be able to report that after much money, time, pain and suffering, these systems actually worked effectively.

Towards the end of the term the better operators in the office could control and direct the presentation of the cases almost regardless of size. It is a shame that much of that experience has been lost, or at least is not being fully utilised. Many of the people with the expertise which is certainly rare in Australia, and may be equally rare in the rest of the world, are now spread across various administrative jobs, assorted law enforcement agencies, and private practices.

Just to refresh your memories the Special Prosecutor's Office was responsible for investigating tax avoidance schemes involving over 6 000 companies and about $800–$900 million worth of fraud on the Commonwealth. During its time more than 500 search warrants were executed and literally millions of documents were dealt with. The Office operated with multi-discipline teams involving lawyers, police officers, tax officers, financial investigators, and clerical support staff. I should stress that although the resources were substantial they were not infinite. The differences between the SPO and most other law enforcement agencies that are traditionally pleading for more resources was only one of degree. There was no way that everyone involved in the schemes could be dealt with or even examined. Priority still had to be set, difficult management decisions about targets system and staff had to be made. *Time was still the enemy.*

It is not difficult to turn a small straightforward case into an old minor disaster. However, it is very difficult to *prevent a large complex case from turning into and old major disaster.* When you are trying to manage these large cases every step in the process from investigation to prosecution seems destined

to maximise delay. For a variety of reasons IT TAKES TIME for most large fraud matters to come to notice. Often the crimes are victimless in the sense that all of the participants benefit, in others the victims are unaware that they have been victims. Frequently, especially where companies are involved exposure as a victim may be seen as counter-productive. Once discovered, IT TAKES TIME to investigate these complex cases. Investigators need to go to the experts and expertise to identify the issues. Witnesses, those shy unaware involved members of the public, are often difficult to track down and seem to suffer from either shocking memories or lack of knowledge. Some become unavailable for bizarre reasons. One I had dealings with, married one of the defendants the day before she was due to give evidence.

Repositories need to be identified, searched, and relevant evidence seized or otherwise obtained. IT TAKES TIME to review the material to create systems to manipulate the masses of information and to prepare the evidence in a form that can be understood by prosecutors, courts, and juries. Finally, IT TAKES TIME to get matters of this nature to and through the court system. All the separate phases have to be carefully controlled. Where any one phase takes over the case managers, and it happens frequently, the results can be disastrous. Cases like the Chelmsford Hospital matter, Cambridge Credit, and Negri River come to mind. Without strict controls the prospects of mounting a successful prosecution in a major case are becoming quite remote. Clearly long delays are unfair to those accused of offences, and unacceptable to those charged with the administration of justice. The courts have provided part of the solution by deciding that they will stay proceedings where there has been unjustifiable delay. Accordingly all agencies will have to re-evaluate their old cases. But what of today's scams? They must not become the 'too old' cases of 1997. How can they be effectively managed without a very unlikely massive injection of resources?

We know of no panacea, but suggest there are some short term solutions. Not absolute solutions but methods and attitudes and applications of current technology that can overcome many of the problems. Before advances can be made, many if not all, pre-conceived ideas have to be forgotten. Firstly, we must look at the use of resources. Resources are difficult to obtain in most areas, but they are completely wasted if they are inadequate for the task. In these times half a job, three-quarters of a job, or even nine-tenths of a job is not better than none.

Secondly it is important to reappraise the traditional approach taken to the gathering of evidence. It is not vital that every available piece of evidence is collected, collated, and evaluated. Not every witness has to be proofed, spoken to, or even identified. Quite clearly if that is attempted even a merely large case will soon become out of control, and worse uncontrollable.

Thirdly not everyone involved in a given case has to be caught and charged and there is no obligation to throw the proverbial book at those who are charged. It is of little value to the community if all the players in a fraud are investigated, arrested, and charged, but the system is unable to handle the additional steps necessary to obtain convictions.

Fourthly it is imperative that senior managers maintain an accurate overview, it is even quite useful if the case officers themselves can stand back far enough to see what they are doing. Of course the quality of your observers has to be up to scratch. They must be unflappable, objective, and flexible.

Fifthly, more attention should be given to fraud prevention. Traditionally both government and commerce seem to concentrate on detection, investigation, and prosecution. Yet where proper preventive measures are taken the incidences and cost of crime will be minimised. It is a pity that most organisations are re-active rather than pro-active. In many cases quite simple steps can prevent complex future problems.

In our experience the most difficult dilemma arises out of the need to make the right legal management decisions. They are the key to major case management and the importance of having the best possible operators making those decisions cannot be overstated. They take experience, practice, and at times a lot of guts. However once those decisions have been made and remain to be implemented we believe one of the most useful weapons available to attack major investigation and litigation work is the computer. Even the smallest personal computer can be useful but a moderately powerful machine with a reasonable data base and a well structured retrieval system can save a massive amount of effort.

We deal with computers and our experience with them in some detail in the paper. Computers can clearly assist the investigation and prosecution of those involved in corporate crime in at least the following areas:

- pre-court document control;
- the records of exhibits and M.F.I's;
- witness control;
- transcript;
- case management; and
- current awareness systems.

I should stress that in relation to these devices we urge caution. Most of us do not purchase five or six motor vehicles when one would suffice. Most of us do not blindly accept what we are told by sales staff, nor do we allow our clerks or our secretaries to select our libraries for us. Yet when it comes to computers many people seem to lose all reason. You would be surprised by the number of people who come to us with tales of woe and most of it is easily avoidable.

Please carefully consider your needs, assign a lawyer or an investigator to determine what it is you want. If you do not have the expertise in-house engage outside help but *do not rush in.* Hopefully, the ideas set out in our paper will be of some use to all those involved in the area but we want to emphasise that we are not saying that ADP systems solve the problem of corporate crime. *Clearly they do not.* We do suggest that used properly they provide a very useful tool. But if they are used badly they will be hugely counter productive.

I would now like to take just a little time to return to the long term importance of education and informed debate. We believe that in the long term EDUCATION is the only solution. That the answer lies in ensuring that the public is fully aware of the facts. For what it is worth we believe the media have the power and a responsibility to provide those facts. Several weeks ago in delivering a paper to a seminar on corporate crime organised by the Commonwealth Secretariat I coined a new word "tanvic" in a lighthearted attempt to get across a very serious message! that at present There Are No Votes In Crime. It was the thrust of that paper that the only realistic, long term weapon against organised crime was education. That there was a need to

educate the public about the real cost of organised commercial crimes . . . but that once they understood the facts, once they grasped that they were all victims there would be an outcry and a widespread demand for action.

Action from the citizens has to be translated into action from the politicians, and until public concern reaches the point where politicians believe their very livelihood depends upon a proper approach to the problem it is unlikely that anything really effective will be done.

However, we are not saying that if by some miracle a successful education program creates a community of informed and concerned citizens that the fight is over. That is really only a necessary preliminary step to ensure the resources are available.

What has to follow is the implementation of a comprehensive strategy that can be effective nationally. Like others we have given considerable thought, to the design of a proper strategy. However, we believe there is little point in pursuing any ideas until there is manifest political will and unity. Promises of action, assertions that matters are being considered, or suggestions that we are getting on top of the problem will only serve to prolong the present agony. I thank you for attending and listening and hopefully later we will be able to deal with any questions.

INSIDER TRADING: TIPS FOR ENFORCEMENT

Robert Nicol
Executive Director (Operations),
Corporate Affairs Commission, N.S.W.

During the past several months it has been difficult to pick up a financial newspaper without finding some reference to insider trading. The Ivan Boesky scandal in the United States has certainly brought insider trading to public prominence. It is trite to say that insider trading is flavour of the month. However, before examining the Australian position it is important to fully understand the policy and rationale behind the prohibition on insider trading.

The rationale behind the legislative prohibition is that, to the extent that it is possible, the market shall have a free flow of information. Consequently, persons because of their positions or contacts are prohibited from dealing in securities if they hold information which is not otherwise generally available. It could be said that the provisions impose an impetus for persons to make price sensitive information available. For example, if I was the director of a large public company, and I was aware of a very favourable contract which is likely to increase the value of the stock *prima facie* I am prohibited from dealing in those shares. Therefore, if I wanted to trade I can only do so legally by making the information generally available.

The prohibition on insider trading is contained in s. 128 of the *Securities Industry Code*—

> A person who at any time in the preceding 6 months has been connected with a body corporate, is prohibited from dealing with its securities where he has acquired information in connection with this position, which is not generally available, but if it were, it would materially affect the price of securities: s. 128 (1).
>
> The prohibition on insider trading extends to dealings in any securities of any other body corporate by a person connected with a body corporate, where he gains information by reason of that connection, which is not generally available and which materially affects the price of the securities of the other body corporate: s. 128 (2).

A person may also be prohibited under s. 128 (3) from dealing in securities, where he obtains information from insiders who are themselves prohibited from dealing in the securities by s. 128 (1) and (2).

> Persons who are prevented from dealing in securities under s. 128 (1), (2) and (3) are also prohibited from causing or procuring others to deal in those securities: s. 128 (4).
>
> A person who is precluded from dealing in securities under s. 128 (1), (2) and (3) is prohibited from communicating insider information to any person, where the securities are listed on a stock exchange and know or ought reasonably to know that the other person will use that information in dealing in the securities: s. 128 (5).
>
> A corporation is also prohibited from dealing in any securities, if an officer of that corporation is himself prohibited from dealing in them: s. 128 (6). (However, see s. 128 (7)).

Unfortunately, people who we believe engage in insider trading do not leave a readily discernible trail. We believe that they seek to hide their transactions through a convoluted and tangled web. Tracing the movement of the securities, one would think, is a relatively easy task. Say we are dealing with shares traded on the stock exchange. First we would go to the stock exchange and they would tell us who the broker was, who was involved in the transaction. Then we would find out who the broker acted for. If the client is a natural person, so much the better. We can go out and interview this person and that person on finding out that the Corporate Affairs Commission is hot on the trail of an insider trading prosecution, would no doubt throw his or her hands up, confess all, turn in their accomplices and the case is solved.

However, in real life it may be a little more complicated. We have found that people have sought to hide their activities in many ways. There was the case reported to the Commission of an unusual movement in shares prior to a significant announcement being made concerning the company. An analysis of the share trading showed one broker to be very active and that broker's script ledger card was inspected to determine the names of his clients. A client was selected who had purchased shares before the announcement and sold some of those shares after the announcement. Investigators went to this client's address at Kings Cross only to find no such address existed. The investigator went back to the broker's office and checked the cash receipt sheets only to find that this client had paid in cash, and that for the shares that had been sold the broker had paid the client with a cash cheque. The investigator, assuming that a false name and address had been used, realised that the client could not receive a share certificate so it was obvious that the client would have to have had the shares registered in the name of the broker's nominee company. The broker was requested to contact the investigator when the balance of the shares were to be sold. Shortly thereafter the client contacted the investigator and stated that she had used a false name to avoid tax. However, if the client had sold all of the shares prior to the investigator commencing his inquiry, then it would have been too late to trace the real identity of the client.

Let's just presume that the person we interview has bought shares in some company and there is no apparent connection between this person and the company or officers of that company. Now, this person does not have to talk to us but if he or she does and gives us an explanation, say; "One day I was looking out my office window and I saw a ship and I noted the name of that ship. Several days later I decided to invest in some shares. I look in the newspaper, and lo and behold, I discover a company is listed with the same name as the ship I had seen the other day and I decided to go out and buy that company's shares." Outlandish, isn't it? But that is the story that was given to one of our investigators when he was investigating an allegation of insider trading.

In the *Commissioner for Corporate Affairs* v *Green* [1978] VR 505, a prosecution was launched under s. 124 (2) of the *Companies Act* (1961). Green was a director of two companies, Endeavour Oil and Gwello. It was alleged that at an Endeavour company meeting, Green acquired knowledge that Endeavour was to make a call on it shares. Green with this knowledge, caused Gwello, a company of which he was a major shareholder, to sell 100 000 of its Endeavour shares. Consequently, when the prices fell after the announcement of Endeavour's call, Gwello had avoided a loss.

There was no admission by Green that the sale of the shares was decided on in light of the information gained at the meeting. Green also volunteered the following information, that Gwello had participated in the purchase of shares in another company in order to keep that company alive, that this had placed Gwello in an overdraft situation, that in order to get the company out of the red and out of paying bank interest it was prudent to sell all shares which were not producing income and it was decided to sell sufficient Endeavour shares to cover the situation.

The magistrate ruled the prosecution had to show that the associated company had made the sale of shares in the light of information gained at the directors' meeting. The prosecution relied on the casual connection which could be drawn from the circumstantial evidence, i.e., obtain the information and later the shares were sold, but in the absence of direct evidence the magistrate ruled that there was no case to answer. This decision was upheld on appeal. This case dealt with a person making improper use of information. It is interesting to note the court's attitude in the absence of any direct admission inculpating the defendant.

You might think that we may be able to use some of our compulsory powers to force people to answer out questions, and of course you're right. For instance, we could hold a compulsory hearing by virtue of s. 7 of the *National Companies and Securities Commission Act.* But even though we can require witnesses to answer our questions, if they claim the answer might incriminate them, we can never use that answer in any subsequent prosecution. We may be able to trace the movement of the shares and the flow of information but that evidence gleaned cannot be used against the witness. However, the evidence could be used in a civil proceeding and the Commission, in the public interest, would be prepared to release the information. This has recently happened in a matter that the Commission is investigating.

Another situation which can arise is where trading is transacted through an overseas stock broker. We can go to our local broker to find out on whose behalf he was trading, he informs us that the trading was carried out on behalf of an overseas stock broker. How do we get that overseas broker to become the fountainhead of knowledge and tell us who his client was? Let's say the broker is coy—we cannot compulsorily require him to tell us the information. That broker may assist us only in a limited way. We may be in possession of a number of names which we believe were used by the client in the transaction. The overseas broker may, in the spirit of co-operation, agree not to show us their books, but to tell us if they have a record of the names we believe were used. Now, if we have got the wrong name we are out of luck. Now, you might say nobody would act like that, but one of our investigators received that reception from an overseas broker when he enquired who the broker's client was in respect of a particular transaction.

Other ways of hiding the identity of a client are effecting purchases of shares through overseas companies, and purchasing shares on overseas exchanges.

As stated earlier, the current concern of insider trading got its momentum from the Ivan Boesky investigation. However, it is my understanding that Boesky in fact turned himself in and gave the American authorities information on the acitvities of other insider traders and thus the authorities were able then to secure evidence for subsequent prosecutions making their task somewhat easier.

I have spoken to some Commission investigators in order to try and identify novel ways of investigating insider trading. We came up with the idea of phone taps and listening devices but, as I indicated before, most allegations of insider trading come to us after the event, so it's little bit too late for phone taps or listening devices. One might say, tap phones or place listening devices before the events—well, we would, if someone would be so kind as to indicate to us who is going to pass on price sensitive information—it would also be helpful if you could tell us when and where the information is going to be passed on. Otherwise, we would have to tap the phone of all the traders, company officers and their friends all day every day on the off chance that some titbit of information may clandestinely pass by mouth to ear.

In the United Kingdom, insider trading is regulated by the *Company Securities (Insider Dealing) Act* 1985 (The *Insider Dealing Act*). However, by the *Financial Services Act* 1986 the Department of Trade and Industry has very wide special investigatory powers in regard to offences under the *Insider Dealing Act.* The following six paragraphs are extracts from *Guide to the Financial Services Act 1986* by Rider, Chaikin and Abrams.

> Under s.177 (1) of the *Financial Services Act*, if it appears to the Secretary of State that there are circumstances suggesting that there have been violations of ss. 1, 2, 4, or 5 of the *Insider Dealing Act*, he may appoint one or more inspectors to carry out 'such investigations as are requisite to establish whether or not any such contravention has occurred' and to report the results to him.
>
> If the inspectors consider that any person is or may be able to give information concerning any such offence they may require that person to produce any documents in his possession or control relating to the issuer of the relevant securities or its securities, to attend before them and to give them all other assistance which 'he is reasonably able to give' in regard to the investigation. Inspectors may administer oaths and examine any such person under oath. A statement made by a person in compliance with a request made under this section can be used in evidence against him. Under s. 177 (7) it is expressly provided that information that is subject to legal professional privilege cannot be demanded by the inspectors. Furthermore, under s. 177 (8) banks need not disclose information 'relating to the affairs of a customer' unless the inspectors have reasons to believe that the customer 'may be able to give information concerning a suspected contravention' and unless the Secretary of State is satisfied that disclosure or production of documents is necessary for the purposes of the investigation.
>
> Section 178 (2) of the *Financial Services Act* imposes penalties in case of failure to comply with a request for assistance or for information by an inspector. Where there is a refusal to co-operate, the inspectors are empowered to certify this to the court and the court is empowered to inquire into the matter. If, after hearing evidence from both parties the court is of the opinion that the refusal to co-operate is unreasonable, it may punish the person concerned as if he stood guilty of contempt. The court may also direct that the Secretary of State can exercise his powers under s. 178. Section 178 (2) also provides, most importantly, that the court may so direct, notwithstanding that the offender is not within the jurisdiction, if the court is satisfied that he was notified of his right to appear before the court and of the powers available under this section.

When the court does direct that the Secretary of State may exercise his powers under s. 178 (3) in respect of an authorised person, he is empowered, by service of notice, to cancel any authorisation of this to carry on investment business after the expiry of a specified period. He may also disqualify him from becoming authorised to carry on investment business. Restrictions may also be imposed on any authorisation in respect of investment business during that specified period to the performance of contracts entered into before the notice comes into force. The Secretary of State may also prohibit him from entering into transactions of a specified kind, or entering into them except in specified circumstances, or to a specified extent. Furthermore, he may be prohibited from soliciting business from persons of a specified kind, or otherwise than in a specified manner.

When the court gives a direction under s. 178 (2) (b) in regard to a person who is unauthorised, the Secretary of State is empowered under s. 178 (5) to direct that any authorised person who knowingly transacts investment business of a specified kind, or in specified circumstances, or to a specified extent, with or on behalf of that unauthorised person shall be treated as being in breach of the rules of the *Financial Services Act* or, in the case of a person who is authorised by virtue of his membership of a recognised self-regulatory organisation or recognised professional body, the rules of that authority.

Section 178 (6) of the *Financial Services Act* provides that a person who is asked to provide information or furnish a document shall not be taken to have a reasonable excuse for refusing to co-operate where the suspected offence relates to dealing by him on the instructions of, or for the account of, another person simply because at the time of his refusal he did not know the identity of that person; nor is it a reasonable excuse that he was subject to the law of another jurisdiction prohibiting him from disclosing information relating to that transaction without the consent of that other person if he might have obtained that consent or obtained exemption from that law.

Thus, it would appear that in respect of insider trading matters the United Kingdom government has abolished the right to silence in a major leap forward in the prevention and detection of crime. It just remains to be seen how these provisions are employed and what the effects will be.

Dr Anisman in his paper on insider trading has draft legislation for consideration. This proposed legislation does not contain similar provisions to the U.K. *Financial Service Act.* One wonders in light of the current concern regarding insider trading in Australia whether legislation along similar lines to the legislation in the U.K. should be enacted here.

PRESENTATION OF PAPER

Robert Nicol

The paper that I have prepared which has been circulated provides information about the methods and responses by regulatory authorities concerning insider trading. Now I just wish to get away from the paper and give you a typical example of an insider allegation investigated by the Corporate Affairs.

It is typical of the allegations that we are being called upon to examine. Briefly the facts are: In November of one year the Stock Exchange was advised by the Secretary of company A, let's say, that negotiations between that company and company B had reached the stage where shareholders of company A were asked to consider and approve the acquisition of a number of gold prospecting licences held by company B. The proposal was to be decided at company A's Annual General Meeting to be held in December of that year. A copy of the Annual Report was posted to company A's shareholders and the Stock Exchange, and this included a report on the gold prospects. The shareholders subsequently resolved that company A acquire the interests in the gold licences.

In January the following year the Stock Exchange received a letter from company A advising that samples had been taken from the gold lease and the samples were awaiting shipment. In April of that year the Stock Exchange queried company A concerning fluctuations in the price of its shares from 25 cents in late March to 44 cents after a period of 2 weeks. The price of these shares over the preceding months was as follows: in November, when the Stock Exchange received the notification, the shares traded as low as 6 cents; in December they traded at 17 cents, and in January, the highest, they traded at 16 cents. The company replied to the Stock Exchange stating they were still awaiting information concerning the results of the assay being carried out. The market, however, continued to spiral until company A's report on the assay result was received in late April. By then the shares had reached 65 cents. Of course the report whetted the market's appetite and the shares continued to climb to reach a peak well over a dollar.

The matter was reported to the Corporate Affairs Commission and we commenced an investigation. The Commission obtained from the Stock Exchange a print-out of trading. The print-out totalled 520 pages covering a period of some 16 months, the trading period, which showed the number of shares traded during that period to be in excess of 18 000 000.

The Commission investigators first had to determine who would be the persons most likely to be in receipt of insider information. It was decided that those persons would be persons associated with company A and persons associated with the company carrying out the assay.

An investigation was undertaken at company A and the names of persons appearing in the Register of Directors, the Secretary, and Managers, those appearing in the Minute Book, and those appearing in the wages book of the company were recorded. The same procedure was carried out for the other two companies. A composite alphabetical list was made and armed with this the investigators visited all forty-five stockbrokers and compared this list with the names appearing on company A's script ledger. Whilst examining company A's script ledger the investigators found names of persons appearing as sellers

of shares who one would believe had they been in possession of insider information concerning the impending result they should have appeared as buyers and this whetted the investigators' appetite.

Three of these people that the investigators noted as buyers instead of sellers, had close family ties with the principal, or a principal, of company A. Another was an employee of the principal, and another lived in close proximity to him. Inquiries revealed that none of these people had previously purhased shares on the Stock Market and most of them had used the same stockbroker. It was discovered that all purchased the shares in early November. The Commission investigators interviewed these persons and questioned them concerning their purchases and they were provided with the following explanations.

1. One said that the principal had said; "If you want to invest some money invest in company A. It wasn't a bad investment", but that person, the buyer, was not told anything about company A's share in particular and there was no other reason given by the principal to buy the shares other than "it wasn't a bad investment".
2. Another said "My girlfriend was buying some and I wanted to be part of the action. I did not want to be left out. I felt like investing."
3. Another said "I was owed some money at the time and I was repaid by way of the shares".
4. Another declined to be interviewed.
5. Another said "When I finally got some money I decided to buy some shares. A friend of mine had been at me for years to buy the shares".

As well as this, there had been continual rumour about the shares for about a month before the Annual General Meeting which as I indicated was held in December, and in the following April the daily press was very active in focusing their attention on company A. Articles appearing in *The Sydney Morning Herald,* the *Financial Review, The Australian,* the *Telegraph,* the *Age,* the *Bulletin.* Now, although the principle of company A did not deal in the shares he had suggested to various people that they should purchase shares, but there was no clear evidence that he had told them the reason why they should buy and sell the shares. At the highest it could be said that he had stated that it was a good investment. From that evidence it would be very difficult to found a conviction for causing or procuring another person to deal in securities. Also it would be very hard in those circumstances to sheet home criminal responsibility to the principal of company A because what information did he pass on, to quote the terms of s. 128 of the *Securities Industry Code* 'that was not generally available and was likely to materially affected the price of the shares'? All he had said 'It's a good investment', not that there was a proposed purchase of gold cross leases, and/or the results of the assay.

Even with the close family relationship between the principal of company A and some of the persons purchasing the shares these people did not fall within the definition of associated persons which is the definition contained in the beginning of the *Securities Industry Code* but associated person is also used in one of the sub-sections of s. 128.

The reason I have brought this case to your attention is just to point out some of the difficulties that are presented or that we face. You see the investigation was massive in respect of the fact that there was over 500 pages

of print-out concerning the trading to be gone through and after that there was the script ledgers of the stockbrokers to be gone through. There were forty-five stockbrokers to be interviewed and their records examined and over that 16-month period there were 18 million shares traded. And there were also the evidentiary problems in respect to 'materiality', because that is used in s. 128 and it has never really been defined. What is material? Is it the accountants' standard of material? i.e. a fluctuation of under 10 per cent is not material; is it material to the person who has bought the shares? is it material to the person who trades in the shares? There is no clear definition of that. Also 'associated person'. It did not cover most of the circumstances here, and also we had the difficulty of proving what was price sensitive information. I believe it is some of these difficulties that lead to the Anisman Report, and if you have read the Anisman Report it seeks to define 'insiders' and then the criminal sanction penalties virtually says that any person who deals in insider trading is guilty. That is, to paraphrase, then it shifts the onus on the defendent of proving that he falls within one of the defences. If you have read the paper there is the recent *Financial Services Act* of the United Kingdom. Now that Act came into force last year and they have introduced a very novel way of dealing with this particular problem under s. 177 of the U.K. Act, where it appears, I believe it is the Secretary of the Department of Trade and Industry, that the provisions of the insider trading, or *Insider Dealing Act,* had someone may be guilty of the insider trading provisions the Secretary may require a special investigation to take place, and the special investigator *may* take evidence on oath and examine witnesses and that examination of the witnesses may be used in evidence against them. The only saving provision is that the person may claim legal professional privilege, or a banker, if he is called upon to give his records over to the special investigation, may claim the particular records do not cover or do not relate to the particular transaction under investigation. As I have indicated in my paper it seems that in England they have, for the first time that I know of, got rid of the right to silence in these particular cases. I am not advocating that we do that here but it is a very novel aproach, and I think from my reading that that approach was instigated because of the Boesky scandal with its tentacles crossing the sea to envelope the Morgan–Grenfell matter.

It is a complex area and we at the Corporate Affairs Commission realise that to investigate this particular area we must adopt sophisticated and astute approaches to the problem, and I believe it is desirable now we have more or closer consultation and cooperation between the public and private sector regulatory bodies.

CORPORATE CRIME: A NEW GROWTH INDUSTRY?

Anne Lampe
Financial Reporter
The Sydney Morning Herald

To the layperson reading a sample of sentences handed down in our courts it would appear that while some crime pays badly or not at all, other crimes—particularly corporate crime—is lucrative and goes relatively unpunished.

Take for example the following sample of penalties handed down in recent months and reported in our newspapers:

- a man who collected $340.00 in dole payments to which he was not entitled jailed for six and half years,
- a man who collected $18,000 in dole payments to which he was not entitled was put away for two and a half years,
- a secretary who made 108 false claims for entertainment and meals, totalling $11,000 received 18 months imprisonment,
- a hungry man who stole food worth $9.24 from a West Ryde supermarket gets a $300 fine,
- a security officer who stole $600,000 worth of goods is sentenced to 13 and a half years in prison,
- a deserted mother jailed for 14 days for stealing $1,266 from her employer to feed and clothe her 20 month daughter. In addition she was placed on a $500 three year good behaviour bond and ordered to repay the money stolen in instalments,

and

- two bottom of harbour tax scheme promoters who sank companies with $100 million in assets receive 14 and 18 month jail respectively and both are out in months,
- a company director who lost $600,000 of small investors' money receives a $10 fine and 200 hours of community work,
- a director of an investment company which folds losing all of the $5 million invested by the public is fined $50,000. The maximum penalty is $125,000 in fines plus five years imprisonment. The director is appealing against his 'harsh' sentence,
- a director of another investment company which made over $1 million in management fees in a company unable to meet all its debts, receives a $200 12 month good behaviour bond,
- a director who obtains hundreds of thousands of dollars by making false and misleading statements receives a suspended jail sentence subject to entering into good behaviour bonds for 3 years.

The courts, it seems, are very reluctant to send to jail corporate wrongdoers who wear Ermenesilde Zesna or Pierre Cardin suits into the court and appear to be well groomed and softly spoken, but don't hesitate to slam others without these props and who have committed far less serious crimes netting relative peanuts behind bars. What is more the latter are asked to repay those from whom they stole, while the former plead the company has collapsed, is in the hands of receivers and never appear to have any funds to facilitate repayment to those who have lost their savings. Hardly ever, it seems, are their private asset holdings investigated with the view of using them to pay out

company creditors. Indeed several leveraged currency operators who have recently had their companies close down and who managed to make sure a lot of money was placed off-shore were quite relieved to have a receiver appointed, simply to get the creditors off their backs. No wonder corporate crime—that is offences committed by individuals hiding behind a low capital corporate veil, or their agents, against members of the public, creditors, investors or other taxpayers is growing at an alarming rate.

In recent history, corporate criminals have been most active in bogus investment schemes, leveraged currency and futures schemes, frauds, insider trading, money laundering and computer fraud. The pin-striped Porsche-driving rip-off merchants are having a festival at our expense. Often by the time our undermanned corporate police catch up with them, the principals have the funds safely offshore and have often flown out, first class, to join their money.

One insurance fraudster is living like a king an Athens, hailed as a successful local lad made good abroad and a respected member of the Greek community. The Greek authorities are not interested in investigating him because he appears not to have committed any offences on Greek soil; he did not have to, he ripped off millions from Australian investors and policyholders. Another fly-by-night leveraged currency operator who has operations in two other countries and who fleeced Australain investors of more than $10 million over two years is running around in a red Mercedes, with a different gold watch for every day of the week, quaffing Bollinger and enjoying luxurious holidays at Cannes accompanied by his girlfried, a former director of the same company.

Sitting in on corporate crime cases in court often makes me feel quite ill. The self satisfied smirks can hardly be contained on the faces of the guilty and their lawyers when a piddling $200 fine or good behaviour bond is handed out after days of court hearings by a magistrate doing his best to sound tough and full of admonishing words about how investors deserve the right to be protected from people such as those in front of him. The sentence does not even qualify as a slap on the wrist.

Often I have seen the drama unfold over a period of two years, beginning with spotting advertisements offering outrageous returns, followed by a flood of poignant calls from investors who fear they have lost their retirement money, their deposit on a home or merely their life savings in a company being investigated by the Corporate Affairs Commission (C.A.C.). There follows a lengthy period of bluff from the company concerned, lies, numerous threats of litigation, using often the best firms of lawyers, similar threats against C.A.C. personnel for allegedly providing us with information, expensive court proceedings just to get a judge to uphold an application to seize books and records, or later, to appoint a receiver when the company is insolvent.

The letters of complaint from the company to our editors and to the C.A.C. are written on top legal letterhead, their counsel selected from the top Q.C.'s. There seems to be no shortage of funds for such actions. And always at the end of the day there is no, or very little, money to pay hapless investors. What there is is often swallowed up in liquidator fees. The funny thing is that the principal's life style hardly appears to change. But just getting the principals into court is an achievement.

Fraud prosecutions—particularly those of a sophisticated sham investment scheme type involving a massive paper chase, a web of sham companies and banks and often crooked accountants and solicitors who are only

too pleased to assist, for large fees, in the setting up of companies in tax havens, the purchase of real estate in false names and other money washing schemes—take money, manpower and speed. All three things are often lacking. The Fraud Squad and Corporate Affairs Commission are operating at less than half the strength required to fully investigate all the scams in the market.

They are hindered by bureaucratic processes, such as waiting for up to three weeks to find a typist to process urgent summonses to be served and by outdated and poorly drafted legislation that is drafted to catch embezzlers and the signatories of false cheques, or whose hands are caught in the till, but which often cannot cope with a Cardin-suited individual who on his car telephone instructs his bank to transfer $5 million to an overseas bank account before lunch. The transaction is electronically carried out and effected in minutes.

It is legislation that is drafted in lofty legal offices with no input from the investigators who have to put in the legwork and make the evidence stand up to obtain court orders. Too often these investigators find, after weeks, often months of gruelling work, that the scheme in question just misses out on being included in a definition of 'security' or 'futures contract'.

Often the various agencies that should co-operate—the Trade Practices Commission, the National Companies and Securities Commission, the Corporate Affairs Commission—don't co-operate at senior levels because of petty rivalries. Because of complicated secrecy provisions the operatives cannot pass on useful information to one another without obtaining written permission from a supervisor.

Whilst in television crime programmes, the F.B.I. and Fraud Squad investigators have no shortage of cars and aircraft at their disposal to enable them to get off in pursuit of villains, tight budgets in Australia often mean an investigator has to wait for higher approval to travel interstate. This has, on occasions, resulted in C.A.C. prosecutors asking courts for more time to gather evidence, requests that often attract harsh words from the presiding judge about perceived inefficiencies within the Commission. C.A.C. investigators are confronted with fraudsters with large funds, offering investment packages by telephone in remote areas of Australia. As a result investigators have had to go as far afield as Cairns, Darwin, Broome and the Riverina to gather evidence to be used in prosecutions and even to have a receiver appointed.

As one investigator points out, the law enforcement officers must contend with expensive counsel who throw every obstacle in the way of investigators, including the mass dumping of computer tapes containing client records with solicitors looking on, the best tax advice for moving money offshore as well as cranky judges who need long narratives on complicated currency and futures scams before they can understand the ramifications, but still insist on the sort of perfect documentary evidence that makes it relatively easy to put cheque forgers behind bars. They forget that corporate crime has moved beyond the simple larceny of a cheque or a bank account.

The new wave of scams involve commodity and currency prices that change every few seconds, buy and sell orders supposedly telexed to remote locations, where the orders appear to be executed, but in fact, more often than not, are collected in a bin in a rented flat somewhere in Asia. Try and tell a judge confronted with copies of these bogus buy and sell orders the transaction is a scam and unless you have watertight evidence of the dumping or non-

execution of such orders from another country or a former employee, he often throws the whole thing out of court, while the villains set off to tell potential clients of their court victory and mutate their operation to drag in more money.

Then there are the massive time delays in our court system. At best a simple hearing is obtained 18 months to 2 years after charges are laid. Delaying tactics by the accused or committal proceedings can extend this time framework significantly. When the case is finally heard the judge admonishes the plaintiff for the massive time delays in getting the matter heard, criticises the disappearance of witnesses and the poor memories of those giving evidence and being cross examined.

In order to speed up the system the C.A.C. often proceeds summarily in the lower courts only to find itself under pressure to reduce and simplify the number of charges laid against the accused. In several cases this has resulted in dozens of charges being reduced to one or two, with the defendant subsequently found guilty of or pleading guilty to one or two charges and receiving a lenient sentence, such as a good behaviour bond or fine, because the hearing has concentrated on what appears to be a simple transgression of corporate law rather than the pattern of premeditated fraud and cheating on a vast scale that it is.

In summary I see the main factors contributing to a growth in corporate crime as—

1. Deregulation of the foreign exchange and commodity trading markets which has removed Reserve Bank controls and monitoring from areas previously fairly closely regulated and watched. Prior to deregulation people who wanted to operate currency scams and move large amounts of money offshore had to make up a pretty good story for the Reserve Bank and faced a fair bit of red tape that hindered them. This is not the case any longer. They can now move money around at will with no one monitoring them.
2. Undermanning of the policing bodies and lack of resources.
3. Poorly drafted legislation.
4. The ability, through electronic money transfers and toll free telephone numbers to attract a lot of money quickly from all over Australia from centralised offices with a minimum amount of documentation. It is not uncommon for scam operators to attract $500,000 to $1 million per week from investors scattered throughout Australia.
5. The ease with which top accounting and legal brains forget ethics and can be bought by corporate criminals seeking high powered help which has enabled these corporate criminals to set up a structure of companies and trusts abroad for the purpose of hiding ill-gotten gains. These top legal brains are able to provide top QC opinions about the perceived legality of the investment scheme being peddled, to scream to ministers of big brother and overregulation at every request by regulators for information about a scheme.

How do we tackle this problem?

1. To me it seems that the key requirement is to provide more people and resources to investigate developing scams. The C.A.C. now has an intelligence unit whose objective is to suss out scams before they

attract a lot of public money and so are on the way to minimising losses from investments in, for instance aqua farming, where some scam operators saw the beginning of a big future.

2. The C.A.C. should keep a close check on the activities of directors, principals and company officers with previous histories of failed companies. Such a list should be kept nationally and internationally, so that each State and other countries are quickly informed of former activities of convicted or doubtful business people. The recent initiative of establishing an international register of delinquent directors to be circulated and updated quarterly among Commonwealth countries by the Commonwealth Secretariat's crime unit, is a welcome step in this direction.
3. Educate the public to be more sceptical and inquiring of high return investment schemes. Certainly publicise through press release and ministerial statements suspected scams or schemes under investigation. Hit the press, radio and television. With respect to the press, make sure that the mass circulation papers—the *Mirror,* the *Telegraph,* and the *Sun*—issue information and warnings to their readers. It is after all, their readers who are often targeted by the get rich quick operators.
4. Put convicted corporate criminals in jail and include among those businessmen who plead guilty to frauds and hope that as a result of that plea they might stay out of jail. Most make sure money has been put aside to pay the small fines usually imposed, but given their leaning to high spending, high living, and the veneer of respectability they try to project, nothing better than a two-year jail term, depriving them of all three things, brings them down to earth and serves as a warning to others. Corporate crime is pre-meditated and carefully planned and jail terms act as a deterrent to others in these circumstances if they accept that they may face the same prospect.

As a journalist I see our role in the game as heightening the public's awareness of the sharp practices as we become aware of them through our contacts, through advertisements and from our readers. At considerable risk of defamation actions we aim to highlight dubious practices as early as possible.

We have a large and loyal group of readers who tend to phone us or write to us about their fears and experiences in the investment field. We also get anonymous calls from operators disillusioned with what their employers are doing with investors' money.

The complaints and other information is passed on to regulatory bodies which are in a position to take action. These bodies usually mean the C.A.C., the T.P.C., the N.C.S.C., or the Insurance Commissioner.

In one classic case a fed up employee, owed money by his employer but who also took umbrage at his employer's blatant bucket shop tactics rang me with information and agreed to make a statement to the C.A.C. That same afternoon he accompanied fraud squad officers to his employer's office, where the employer was arrested and charged with conspiracy to cheat and defraud. A receiver was appointed the very same afternoon.

Corporate criminals must be hit in the hip pocket nerve. The authorities must seize their assets, confiscate ill-gotten gains, freeze the funds before they have a chance to be moved offshore where possible, when the scam is identified. As one prosecutor said, keeping the funds at home has a magical effect on keeping the perpetrators in the same country as where their money is.

We watch for advertisements that appear to offer suspect claims, follow them up and try to have them removed if possible. I, for one, fought a long and bitter battle with our revenue besotted advertising department to drop leveraged currency advertisements last year and eventually succeeded in moving them out of the business section. However, they were merely moved to the front of the paper where they were even more visible and to the sports pages, where they appeared to be better suited.

Finally we can give much unwanted publicity to corporate criminals who are trying to appear to their friends to be respectable citizens. By writing up their activities, charges laid against them, reporting on the court proceedings, highlighting evidence and convictions, we probably inflict worse punishment than any fines they are asked to pay. Wherever possible we should attempt to highlight the role of professional advice in the scam.

They say a picture is worth a thousand words. The picture of a guilty businessman leaving court often says it all. It is visible, it is lousy publicity for him, and the picture, together with an outline of what he did can serve as a warning to others that a similar fate may await them. The public disgrace among people who had hitherto thought him an honest, bright businessman—their families, friends, business associates—it is something that is difficult to avoid when article and accompanying photo are splashed all over 'page 29.'

Unfortunately, too often I hear from liquidators in particular, that so many people who are affected don't read the *Sydney Morning Herald* or the *Australian Financial Review*. I would like to see more corporate crime covered by the popular tabloids which have huge populations of gullible readers, to bring the activities of some of these corporate criminals to the attention of the very people they often target.

CORPORATE CRIME—PREVENTION IS BETTER THAN CURE

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Introduction

Many recent surveys suggest that the incidence of corporate fraud is quite extensive. Often, companies have experienced fraud many times, and the sums involved are considerable. They range from small-scale yet persistent frauds perpetrated by individuals exploiting weaknesses in their employers' management systems, to major scandals involving millions.

Are the victims just unlucky, or is corporate fraud something that could be prevented? While it will never be possible to prevent all frauds, it is possible to identify many of the risks and instigate procedures which, at least, provide deterrents. This, in fact, would help prevent many frauds.

Businesses which suffer frauds often do not possess the right controls or the controls in place can easily be evaded. Because each business is different, it may not always be easy to identify the areas of highest risk. However, the way the business is conducted can, in itself, be an effective deterrent to fraud. Like most criminals, those who perpetrate frauds will be deterred if the risk of detection is high.

The Nature of Fraud

Corporate fraud is nothing new—it has existed more or less since the time when corporations were first formed. So, why does it keep re-emerging in the public arena?

In many ways, fraud is similar to other types of theft. For example—

- easy targets are often chosen,
- some individuals are frequent offenders,
- large crimes are usually carried out by professionals, and
- no matter how much protection is put in place, it can never be 100% effective.

However, it does differ from the more traditional theft in some important respects—

- It is usually perpetrated by an employee of the company or someone doing business with it.
- The opportunities are created by deficiencies in the way the company operates or controls its business.
- The fraud is often not discovered for a substantial time. When it is, the offender is often identified but often not prosecuted, which is the exact opposite of the situation for many other kinds of theft.

Further, the nature of corporate fraud has undergone significant change over the past few years. Gone are the days of people dipping into the till or surreptitiously taking stock out the back door. As the modern corporation has matured and advanced in step with large scale use of computerisation and other technological changes, so too has corporate fraud capitalised on emerging technology to develop increasingly sophisticated techniques.

Two main developments of the late 1970's and 1980's must be continually borne in mind if we are to adequately understand the current state of corporate crime and thereby be effectively armed to combat it.

Firstly the emergence of 'white collar' crime has seen a change in the level and background of personnel involved. Mis-appropriation of corporate assets and fraudulent manipulation of reported results is now often perpetrated by those involved in higher levels of management. Such people are typically perceived to be above reproach (at least by their subordinates who are directly involved in many detection procedures) as well as being positioned above most of the controls and procedures which exist.

Secondly, these executives usually have the benefit of a high level of education as well as access to sophisticated tools to aid their endeavours.

Based on the preceding, we can highlight some initial conclusions—

- Perpetrators, to a large degree, come from within the ranks of higher level management and they are often either above most control procedures or will find their circumvention fairly easy.
- They are often highly educated and have access to state of the art tools.
- We can conclude that fraud may remain and grow to massive proportions during a considerable length of time.

Types of Fraud

1. *Management Fraud*

Particularly where senior or sensitive positions are involved, it is important that detailed and independent references are obtained. A person in a senior position will often be able to override internal controls or persuade junior staff that there are pressing reasons why procedures should be ignored in relation to a particular fraudulent transaction.

2. *Purchasing Fraud*

Purchasing is particularly vulnerable to fraud. An especially difficult area is where frauds involve collusion with third parties. Often a buyer is ideally placed to commit a fraud, especially if in collusion with a dishonest supplier. Knowing where the risks lie and having effective and efficient internal control procedures are vital in prevention of such purchasing frauds.

3. *Treasury Fraud*

The treasury function in a large organisation always carries a potential risk, not only from ongoing minor frauds, but also from the one-off transaction involving very large sums of money. The controls and review of the operations in the treasury function should be designed to meet these specific risks.

Loss through fraud can arise in many ways and some specific examples include—

- theft of cheques, both coming into and going out of the organisation and the use of dummy bank accounts with similar names to the original payees,
- theft of assets;
- collusion with customers;

- short deliveries;
- interference with creditors and debtors ledgers;
- sale of the company's assets at deflated prices;
- own account trading by employees;
- frauds involving commission payments;
- expenses frauds;
- fictitious overtime or fictitious employees;
- loss of information, the theft of customer lists, business plans or other business secrets such as computer software; and
- manipulation of information to improve apparent company performance.

Management clearly has a difficult balance to strike between installing controls which are so comprehensive that fraud becomes almost impossible and keeping overheads to a sensible level. The solution of this dilemma is not straight forward but the problem is soluble.

Is a Sound System of Internal Control Sufficient?

Historically, systems of internal control have predominantly focused on detective control procedures. However, frauds may remain undetected for considerable periods of time, thereby allowing their effects to continually accumulate. By the time they are discovered, millions of dollars of company assets may have been diverted and be otherwise unrecoverable.

Accordingly, given the gravity of these ramifications, reliance on controls of a detective nature is no longer necessarily adequate to the task. It is essential that companies supplement their existing procedures with appropriate preventative controls. Now, more than ever, the axiom 'prevention is better than cure' becomes a motto to which we should adhere.

What Preventative Controls Should be Employed?

Several areas of improvement in controls are available for a company to enhance their capacity to prevent corporate crime.

Firstly specific aspects of internal control can be examined and strengthened in those areas which allow prevention of misappropriation rather than detection after the fact. Of crucial importance, is the segregation of custodianship of assets from the systems which generate their transferral. For many companies, readily marketable assets will involve cash, securities and inventories. These assets, at a minimum, should be subject to such independent custodianship.

Secondly supervisory overviews can play a much more important role in the prevention of corporate crime. Such overviews include greater direct executive supervision, along with closer monitoring of budget/actual performance and asset levels.

Instituting such procedures, whilst allowing for an improvement in the ability of the company to detect corporate crime also provides an effective tool for dissuading potential criminals where such procedures are communicated to all levels of staff and are perceived to be effective in the prompt detection of any abnormalities.

What can Management do to Fight Fraud?

The main mechanism available to enhance the ability of an organisation to detect corporate crime is a sound system of internal control. Long established procedures such as—

- segregation of duties;
- reconciliation of account balances; and
- examination of transactions in risk sensitive accounts,

must be reconsidered to ensure they are still sufficient to accommodate the changing environment.

Set an Example

The first and most important thing is the tone from the top. A sloppy attitude to control does not go unnoticed by other employees, and will encourage fraud if the risk of detection appears low. Directors and senior management have a responsibility to ensure good practice. They must set an example in creating a culture and corporate integrity. Good housekeeping, good financial controls and reliable and prompt management information are all important aspects of this culture.

Promote a Clear Anti-Fraud Policy

The board of directors should also ensure there is an effective and well published anti-fraud policy, dealing with—

- a published policy of 'Corporate Integrity';
- pubished guidelines on receiving and giving entertainment and gifts and commissions to third parties;
- well defined and clear procedures for—
  - reporting instances of fraud to the board;
  - investigation of suspected fraud;
  - dismissal and prosecution of perpetrators;
  - recovery of losses; and
  - references for employees dismissed in connection with frauds;
- defined responsibilities of the board of directors including effective oversight of the anti-fraud policy and compliance with it;
- relevant responsibilities for non-executive directors and the audit committee;
- relevant responsibilities and reporting lines for internal audit.

Know the Risks and Operate Effective Controls

The controls need to match the requirements of the business. What is suitable for a stockbroker with a large private client base is different from what is needed for a manufacturer of industrial machinery. Moreover, the 'control environment' should allow creative action and entrepreneurial behaviour which lead to growth of the business. The controls should be based on knowing the risks after a thorough and realistic assessment of the business and the ways in which fraud could take place. It will usually be necessary to consider.

Risks to assets—where money can enter or leave the organisation, for example the loss of existing assets or the payment of fictitious liabilities.

Risks to sensitive information—whether computer based, or other information on matters such as customer details, contract terms, or bids and tenders, and

Risks to published information—such as manipulation of company accounts or insider trading through premature release of 'price sensitive' information.

Entry controls—the defences which should prevent or, at least, deter white collar criminals entering your organisation, whether as employees, temporary staff, suppliers, customers or visitors, will usually include—

- checking references of employees thoroughly, not just most recent employment, particularly where the appointment involved gives access to sensitive information or to the assets of the business;
- limiting and controlling the use of temporary staff;
- taking proper business references on suppliers and customers; and
- ensuring physical security in high risk areas.

Internal controls—the defences which should ensure that the resources of the business are used properly in pursuit of its objectives, will vary from simple rechecking of the work of others, through a variety of procedures, to the review of management information. They will usually include—

- realistic budgets being subjected to rigorous review;
- expenditure authorisation;
- cash management procedures;
- security of cheque books, payment systems and postage;
- prompt billing and follow-up of non-payments;
- review of non-routine payments;
- controls over computing activities;
- segregation and, where practicable, rotation of duties;
- ensuring staff take their full allocation of holidays; and
- personnel reviews to highlight individual financial risks.

Cost is often given as a reason for removing internal controls such as these, and management must ensure that the controls are in a reasonable relationship to the risks involved. However, cost is a poor excuse if those risks have not been realistically assessed.

Internal Control enforcement—the operation of internal controls is the responsibility of management. An approach which ensures that management check employees' work and in which the checks are unpredictable, but not infrequent, encourages adherence to laid down procedures.

A well organised internal audit effort is a major weapon in the discouragement of fraud through tighter internal control. Internal Audit should have clear objectives and clear reporting arrangements. they need to have appropriate skills, training and experience, including computer skills. They should be able to ensure that action is taken to improve efficiency and control.

Follow Up Warning Signs

Management should be on guard whenever there are unanswered questions in respect of results or the function of internal controls—especially if it is 'not convenient' to make a review. These symptoms should be followed to their rightful conclusion. Loose ends are often tell tale signs of something untoward.

Have a Discovery Plan

Dealing with a substantial fraud will inevitably be unpleasant, highly disruptive of the time and attention of senior management and indeed of the rest of the business. It will almost always be a 'one-off' experience and, within most organisations, experience of dealing with such matters is limited.

When things go wrong, management can act decisively and quickly to minimise the damage to the business if it has a discovery plan which sets out a clear guide on what to do.

The discovery plan need not be complex, but should cover—

- suspension of suspected employees and ensuring that they are not able to cause further loss or destroy evidence of what has been done;
- preservation and presentation of evidence of what the fraud was and how it was committed;
- retrieval of keys, changing locks, computer passwords;
- removal of bank, computer and security authorisations;
- investigation to determine—
  - how much has been lost?
  - how was the fraud detected?
  - what controls were avoided?
  - why did management not find it earlier?
  - what other losses are there?
  - what can be learnt from the episode?
  - what should be done to prevent reoccurrence?
- reporting—
  - to the police;
  - to the relevant regulatory authorities/trade associations;
- recovering the loss—
  - through insurance, where applicable;
  - by civil action against the offender;
- public relations, what to say to the press, T.V. and radio, to employees, customers, suppliers, bankers and shareholders, and who will say it and deal with queries.

The reporting of fraud is often the most difficult issue, in practical terms, for an organisation to tackle. The survey which Arthur Young carried out showed that not a single company interviewed and prosecuted every fraud, not even every serious fraud.

There is usually a reluctance to publicise what is an internal, distasteful affair. The organisation may feel that publicity will show up weaknesses in the whole management, rather than one unfortunate episode. If management do not act rigorously, the company is open to future fraud because of damage to the 'corporate integrity' policy. Research shows the criminals go on to repeat their crimes, but usually they get bigger and harder to detect.

Look at the Situation Regularly

Though there are stages in the life of business when it is more exposed to the risk of fraud than at other times, these are exactly the occasions when management has its hands full with other problems. For example, during time of rapid growth; when there has been a merger and management are not quite sure about the controls in the company they have acquired; or during a period of decline when morale may be low and management is fighting to save the business. Another situation of high risk is when remote operations are involved and management continually relies on financial and management information from those operations.

By being active rather than reactive in subjecting an organisation to regular anti-fraud examinations and by investigating thoroughly whenever there is an unanswered question, an organisation can reduce the risk of being caught off balance by having to deal with fraud.

PRESENTATION OF PAPER

Stephen Beihl, B. Comm., A.C.A., C.I.S.A.

Firstly I would like to apologise on behalf of my colleague, Garry Dinnie. Unfortunately he was called away to business in the U.S. and couldn't be here today. Briefly, my background is that I am a Chartered Accountant with Arthur Young and I have only recently moved to Sydney after a stay of 4½ years in Canada. My particular area of interest is computer security.

Many recent surveys have indicated that the incidence of corporate fraud is widespread and increasing, and this has certainly been my experience. Losses from corporate fraud range from small amounts to many millions of dollars and it is the general concensus that reported losses attributed to fraud are only the tip of a very large iceberg.

What can a corporation do to reduce the risk of fraud? In many instances businesses suffer fraud because they do not have the right controls in place, or the established control procedures have not been followed. Certainly my experience has been that the latter is quite frequently the reason why a fraud has occurred particularly where reviews and approvals are not carried out or not performed carefully enough. If a business has in place effective preventive and detective controls then the risk of fraud is reduced substantially. I would like to emphasise, however, that the implementation of controls needs to be balanced against the risk of fraud occurring and the cost to implement these controls. No system of controls can be 100 per cent effective but can only make it increasingly difficult for fraud to occur.

Before proceeding further I think it is important to firstly define the characteristics of corporate fraud and the types of fraud committed. Corporate fraud is similar to traditional theft in that easy targets are chosen, some individuals are frequent offenders and larger crimes are often committed by professionals. More importantly, I think, however, are the differences from traditional theft. Firstly the fraud is usually committed by an employee or someone who has dealings with the company. Secondly the opportunities for fraud are created by the deficiencies in the way the company operates or controls its business. And most importantly corporate fraud is often not discovered for some time and when it is the offender is often identified but not prosecuted.

The reasons for not prosecuting these offenders are not always clear but generally seem to be because the company wants to avoid bad publicity and management is concerned that the resulting publicity will reflect poorly on them as a whole rather than showing the fraud as an isolated incident. Unfortunately this attitude tends to cause further frauds as offenders are perceived as being immune from punishment, even when they are caught.

The nature of corporate crime also seems to be changing in recent decades. For example, the emergence of so-called 'white collar' crime has become more prevalent. Fraud committed by high levels of management is particularly difficult to prevent because of their position of power within an organisation. Secondly these executives are better educated than in past years and have access to state of the art tools and, finally, the increasing use of computers to record corporate information, effect control procedures, and provide the basis for management decision making has meant a change in the methods by which fraud can be committed. This is mainly due to large volumes

of transactions processed by computers and the concentration of functions and capabilities caused by computers. For example, where previously cheques could only be manipulated by persons with physical access to them, now anyone who has access to change the computer programmes which print the cheques can change how the cheques are printed. Control objectives, however, are not changed with the introduction of computers only the methods by which they are achieved.

In the paper we have outlined some of the more common methods of fraud and I will not go into them in detail again. However, I would like to make two comments: Firstly the *treasury function* of corporations particularly with more and more companies becoming players on the short-term money markets always carries with it a potentially high risk. The risk is expanded because major frauds can be committed through 'once off' transactions and an example of this was in *The Australian* (15 September) where almost £5,000,000 in bonds was fraudulently transferred to an account in Switzerland, or through the unauthorised use of corporate funds and an example that I have come across personally is where large amounts of money are transferred from one operational entity to another and have been diverted for short periods of time to an employee's account to earn substantial amounts of interest. Secondly the *theft of computerised information* is becoming more and more an issue. For example insurance companies are very aware of the competitive disadvantage they would suffer should their computerised policy master files end up in the hands of a competitor.

So what can an organisation do to reduce the risk of fraud? Firstly it needs to be emphasised that different organisations face different types and degrees of risk and that the procedures adopted will be different for each organisation. They should reflect the results of a realistic risk versus cost assessment. Secondly organisational controls have in the past typically been detective in nature. Whilst effective detective controls over a period of time become to some degree preventative in nature, management also needs to consider the use of preventative types of controls. This is particularly important in today's environment where the volumes of business transactions mean that undetected fraud can quickly amount to large sums of money.

I will go into some more examples of preventative controls but two that come readily to mind are security checks on potential new employees, and the establishment of an appropriate segregation of duties.

So what are the sort of controls that should be considered by management? Firstly management should institute a corporate culture which actively discourages fraud. This can best be implemented through the mechanism of an anti-fraud policy statement. This statement would cover things such as corporate integrity, guidelines on receiving entertainment, gifts, commissions, and a plan of action for when a fraud occurs. For example, what procedures should be followed to suspend an employee, the removal of the rights attached to that employee such as car keys and passwords into the computer system, collection of evidence, and to institute loss recovery procedures.

The policy statement should also address the responsibilities of directors, the audit committee, and the internal audit department. To be effective, however, it is just as important that management convey to their employees by their attitude that they treat the issue of fraud seriously and intend to closely follow the anti-fraud policy.

There are two main categories of controls which can be instigated and these are entry controls and internal controls. Entry controls should be established to deter criminals from entering or dealing with your company. And examples are thorough reference checking for potential new employees, limiting and controlling temporary staff, for example by assigning close supervision, by only assigning temporary rights (for example time limits on passwords to computerised systems) and finally the most common is physical security; car keys, guards and so on. We went through in considerable detail in the paper on internal controls which can be established (see page 50) and I think I should only go through some of the more important ones. Possibly the most effective is the establishment of a realistic budget. The follow up of actual results to budgeted results can in many cases pick up large scale frauds. To be effective, however, the budget must firstly be realistic, and secondly there must be close and complete follow up of all variances and also instances where variances would be expected but have not occurred. For example, the sales have decreased but the cost of sales have remained at budgeted levels.

The implementation of an appropriate segregation of duties is also important particularly to ensure that the custodianship of assets is separated from a recording of transactions. Anyone involved in handling cash should not have the ability to be involved in recording debtors. In computerised systems this has to go a step further and the appropriate segregation of capabilities as opposed to normal duties must be established through restrictive access profiles. Expenditure authorisation should be instigated and the most common example of this is dual cheque signatories for all payments. A cash management procedure should be instigated. Many organisations perform bank reconciliation procedures. However, they are not always performed promptly and in some cases it is not unusual to have the bank accounts unreconciled for up to a year. Without proper reconciliation it makes it extremely difficult to quickly detect fraud and bank reconciliations are an effective mechanism to detect many cash orientated frauds. Finally a policy of regular vacation taking should be enforced. In many instances fraud has been detected by someone temporarily filling in the roles of another employee.

If these controls are established how are they to be enforced? And it is the enforcement which is the most important issue. Some of the procedures which are implemented by many of our clients are the enforced establishment of an internal audit department. Whilst the mandate of an internal audit department is not to chase frauds it should however ensure control procedures are adhered to. Secondly management should ensure that frequent and unpredictable reviews are performed on control procedures. For example, by visiting warehouses to ensure that goods receiving procedures are enforced and so on. And finally any unanswered questions with regards to results or internal controls should always be promptly and completely followed up.

In conclusion, I would like to emphasise that management shouldn't assume that existing controls are always effective. A change in circumstances can make existing controls ineffective and increase the risk of fraud. Perhaps the best example of this is during periods of rapid growth where employees are called on to do additional work and control procedures are often the first to be dropped. Other periods of risk are mergers and when a company is in decline and fighting for its survival. Finally, the management of any organisation which has remote operations should not rely on financial reporting packages, but should also perform regular visits to these sites.

SOME THOUGHTS ON INSIDER TRADING AND SELF-REGULATION

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Insider Trading is essentially a double problem of ethics and disclosure.

Ethics

The media and market watchers are fascinated by the developments of Insider Trading on Wall Street. Some extracts from *Business Week* August 10 1987 by Charles Wells are illuminating. 'The Case Against Drexel: (Drexel, Burnham, Lambert Inc.) Will the Government come up short?'

- If Drexel did illegally tinker with these and other deals to put added pressure on the targets, why would it have done so? Why would it have taken a large risk, such as possible S.E.C. (Securities Exchange Commission) action or marginal gains? One possible answer: Drexel didn't do any thing illegal. But if it did, *Business Week's* sources suspect the answer probably lies in Drexel's uncommon corporate culture and in the uncommon personality of Michel Milkin (the head of the Californian Junk Bond Division).
- For the organisation with 10 500 employees and $4 billion in revenues, Drexel is remarkably unstructured, which fundamentally reflects and shapes its culture. Drexel is a loose, decentralized confederation of 500 independent profit centres.
- There is no organisation chart for the firm, only a vague chain of command, no middle management cadre, few executives with formal titles, hardly any regular meetings, only a trickle of interoffice memos. Groups assemble, disassemble, and reconstitute almost entirely *ad hoc.* 'We don't want to let bureaucracy stifle people's creativity', explains Joseph (the C.E.O.). 'We want to let people run their own business to the maximum extent possible'.
- Drexel has developed a highly entrepreneurial environment that has fuelled Drexel's astonishing success.
- But some sources question the firm's willingness to police its staff zealously. According to a firsthand account, one top Drexel executive recently remarked: 'There will always be a few bad apples, but rooting them out would destroy the creative process'.
- Drexel people came to see themselves as tougher, more willing to take risks and defy convention. Brains and hustle would triumph over pedigree and etiquette. The outsider has attracted to Drexel many nouveau entrepreneurs who needed help bootstrapping their way into the big leagues. 'It's a conscious form of reverse snobbery,' says a former Drexel banker.
- 'Challenging rules and traditions can lead to a lot of creativity,' says a Drexel former staffer, 'but it can also lead you to push the boundaries of your personal standards. It can lead to an attitude where it's O.K. to bend the rules a little to close a deal.' Adds one insider: 'The Drexel game is played at the edge.'
- 'Milkin (head of the California Junk Bond Division) was putting so much money in everyone's pockets that nobody wanted to question him,' claims a former Drexel man.

- 'With Milkin, it's different. Michael wants to win the game. Michael wants to have it all. Michael wants to do every piece of business and every deal and make every dollar.' Milkin has cultivated close friendships with many of Drexel's top clients, and several of them have said their primary loyalty is to Milkin, not the firm.
- 'It's a mentality where you want to win very much, and you want to make sure that you win, so you do everything you can do.'

The article highlights the pressures to vary codes of conduct and ethical standards. Drexel's culture is apparently one reason for the current situation where they are under investigation by the S.E.C.

It is commonly believed that the publicity and the S.E.C. investigation has had some detrimental effect on Drexel's business. Later in that same article it is reported that Drexel's market share of U.S. public corporate underwritings for the first half of 1987, according to I.D.D. Information Services Inc., dropped to 7.3 per cent from 12.5 per cent for the first half of 1986. Its share of junk-bond deals fell from 51.9 per cent to 32.3 per cent. The company's previous growth has come to a halt. Maybe this is an example of the market pricing a firm's ethical standards.

Indeed, culture appears to have a price.

Disclosure Price Sensitivity

I once thought that it was reasonably simple to establish whether information was price sensitive. Obviously price sensitivity is only one of the elements to be proven for insider trading, however, I have only dwelt on this aspect because of the difficulties I perceive in prosecuting in this area.

Some findings on market movements prior to announcements have been available for some time:

- Brown, Finn & Hancock on Dividends and Profits found in the period 1963–1973 that:

  'prior movements anticipate the profit or dividend announcement, substantial reactions to the tie, and little or no reaciton thereafter.'

- Ball, Brown & Finn on Share Capitilisation Changes found in the period 1960–1969 that:

  'Abnormal returns were earned, on average over the year prior to and at the time of bonus issues, rights issues and price splits,' and 'in each case, much of the abnormal return occurs in the month of announcement'.

Ball concluded that:

A large body of studies, conducted overseas and in Australia, has produced evidence of a remarkable degree of consistency. The 'classical' pattern is one of prices moving in advance of and at the time of particular information announcements, with little or no movements after the announcements.

Similar findings were contained in another *Business Week* article from the 24 August. In 'Insider Trading: Business as Usual' we find the following:

- A study of pre-bid trading in takeover stocks conducted for Business Week by Data Resources, using data from *Mergers & Acquisitions* magazine's data base, shows that in the year since 1 July, 1986, 70 per cent of the 130 acquisition targets showed the same pattern. That may not seem like a large number, but in fact, it's extraordinary. What are the odds against 70 per cent of any 130 stocks beating the market? According to *Data Resources*, they are astronomical: 392 000 to 1.
- It seems that once the shock of the Boesky Investigation wore off, the scandal had no lasting impact on the number of pre-offering (takeover) stock-price runups (price increases).
- If runups like these are a rough barometer of buying and selling on the basis of insider tips, the implications are grave for the government's crusade against insider trading.
- The evidence strongly indicates that pre-deal buying on the basis of unfairly obtained information won't be stifled.
- Sometimes a stock climbs because a potential acquirer is accumulating the shares. Strong earnings reports also help fuel a price rise. And media speculation and previous bids often mark a stock as a likely target.
- A February 1987 S.E.C. study of pre-merger activity in stock prices, while pointing to the multiplicity of public sources that might drive up target-company stocks, noted that such "street talk" . . . could ultimately be fed by illegal disclosures'.
- The bull market, of course, has provided the momentum that rumours like these need to grow.

I would not have thought such evidence would be available so soon after the wide publicity the Boesky affair received. But is there a reasonable explanation for pre-announcement price movements? In a perfect world all information would be disclosed. There would be no price sensitive information to trade on. Analysts are now accepted as having sophisticated techniques based upon financial modelling programmes. Analysts are encouraged by the market to predict profit outcomes or, in the case of resource companies, the extent of reserves. After company visits by analysts the research results are checked with the company. Obviously the analysts obtain, by this process, a high degree of credibility and it is an effective process to ensure the value of the company is correctly portrayed to clients of the analyst. Release of the analyst's report may affect the price and the resultant trading should correct the market price.

Is such a process subject to abuse? Won't the unscrupulous overvalue their assets or prospective profits to artificially inflate their company's value? Maybe in the short term the company might be overvalued but once the promoter is seen to provide unreliable information, it will soon be discounted.

Past performance indicates analysts' predictions on profitability are remarkably accurate. If the predictions are accurate then profit announcements are probably not price sensitive by themselves. The analyst's past projections have eliminated the 'price sensitivity'. Similarly, capital raising in many cases are able to be predicted by analysts. One might not be privy to the terms of an impending issue but it is possible to predict the company's needs. Analysts' financial modelling programmes might even come up with the same formulae

as the underwriters. Is that price sensitive information? No, the information has been gleaned other than from the inside, and therefore it is not something in which the regulators would take an interest.

If one analyst can establish a company is undervalued can't he predict that it will be taken over? If there is turnover in the stock, can't a dealer put two and two together and come up with 'takeover'? It follows that the odds of these 70 per cent of companies (the ones mentioned in the second *Business Week* article) doing better than the market are greatly reduced. Again the information, in such a situation, may not have come from insiders.

It is obviously a very complex area.

In conclusion, as a regulator, how does one prove information is price sensitive?

Self Regulation

I would like to finish with a few comments on self-regulation.

Self regulation normally involves:

- the licencing process;
- education and training of licencees;
- establishing business conduct rules and a code of ethics;
- monitoring compliance with financial conditions;
- administering discipline; and
- maintaining reporting requirements.

The regulatory authority in administering Self Regulatory Organisations (S.R.O.'s) should have the power to enter and inspect any S.R.O.'s operations, to suspend S.R.O.'s, to limit activities, functions or operations, to suspend or revoke their registration or to exercise a variety of specified powers over the directors, officers and employees of the S.R.O.

With such wide powers, the regulatory authorities must ensure they do not undermine the S.R.O.'s autonomy and its authority over its members. Undermining could easily take place if the S.R.O. took disciplinary action against those for whom it is responsible, and if after disciplinary action by the S.R.O., the regulatory authority then took further disciplinary action in the matter. The defendant would be subject to double jeopardy and the authority of the S.R.O. undermined.

Furthermore, communication between the S.R.O. and the regulatory authority must, to the greatest possible extent, be open and frank. Presently in Australia the regulatory authority is limited in what it can tell an S.R.O. about the S.R.O.'s own members. Laws of defamation should not hinder communication between the regulatory authority and its S.R.O.'s. I believe that will change under the new licencing procedures currently being prepared by the N.C.S.C. However, if, there is not open communication between the regulatory authority and its S.R.O.'s then problems will inevitably occur.

An effective S.R.O. should encourage each of its members to install their own compliance functions, thereby sub-delegating compliance. That position is common in the U.K. and U.S.A. but as yet not widespread in Australia. The installation of a compliance team should be considered by all professional organisations to monitor their ethical conduct. A small price to pay to maintain one's reputation.

Should the authorities determine that a Self Regulatory Organisation is not performing its tasks efficiently and conscientiously, and monitoring the activities of its members, in line with the criteria for its establishment, then, and only then, should the authorities have recourse to the Self Regulatory Organisation in the first instance and later to members of the Self Regulatory Organisation.

PRESENTATION OF COMMENTARY

Jim Berry

My position is Manager of Regulation and Compliance at the Australian Stock Exchange, Sydney, formerly the Sydney Stock Exchange. As such my responsibilities are both the financial reporting requirements of member organisations, i.e., brokers, and increasingly ethical matters.

Since Patrick Partners demise in 1975 the Exchange has concentrated on accounting matters to ensure that we avoid such a situation again but in the sort of environment that we are in now we are increasingly looking at ethical matters.

Now I have adopted a bit of a scattergun approach to raise a few issues. I would just like to repeat an article from February this year from financial papers in the share market column. It says Broker X, which is partly owned by Company Y and an underwriter to the rights issue, was 'selling out of company Y as fast as it could before the issue was announced one broker said'. (This was immediately before the announcement of rights issue.) The stock opened at $5.24, and was 'on the back foot pretty well all the day, closing 28 cents down at $4.98'. Now I would think there is good reason for a broker to be very wary of his reputation, if he does not, he leaves himself open to serious charges of market manipulation, insider trading, etc. It is something, however, I believe that the securities industry as such is not very well informed about.

To my mind insider trading is essentially a double problem. One is disclosure, and the other one is ethics. In the ethical problem I have in my commentary provided a page and a half of extracts from a recent *U.S. Business Week* article on 'The Case Against Drexel: Will the Government Come Up Short' this argues whether the U.S. S.E.C. will be successful in their investigation of Drexel Burnham Lambert Incorporated and the article talks about the type of organisation that Drexel is. (See pages 56 and 57)

I realise this is just a magazine article and it is hearsay, etc., but it is talking about one of the top U.S. firms dealing in securities and what I concluded from the article is that the pressures to vary codes of conduct and ethical standards are great, and in this sort of bull market the pressures are much greater.

It is commonly believed that the publicity from the Boesky and the Drexel investigation has stopped the rapid increase in the growth of Drexel, and I would like to hazard a comment that maybe this is a cost of running the type of organisation that Drexel did. If you are going to play close to the line, then you have to expect the market to assess you.

Later in my comments I talk about the self regulatory function and I believe what should be happening is that each firm should have its own compliance section to address the types of problems that we have raised (See pages 59 and 60)

The next matter I would just briefly like to talk about is disclosure and price sensitivity. Following on from what Bob Nicol said I think it is extremely difficult to establish price sensitivity. Back in the 60s Professor Ball and the Australian Graduate School of Management basically stated that 'prior movements anticipate the profit or dividend announcement and substantial reactions at the time and little or no reaction thereafter' (see page 57). In other

words, for B.H.P. to come out with a profit announcement of X dollars, because people have been visiting the company doing research reports, that company's announcement of their profit is probably not price sensitive. Now, that is probably a revelation to some solicitors.

Taking that a step further, subsequent to the Boesky affair there is a recent report in *Business Week* on the 24 August and that shows that in 70% of the 130 acquisitions since insider trading first came to light, the market in those securities has risen substantially. An analyst has come out and said that the odds against 70% of those stocks moving is 392,000 to 1. The article concludes that once the shock of the Boesky investigation wore off the scandal had no lasting impact on the number of takeover price increases.

Now, I find this fascinating. If we are led to believe that publicity will dampen and make everybody more subdued in the way they invest, then one would have thought that these sorts of price movements should not have happened subsequent to the Boesky affair. So I have briefly set out what I think could be the reason. If you are the management of a company you would like to see your shares correctly priced, what you do is provide openings for analysts to come along to review your operations. You provide enough information so that they can come up with a reasonable estimate of profitability. So basically it is the standard of information that is being provided to analysts that is, in effect, making a lot of so called non-public information non-price sensitive.

This was not always the case. In the '60s the attitude was that if you were a company manager you wanted to keep as much fat on the bone. Therefore you didn't revalue your assets. So we have come a long way since then. But in the current environment there are people with great financial modelling products and there is a great deal of information out there in the market place that is non-confidential, and from that Mr Brierly, Mr Holmes a'Court are arriving at the value of companies' assets all the time. That is what their job is. so they are getting in there buying up undervalued assets and then letting the market judge the situation.

If analyst X can come up with the same conclusion as Mr Brierly or Mr Holmes a'Court as to a company's worth or the analyst or corporate finance department of a broker sees activity then you don't have to be too clever to go along and recommend to a fund manager to start buying that stock. Now, that to me is a very simplistic way of explaining why the Wall Street figures showed that 70 per cent of 130 offerings had pre-price risements rising.

On to the problem of publicity. I was on a recent committee for the Securities Institute to put a paper to the N.C.S.C. on the Anisman suggestions on insider trading. That is contained in J.A.S.S.A., the recent issue of the Securities Institute, and we suggested that publicity was very necessary. This is going on from Anne Lampe's point that really publicity ensures that practices are exposed to public debate. Therefore, we are encouraged that the N.C.S.C. is proceeding with some insider trading cases, because what I think has been lacking is the practitioners in the market have not been discussing the matter at both theoretical and practical levels. Therefore, I think that the public debate that will ensue from those cases will be invaluable. Whether or not they are successful is probably irrelevant.

From a professional's point of view the ultimate penalty is to be charged with professional misconduct. It must effectively ruin that professional's reputation.

Finally, I have a few thoughts about self regulation, and it is something that you might think is a little bit out of context in this arena. Self regulation is basically the delegation by the regulatory authority to a body of people or the Board of let us say the Stock Exchange to administer its own members' affairs. The Green Paper on Licensing by the N.C.S.C. suggests that self regulation be extended past the Exchanges to a group of other people including Unit Trust Association, the Merchant Bankers' Association, etc., and the N.C.S.C. is drafting legislation in that regard now.

So it will be something that will in a year or so be really a topical matter and I thought I would just touch upon it because a self regulator does have disciplinary responsibilities.

The regulatory authority should have the power to enter and inspect any S.R.O.'s operations, to suspend S.R.O.'s, to limit activities, functions or operations, to suspend or revoke their registration, or to exercise a variety of specified powers over the directors, officers, and employees of S.R.O.'s. I believe this is necessary so that the delegation process can be properly administered (see page 59).

S.R.O.'s have the advantage of less constraint regarding resources and I can say from my position in the Stock Exchange that basically that if we want some resource we get it. I would suggest that is one reason, maybe the major reason, that the governments have, in both Australia and the U.K., really pumped for S.R.O.'s. With that power over the S.R.O.'s I think that it is imperative that the regulatory authority must ensure that they do not undermine the S.R.O.'s autonomy and its authority over its members. Undermining could easily take place if the S.R.O. took disciplinary action against those for whom it is responsible, and if after that disciplinary action by the S.R.O. the regulatory authority then took further disciplinary action in the matter, the defendant would be subject to double jeopardy and the authority of the S.R.O. would be undermined. I think that is a real problem.

Furthermore communication between the S.R.O. and the regulatory authority must be open and frank. Presently there are laws of defamation and I believe that is being addressed in the next amendments to the Securities Industry Code.

Getting back to the problem we had with the culture of Drexel, an effective self regulatory organisation should encourage each of its members to instal their own compliance functions thereby sub-delegating compliance. That position is common in the U.K. and the U.S. but is not widespread in Australia. I would suggest that if we had a Boesky affair in Australia then we might have a few more brokers, merchant banks and banks with their own compliance sections. The installation of the compliance team should be considered by all professional organisations to monitor their ethical conduct. It seems a small price to pay to maintain one's reputation.

The N.C.S.C., should be congratulated on commencing action on three insider trading cases that it's alluded to, but really the authorities have to recognize that if the self regulatory organisation is not performing its tasks efficiently and conscientiously and not monitoring the activity of its members in line with the criteria for its establishment then, and only then, should the authorities have recourse to the self regulatory organisation in the first instance, and later to the members of the self regulatory organisation. This is getting back to my problem of double jeopardy.

And, finally, I would just like to touch on one of the problems in the previous speaker's paper, being firms in general not willing to come forward to disclose defalcations by their employees. Now, in the examples that I have seen it involves the member organisation in a great deal of additional administration that will in many cases last for several years. It is an easy answer to say: "Look, we will take the easy way out and therefore we will just sweep the matter under the carpet, we will dispose of the matter and we will be finished with the problem". The problem, in the case of something like the Stock Exchange where there is a merry-go-round of people moving from one organisation to another, is that the bad apples never get rooted out. So the Exchange in Sydney has adopted the policy of requiring brokers to inform the Exchange where somebody has breached a trading rule or something that requires ethical consideration.

BUCKETSHOP—BUSTERS

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Introduction

This paper will discuss one specialised area of fraudulent[1] practices in the 'futures' industry in Australia. The topic needs to be discussed in context and accordingly the reader should understand that by and large the fraudulent practices discussed in this paper are confined to non-members of the Sydney Futures Exchange (the Exchange). The Exchange is the ninth largest futures exchange in the world and is the biggest futures exchange in the Asia-Pacific Region. As an indication of the Exchanges increasing role as an international exchange the Exchange during this year has been invited to make presentations and to participate as panelists at international seminars on futures in Chicago, Tokyo, London and Zurich, together with representatives from the major exchanges in the northern hemisphere, including the Chicago Board of Trade, the Chicago Mercantile Exchange and LIFFE.[2]

The Exchange and the futures industry in Australia has a good reputation and it is unfortunate that certain companies and individuals who are not part of the main stream of the futures industry, have engaged in fraudulent practices.

In Australia fraud in the area of futures can be divided into two broad categories. First those individuals or companies who offer so-called leverage currency contracts to members of the public.[3] Secondly those individuals or companies who purport to be futures brokers, but instead of executing the orders on a recognised futures exchange, bucket them.[4] These bucket-shops trade such exotic commodities as Tokyo Red Beans and Maebashi Dry Cocoons.

The leverage currency dealers do not, as a general rule, represent that they trade on a recognised futures exchange. It was, however, normal practice for them to take a principal position against their clients. This meant that a loss to the client was an equivalent profit to the company, and conversely, a profit to the client was an equivalent loss to the company. Therefore, it is in the company's interest to let losses mount and close out [5] the client's contracts while in a loss situation. Profitable contracts are 'rolled-over' [6] into new contracts with the hope that a loss would result. Excessive commissions are also a characteristic of these operations. These companies operations are analgous to a bookmaking operation where the clients have a bet with the company on the movement of various currencies or other commodities.

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[1] The term 'fraud' as used in this paper implies abusive conduct as opposed to fraud in the narrow criminal sense.

[2] SFE *Newslink*, Issue 2 August 1987 at 1.

[3] The term 'leverage currency contract' is used in a generic sense here, and the contracts have been known by a variety of other names.

[4] Bucketing is discussed later in the paper.

[5] 'Closing out' means entering into an equal and opposite contract. The difference in price between the contracts will determine whether a profit or loss has been made.

[6] Profits are realised by closing out the client's position. The profits are then used to re-establish a position in the market, hence the client's position is 'rolled-over'.

The demise of the leverage currency dealers was brought about by decisive action taken by the N.S.W. Corporate Affairs Commission (C.A.C.) under the *Futures Industry (N.S.W.) Code,* and the *Companies (N.S.W.) Code.*

The second major group are those companies or individuals who purport to execute orders on recognised futures exchanges, but in fact the orders are never placed but rather they are bucketed (of course, not all companies who trade Japanese markets bucket). It is this type of operation which this paper will discuss.

What is bucketing?

Bucketing has been described as the failure to execute an order on a recognised futures exchange when required to do so.[7] Bucketing involves a broker not complying with the instructions of his client to execute a contract on a recognised futures exchange.[8] Put crudely, the orders are normally telexed offshore to create the illusion that they are being executed, when in fact they are not.

Bucketing is prohibited by s. 128 of the *Futures Industry Code* (the Code), which provides—

> A futures broker shall not deal in futures contracts on behalf of another person unless the dealing is effected—
>
> (a) on a futures market of a futures exchange or recognised futures exchange;
>
> (b) on an exempt futures market; or
>
> (c) as permitted by the business rules of a relevant organisation of which the broker is a member.
>
> Penalty: $10,000 or imprisonment for 2 years, or both.

The effect of s. 128 is to compel all trades to be executed on a futures market, unless otherwise permitted by the business rules of an exchange. Section 128 is the principal anti-bucketing provision of the Code. Section 45 of the Code will also be relevant as it prohibits the establishment, maintenance or provision of a futures market that is neither a futures market of a futures exchange nor an exempt futures market. This section prohibits a company taking a principal position against a client. When a company does take a principal position against a client in an off-exchange situation the opportunity for abuse is obvious.

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[7] D. Chaiken, 'Commodity Investment Fraud' (1985) 6 *Company Lawyer* 261 at 266.

[8] See M. G. Hains 'Duties and Obligations of a Futures Broker to his Client' (1987) 3 *Aust. Bar Rev.* 122 at 125 and 129. See also *Drexel Burnham Lambert International NV* v. *Nasr* [1986] 1 FTLR 1 at 12; *Options Investments (Aust) Pty Limited* v. *Martin* [1981] VR 138 at 142; *Commodities Exchange Act* 1974 s. 46 (D): and *Re Seigel Trading Company Inc* [1977–1980 Transfer Binder] Comm Fut L Rep (CCH) II 20, 452 at 21,827 (1977).

Why Australia?

A number of factors have assisted the growth of this type of activity in Australia. The factors include—

- the deregulation of the Australian financial sector, for example, the lifting of exchange rate controls which allowed brokers to more freely deal on foreign exchanges. The deregulation of the financial sector and its resulting sophistication has encouraged the growth of Sydney as a major financial city in the Pacific Basin, in particular we have seen a growth in the use of futures contracts;
- a growing public awareness of futures;
- the greed and gullibility of the Australian investing public;
- the wealth of Australia;
- the absence of national legislation to regulate the futures market in Australia prior to 1 July 1986.[9]

A very important factor was that in the early 1980's when the Australian futures market was experiencing tremendous growth this type of fraud was prevalent in Asia. The authorities took steps to curtail the abusive activities of certain companies. Unfortunately, the authorities in Asia laid no charges against the people involved nor did they advise the relevant Australia regulatory authorities which permitted these companies to move into Australia unhindered.

Characteristics of a Bucket-Shop

Generalisations should, as a rule, be avoided. However, there are certain characteristics which suggest a bucket-shop operation. Not all bucket-shops will have all characteristics. Similarly, the presence of some of these characteristics does not necessarily mean there is a bucket-shop.

Some of the characteristics are listed below—

- palatial offices where no expense is spared. It is not uncommon to find fancy wall charts plotting the movement of Maebashi Dry Cocoon or some other exotic commodity in the reception area (the charts are usually out of date), and a jar of Tokyo Red Beans may be visible in the plush reception;
- employees are literally taken off the street, their previous experience or personal qualities are of little significance. What little training there is, emphasizes salesmanship rather than providing competent advice to clients;
  The client advisors do not know a great deal more about futures than the people they are cold-calling. Staff turnover is generally high;
- client advisors are paid a small retainer and their income is principally derived from commissions. It is common for commissions to be based on the number of trades executed per month. The higher the number of trades per month, the higher the commission per contract traded. The commissions are generally very high;
- client advisors are set 'quotas' to attain each month and considerable pressure is brought to bear for those quotas to be achieved;

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[9] The only legislation prior to 1 July 1987 was the *Futures Market Act* 1979 (N.S.W.)

- trades are predominantly 'executed' on overseas markets, in particular, the Japanese markets. One reason why the Japanese markets are chosen is because prices on Japanese markets do not fluctuate minute by minute, but are set for all contracts traded in a particular session. Hence the trader is able to advise clients that contracts have all been traded at the one session price, whereas in reality they have not. Additionally, the client is less likely to have access to, or be familiar with, market information on Japanese markets nor will they be familiar with the commodities traded. Quite often there will be one or two companies through whom the orders will pass before they 'reach' the Japanese floor member. Invariably, the companies will be in different countries and the 'audit trail' supporting the executing of orders will be lost. Bucket-shops are unable to substantiate that orders are being executed on a recognised futures exchange beyond providing telexes. One purpose which the intermediate companies serve is to act as a barrier against investigation, for example, when asked who the orders are being passed onto, they will respond that it is a trade secret.

  Bucket-shops will not normally deal with floor members of Japanese markets directly because it would be more difficult to bucket;
- it is standard broking practice to place orders by phone. Confirmation of the orders will generally be made by telex or facsimile at the end of each day. Daily trading advices are issued together with monthly statements at the end of each month. However, bucket-shops will generally place the orders by telex and receive confirmations by telex. There is no evidence that the orders are executed beyond telexes;
- clients sign a discretionary account or 'authorisation letter' conferring upon the company a right to trade on behalf of the client at the company's absolute discretion. Clients would be safer if they gave the company a blank cheque! The Client Agreement Forms used normally contain extensive exclusion clauses, as well as an array of outrageous clauses, such as clauses which:
  (a) permit bucketing, although the effect of the clause would not be understood by the client. The clauses can on occasion be very subtle and although the writer has had considerable experience in vetting Client Agreement Forms, occasionally he has found these clauses can go unnoticed;
  (b) provide that the company's authority to trade can only be withdrawn in writing. This permits the company to continue trading after being orally advised to cease trading. The client has forgotten the contents of the 'fine print' which says authority can only be withdrawn in writing and the client will not be reminded of this when they orally withdraw authority;
  (c) provide that an entry into the company's general ledger is conclusive evidence that orders have been placed on a recognised futures exchange;
- clients accounts are churned. That is, trades are placed for the purpose of generating commissions for the company rather than in the interests of the client.[10] The company will inform a client that they are trading

[10] See generally "Commodity Litigation" *New York Law Journal* May 23 1985; *Commodities Law Letter* April 1984 and March and April 1985; Chaiken at 266.

one contract for the client, when in fact the contract size is double or even quadruple the actual size of the contract traded on the Japanese markets. The use of double and quadruple contract sizes facilitates churning (although it is not an element of churning in its own right).
Even when the accounts are not discretionary, relatively unsophisticated clients are targetted. Invariably the client will follow the advice of the company and its representative;

- nearly all of a client's money is committed to the market straight away. No money is left in reserve to pay for margin calls. The writer has seen cases where hundreds of positions were opened on the first day of trading;
- bucket-shops typically obtain clients by cold-calling through the yellow pages or other forms of client lists. The client advisors emphasize the profits that can be made and rarely dwell on the risks involved;
- the directors of the company or senior management are the only ones who know what is going on and the employees are generally not told a great deal;

If a client complains about losing money, the company will say that 85 per cent of people who trade futures lose money. A convenient excuse for use by these companies. What they fail to tell the clients is that 99 per cent of their clients lost money.

Why were they allowed to flourish for so long?

There is no single factor which permitted the activities to exist for so long, but rather a combination of a number of different factors—

- the absence of national legislation permitted these companies to exist in a 'void', that is, they could trade without being a member of the Exchange or being licenced by a regulatory body;
- clients did not fully understand futures, never mind the elaborate ploys being used. This is particularly important because this resulted in few, if any, complaints being made to the C.A.C. If a complaint was made to the Exchange no action could be taken because they were invariably not members of the Exchange and hence the Exchange had no jurisdiction to investigate the complaint. Additionally clients were reluctant to complain to anybody because they are embarrassed;
- even if a complaint was made to Corporate Affairs, the Commission lacked the expertise to investigate the elaborate ploys being used. There is little doubt that the C.A.C. is today much better equipped to combat this type of fraud. Both the C.A.C. and the Exchange initially lacked knowledge about the Japanese markets and this hindered any proper investigation;
- the failure to recognise the extent of the fraud in the early stages. It is only over the last 6 to 12 months that the extent of the fraud has become known;
- the evidentiary problems of proving fraud. For example, it is difficult to prove that the absence of an audit trail means that the orders were not placed. Additionally, most of the evidence is off-shore.

Why use Foreign Exchanges?

The reasons for using a foreign exchange are simple and include—

- an investor is unlikely to be familiar with such markets;
- language barriers;
- the problem of establishing an audit trail through a number of overseas jurisdictions;
- evidence is normally overseas and it is costly and resource intensive to obtain;
- difficulty is obtaining the assistance of overseas regulatory authorities;
- the inability to check a broker's trades because there is no official prices published daily;
- trading in obscure commodities necessitates more dependence on brokers for advice and other matters such as price, market volatility, market trends and cash market conditions.

Problems faced by Regulators

The problems faced include—

- lack of resources and man power to investigate all the companies suspected of such behaviour;
- lack of complaints by people who have been ripped off. These people fail to realise that the information they have can give great insight into the company's operations when they speak to the correct people;
- difficulties in checking foreign qualifications. On occasions, the companies who provide the references are of questionable integrity themselves;
- you can not refuse membership of an Exchange or the issuing a licence on a suspicion. Section 53 of the Code gives an applicant for membership a statutory right of appeal if they are rejected from membership;
- the best evidence is usually obtained too late for any effective action to be taken;
- the evidentiary problems already discussed.

Conclusion

The quickest and most efficient way of closing down these operations is to give extensive coverage in the popular press to their fraudulent activities. Once their cash-flow is curtailed the companies quickly close up. It is also important for regulatory bodies to exert pressure on these companies by court action and by other means.

The current crack-down on these fraudulent activities will in the long term be beneficial.

PRESENTATION OF COMMENTARY

Michael Hains

By way of background I am a practising Solicitor employed by the Exchange and I have been specialised into compliance area at the Sydney Futures Exchange. It came more by chance than anything else that there has been a lot of allegations of fraud in the area of futures in the last six to twelve months.

Before I speak to my paper I would like to comment on Anne Lampe's paper. I identify very much with what she has said. Particularly, I am familiar with not only companies which purport to execute trades on a Japanese market but the Exchange itself has also carried out a surveillance on non-members trading leveraged currency contracts. The reason behind that is fairly obvious and that is that these people may at some stage wish to legitimise themselves and get into the main stream of the futures industry in Australia. Therefore it is necessary for the Exchange to know and be able to identify the people who set up these operations so that it can take the necessary steps when they try to legitimise themselves.

Anne Lampe has done a very good job at giving publicity to these questionable operations, a couple of the companies had been in the paper on and off for about six to eight months and then the Corporate Affairs Commission succeeded in getting a receiver manager appointed to one of them. Quite often the Exchange gets calls from members of the public about leveraged currency dealers. I think it is unfortunate that people can be ripped off so easily. They don't even make basic inquiries. If I was going to invest in one of these leveraged currency contracts one of the basic safeguards that I would take is to at least ring up the Exchange or some other regulatory body and ask 'Have you heard of them?' Obviously the Exchange can't say 'Oh, they are shonky, don't invest with them' but the way you attack the problem is to point out the virtues of Exchange membership; are they licenced? are they a member of a self regulatory organisation? what safeguards have you got if you lose your money? can you arbitrate? For example, Sydney Futures Exchange has a system where if you have a complaint against a member you don't have to go to litigation you can use the arbitration procedure which the Exchange offers. The Exchange also offers a Fidelity Fund if the money has been fraudulently misappropriated. Unfortunately people tend to see the dollar signs: these salesmen offer great returns: and basic safeguards go out the window. People on occasions can't get down to the bank quick enough to draw their cheque, which I think is very unfortunate and perhaps a poor reflection on the Australia investing public.

One of the other interesting things that I found about Anne Lampe's paper was this question of the telexes going off-shore and trying to establish to the court that in fact the orders have never been placed. I am sure in some companies it is just a big scam. When people come to me and say 'Oh, but they have telexes, they executed the orders' my response is 'Well, do you want me to go downstairs and I will telex one out to so-and-so and give you the telex'. I mean there is nothing in a telex. A telex is the easiest thing to forge.

What you need to do in these type of cases is look at what standard broking practice and compare that to what these companies offer. Say, for example, with the telexes. Standard broking practice is that orders are phoned through. Even with overseas trading you phone it through and at the end of the day you will do one or two things. Normally you will fax the confirmations off

saying 'These are the orders we placed' or else you will telex them off, but also at the end of every month monthly statements come in issuing from the overseas broker. In some of these companies where the allegation is that they are bucketting the orders, that is they are not placing them on an Exchange, the only thing you will ever see is a telex. Nothing more. No monthly statements, no confirmations at the end of the day and so you have to get across not only to investors but also to the court that it is vitally important to compare what these people do to what is standard practice, and if it varies from that then the conclusion which they should draw with appropriate expert evidence, of course, is that they are not conducting legitimate operations and they should be closed down. One of the other things which I can very much identify with is the wall thrown up by solicitors employed by leveraged currency dealers or other companies. It can be incredibly frustrating when you send out letters seeking certain information and what you get back is no answer. You get a letter back from the solicitor saying 'On what grounds? point to what power you can request that information? Do this. Do that.'

In the earlier stages when the Exchange was handling some of these matters it was causing problems but it has got to the stage now where, for example, on Japanese markets the Exchange has a great deal of knowledge of what actually takes place. So this throwing up the walls can in fact go against these companies in the long run because the Exchange is in the position to know what documentation should be there. We have got information from the Japanese Exchanges and other sources. Trying to keep the Exchange in the dark is no longer going to work. It is getting to the stage now where the Exchange is in the position that it knows more about Japanese Exchanges than these people who purport to execute trades on the Japanese Exchanges.

To return to my paper; What is a bucket-shop? A bucket-shop is a company where they purport to execute the clients' orders on a recognised futures exchange when in fact they do not. The orders can end up in a bin somewhere in Asia. I would view bucketting as the ultimate abuse on the futures broker-client relationship. It is just a systematic and well organised form of fraud.

I suppose the question that needs to be asked is 'Why did people pick Australia?' I suppose one point which I did not put in the paper is that these people at one time or another are eventually going to go to all countries in the world and like it or not Australia is a wealthy country and they are going to finally come here.

Bucket-shops are not a phenomena which is restricted to Australia. Australia has seen it in the context that orders are purportedly being placed on Japanese markets. The interesting thing is that the Japanese have an identical problem. They are called 'black firms' in Japan. However, there they have not got problems on their domestic market. There problems are with Japanese firms who are purporting to execute trades on U.S. Exchanges as well English Exchanges. So it is not as if this phenomena is restricted to Australia.

In the early eighties Hong Kong had similar problems as well as Singapore. In fact if anyone saw the *Four Corners* programme about three or four months ago they actually had extracts of that report from the Singapore authority. I think it is rather unfortunate the regulatory authorities in Australia weren't advised that this type of operation was being conducted in Singapore and had been closed down. It would have been a vital piece of information. Of course, it would have given the regulatories in Australia an insight into what they were doing and how they were doing it.

The next thing is to look at some of the characteristics of these bucket-shops. They are very smooth and well organised operations. They have very plush offices. It is possible where clients are hesitating the salesmen will invite them in. 'Oh, come on in and have a look at our office'. I mean they spare no expense in fitting them out and the people think 'Oh, this must be fairly respectable and they have got very good offices'. Customers also see all these fancy screens, Reuters screens, and think 'It must be quite a good operation. I feel safe' and the next thing they are parting with their money. I think it is just simply part of their overall ploy.

Another one of their characteristics is that their salesmen are literally hauled off the street. They are given about two days' training and basically that is an emphasis on how to sell futures as opposed to providing advice to the clients and they get to the stage where they grossly misrepresent the profits that can be made 'They say look. Give me $10,000 and in two weeks I will have turned it into $20,000' or 'I had someone invest $5,000 with me the other day and now they are up to $25,000.' There is a constant emphasis on the profits never on the risks. Actually if you listen to their spiel you will find that there rarely, if ever, talk about any risks.

Another characteristic of them is that their client advisors are paid on a commission only basis and the structure is such say, for example, if you trade say one to fifty contracts a month you might be paid $10 a trade. But if you manage to do over 200 a month then you're paid say $30 a trade. It is fairly obvious that traders will build up their volume so that they get more money. The dangers are fairly evident when they are paid on that basis.

Another thing that never ceases to amaze me that when you start reading some of the client agreement forms that these companies offer. A number of them actually have clauses in there which permit the company to bucket. The agreement actually says they can take a principal position against their client. I am sure that clause is never explained to clients and it can be done in a very subtle way. One of the other jobs I have at the Exchange is I vet all client agreement forms of all members so I have probably vetted somewhere between eighty to one hundred of them and some of them are so subtle when you get a bucketting clause in them. I can remember on one occasion when I read over one and did not even pick it up and yet I had had considerable experience in picking out that type of thing. I get quite annoyed when I see clauses like this because the abuse that those clauses can be put to is fairly obvious. For example, all clients sign a discretionary count or what is sometimes referred to as an authorisation letter which basically gives the broker absolute authority to do anything they like with that client's money. There have been instances where clients have phoned the company involved and said 'Do not trade on my account anymore. I want all my money back' and the company went merrily away and lost another $15,000 or $20,000 the next couple of days on that client's account. The solicitor's letter to that client my say 'Please go to clause such and such of the client agreement form. You need to withdraw the brocker's authority in writing'. That is simply ridiculous and most unfortunate. I would like to see one of those agreements challenged in court I suspect you could open up under the *Contracts Review Act* in New South Wales.

The question which I suppose anyone is entitled to ask is "Why was it allowed to flourish so long in Australia?" It existed probably for about 18 months to two years prior effective action being taken. I think one of the important things is that there was a void in the legislation. I think the Corporate

Affairs Commission prior to the 1st July 1986 which was the effective date of the *Futures Industry Code* did not think that what these people were offering were a prescribed interest. It only actually came out later in the leverage currencies cases that what they were offering in fact was a prescribed interest, but those actions taken late last year and early this year were taken both under the *Futures Industry Code* and the *Companies Code.* I have considered the question: would they have succeeded prior to the 1st July 1986 on the *Companies Code* alone? The feeling is that they would not have because I think one of the things which perhaps influenced the courts indirectly is that it became publicised in the press exactly what the types of operations these people carried out and it subtly has influenced the judges and their thinking.

Again, people did not realise they were being ripped off. When they complained to the broker, the broker could produce the magical telexes to say that the orders were placed, and quite often the response they give is 'Eighty-five percent of people who trade futures lose money'. I think perhaps that is one of the greatest excuses ever invented for this type of operation. What they fail to say is of course 99 percent of their people are losing money. Additionally clients just did not know they were being ripped off and it wasn't until the papers brought it to their attention they began to think 'Oh yes, the same thing happened to me'. I am intrigued how some people did not complain to the Corporate Affairs Commission or the Sydney Futures Exchange. Obviously the Exchange was restricted if it was a non-member.

The next point is why they used a foreign exchange. I think basically the points are made in my paper. Australian investors are not familiar with the Japanese market. There are language barriers. The problem of establishing court audit trails overseas. What happens is the telex does not go straight to Japan. The telex goes perhaps through Singapore, Hong Kong, and could go through up to two intermediaries before it is finally telexed to Japan itself. It is fairly obvious why they do that. That is you lose the audit trail, and they sit back being quite smug about it and they are thinking that 'Oh well, the Exchange or whoever it is has to prove we did not place them'. If we lose the audit trail we cannot take any action against them. These people are very skilled in what they do. The great difficulty from an evidentiary point of view in running these cases is trying to prove a negative. You go into the court and you say 'Standard broking practice is that an audit trail should be there. There is no order trail. The conclusion that we are asking you to draw then is the orders were not placed'. A very difficult argument to run in court. Obviously the judge is going to have some doubts. It could be legitimate or it might not be.

They can pretty much identify with the last topic—problems faced by the regulators is being employable by the Exchange. It has a co-regulatory role under the *Futures Industry Code* with the Corporate Affairs Commission and they are fairly brief and speak for themselves.

In conclusion I should say that by far the quickest and the most efficient way of closing down these operations is to stop their money flow. The best way to do that is to give them bad publicity. Once their cash flow is severely interrupted they close up very quickly.

I think perhaps on a brighter note, the question is 'Are we going to see a continuation of this kind of activity, leveraged currency dealers and some companies which purport to trade on Japanese markets?' My feeling is 'No, we are not'. As far as I know most companies who traded Japanese markets and, of course, it does not mean that all companies that trade Japanese markets are

fraudulent, but there are very few that trade Japanese markets anymore. The American experience has shown once you get rid of one form they are likely to develop another. Perhaps because the leverage of the contracts is such that a small outlay can get you a large profit so it is just it has the characteristics of attracting these money merchants and fraudulent people. The only way to try and combat that is for regulators to have a high profile and show these people that there is somebody there who will take action against them and make them think twice before they ever try that type of activity in Australia.

Question

I have a question for Michael Hains. In the situation where an associate member of Sydney Futures Exchange closes down and threatens to go back, say, to Malaysia and all the moneys are camped in Malaysia, have you got a compensation fund? How soon does the compensation fund pay out to the investing public?

Michael Hains

The question is first of all it is not an automatic payout from the Fidelity Fund or under any Act, either the *Futures Industry Code* or the *Securities Industry Code.* It is first necessary to submit a claim. But let's assume there is a claim. Given your example I do not know how long it would take. It would depend on how long before you could establish whether or not the moneys are recoverable from Malaysia. You would need to make certain enquiries in Malaysia, for example, to go to their regulators and present the factual situation to them and ask 'What are you going to do?' That of course takes time. After you have done that you would then need to assess the likelihood of success in litigation against any company that may be in Malaysia, and after you have considered those two options then you would be better informed to make a decision on whether the payment should be made out. It may take 12 to 18 months.

John Jefferson, Corporate Affairs Commission

My question is to the whole panel. Is there any particular legislation that they would like changed, or, any additional legislation, or any extension to the regulations that would help prevent corporate crime or would help in policing corporate crime?

Jim Berry

From the Stock Exchange point of view we would be much happier if there was complete protection to the self regulatory organisation to have complete and open communication between the Commission and the Exchange so that no defamatory action could be taken. That is one basic thing I believe is necessary.

Michael Hains

I have to support Jim Berry on that. Of course, the Sydney Futures Exchange is a self regulatory organisation as well. There are two problems that have to be faced. One of the problems is that you cannot often be as honest as you would like in correspondence with the fear that it will be subpoenaed into court. In the not too distant future I am actually going to do research looking at the basis upon which public interest immunity is based. For example, the Corporate Affairs Commission can rely upon that when they are subpoenaed for documents. I am going to see whether the same sort of principles could ever apply for correspondence between two self regulatory organisations. I suspect that it does not but it is certainly something that we need.

Another thing which I think is vitally important is the secrecy provisions which bind both the National Companies and Securities Commission and Corporate Affairs Commission. They have changed slightly so that they can more freely give us information. It can get to a situation where you are at one way street, i.e., going from the self regulatory organisation to Corporate Affairs. Corporate Affairs are more than willing to assist but they are bound under the statutes by which they are constituted not to make certain documents available. That can be overcome on occasions when the Commissioner gives consent, but it can take time to get that consent. Permitting them to release documents a little more freely to self regulatory organisations would be a great step forward.

Terry Griffin

Could I just make a general comment on that to justify my place on this panel.

It seems to be that there are any number of changes that any prosecutor could run off. There are ways of making the fight against organised crime more effective—forcing people to incriminate themselves would be a pretty useful one. But it has to be a balance quite obviously, and one of the things that it seems to me that many of the speakers have put forward is that there is an education problem. The balance has to be that which the community seeks between the power it gives its investigators and the rights of the individual. I do not think anybody here or any regulatory authority is going to or should be able to say 'We want these rights and we want 'em now'. But the important thing is to have the public in the position where they understand the problem, and then decide what powers they are going to give the law enforcement agencies to meet the problem. War is a good example. In wartime a lot of civil liberties and individual rights disappear and people generally agree it is in their best interests. In times when there are not those severe threats people are not prepared to let their rights go so freely. I think the job of people who are concerned and have some knowledge is to educate, and then find out where the public want to draw the line. I think that is the basic problem at the moment.

Robert Nicol

If I might just respond in relation to my paper which was on insider trading which I dealt with solely.

I think there has to be a change to s. 128 of the *Securities Industry Code.* I would like to see something along the lines of the draft proposed by Dr Anisman in his paper *Insider Australian Legislation for Australia—The Outline of the Issues and Alternatives.* It is a Green Paper and I can only refer to what I said earlier and draw your attention to the English legislation which I said at the time is novel. If you read the paper later you might care to think just what the English have done at this particular stage in relation to the extreme that they have gone to with their legislation.

Professor Brent Fisse, Director, Institute of Criminology

I would like to ask a question in particular of Brian Rowe and Terry Griffin in relation to some of the problems about criminal prosecution which they discussed in their paper. Obviously there are a large number of difficulties associated with successfully using the criminal process in areas such as complex fraud. That leads one to ask to what extent should we be relying more and more on civil liability and the civil process as a means of at least doing something to control the villains of the piece?

Bryan Rowe

I think you are right. There are a number of difficulties with the major fraud cases which we have highlighted in our paper. There is a view around that in some instances it is much better to get the money back than to just put the criminal in gaol for a couple of years.

In the Federal arena there may not be a need to do anything more as the penalties are quite good for conspiracy to defraud—they have gone from 3 years to 20 years. Primarily, I believe that there was never an offence to defraud the Commonwealth on your own. There is now, and the maximum penalty is 10 years. The criminal penalties may now be seen as effective. But I think there is a need to use civil powers either on their own or in conjunction with the criminal ones. We are seeing greater successes in the combination of civil remedies initiatives as well as the prosecution initiatives. I was glancing at the *Sydney Morning Herald*, I think this morning or yesterday, where it appears that one of the potential witnesses in an enquiry has slipped off to England, presumably to stay away for a couple of years then come back when it has all blown over. Allegedly the Tax Office yesterday froze all his assets including a $1.2 million dollar Gold Coast unit. Now, that may have an effect, of either bringing him back or making him live in somewhat lower circumstances while he is away. But I do agree that the civil remedies initiative is the one that should be pursued. We all should be trying to ensure that the necessary legislation both here and overseas is put into place because the criminals do not obey the boundaries like we do and also we cannot take effective action unless the other countries reciprocate. It is not just a matter of passing legislation in Australia. The legislation has got to be in place overseas as well and there should be a major effort to get that legislation in place as soon as possible.

Robert Nicol

Could I just respond to that? When the *Futures Industry Code* came in on the 1 July 1986 the Corporate Affairs Commission had powers to get receivers appointed under the Code as well as criminal sanctions. It was a resolution that we made at the Commission that we would firstly go with the much speedier civil remedies of having a receiver appointed. It was quite effective. During the last financial year we had twenty-three receivers appointed, most of them over the leveraged currency dealers' actions. Now we find we have to put the criminal briefs together which is a little bit harder and slower but it was effective in the first instance. We were not aiming at all leveraged currency dealers but those that were flouting the law, bucket shops etc., getting them closed down and trying to protect investors' funds.

Patricia McMahon, Law Student

I would like to ask Robert Nicol. Where do you draw the line of insider trading? Surely it is unrealistic to expect companies and officers to trade blind on the market, and what do you think of Chinese Wall arrangements within companies?

Robert Nicol

The legislation must draw the line. If I could just refer to the current legislation. You see s.128 subsection (1)—

> a person connected with a body corporate shall not deal in securities of a body corporate etc., etc., if he is in possession of information not generally available but if it were would be likely to materially affect the price of those securities.

It is virtually up to the court, isn't it, to interpret that section and draw the line.

I can only go on the legislation and that is what the legislation says. Anisman is his Green Paper takes it a lot further in that he defines, what an insider is, the particular categories of insider at s. 11E and then at s. 31.

> An insider of a company who knows material confidential information relating to a company or security of a company shall not purchase or sell a security of a company or an option or other right to purchase or sell such security.

So there is a complete embargo, and then there are three sections comprising subsections all giving him defences, ways out. So there is an embargo but there are defences, the onus virtually shifts then to the defendant.

Patricia McMahon

One member of the panel mentioned there was a lot of information circulating in the market place. Wouldn't that be regard as price sensitive information?

Robert Nicol

Once it becomes public it takes it out of the realm of 'would be likely to materially affect'. If there is a rumor in the marketplace, and people generally know about it, then it falls under the current s. 128. He is in possession of that which is generally known.

The other thing that the Anisman Paper does is it defines information to be a 'fact, intention, opinion, motive, and a statement concerning such matter', whereas the current legislation just says 'information'—there is no definition of it.

Jim Berry

Could I just take your question just a little bit further? The Securities Institute submission to the N.C.S.C. on insider trading says that it does not matter what the association is, it is the information that causes the damage, rather than precisely how it is obtained or who obtains it. Therefore the legislation could be much simplified by preparing an appropriate definition of what falls under the heading 'confidential information', i.e., information that is price sensitive and confidential. Accordingly any person broadly defined who uses such confidential information should be caught by the legislation. We basically took the tack that it is not the relationship, it is the *use* of the information and so therefore we had great difficulty with Professor Anisman's approach. We saw from practitioners in the market that the proposed legislation

created such confusion in the way that it was structured—how really could a stockbroker who had Chinese Walls in place work out through the definition of insider, whether in fact he was an insider, so we took the ethical approach to say that if you have the information you should not use it.

Your second part of the question is about Chinese Walls. The Exchange instituted a rule on the 1st March 1984 as regards Chinese Walls which is the first time this ethical matter was put into the Rules. I think that it is quite effective in the professional type organisations, those people who go to great lengths to ensure that they have adequate security resources in place between two physically different parts of their organisations. In certain instances I have found that there might be a corporate Chinese Wall around, say, a corporate finance department, and that the corporate finance department of a stockbroker decided to take a major position in a listed company and that position might be held for six, nine or twelve months. Now, obviously the Chinese Wall needs to be extremely good to keep the information confidential to the corporate finance department for that length of time because in that length of time the broker has to carry on his other activities. Most likely, if it is a specialist stock, he would be producing research reports in which he would have recommendations on that stock, as well as on companies that might be associated with it. He also might have client advisers who are making recommendations on that stock. I have looked at Chinese Walls situations in the larger brokers and I have found them to be largely effective. It is then a fascinating process how the confidential information in effect breaks down over a period of time because of rumors in the market. Let us say the broker is dealing as principal in selling off the stock. Therefore the market puts two and two together, and the professionals come to the conclusion that that broker has a principal position. It then starts to become non-confidential information because of the types of rumors that are going around in the market. It might then come back to a client adviser on the other side of the Chinese Wall where he is asked 'Well, hasn't your firm got a large principal position in this company?' It is a very complex area. I am not going to say it works in every case but in the larger firms that have actively pursued putting in Chinese Walls I have seen it work. I have also seen where it does not work so well and I would suggest it is more a problem of how does a two partner partnership work with this side saying, 'I have got this information' and that side saying 'No, I can't tell the other person about it'.

Dr Jeff Sutton, Director, Bureau of Crime Statistics and Research

I feel as if I am not a member of the Club—I do not know what Chinese Walls are. It does seem a bit like a Club. I am looking at it from the point of view of a person who is mainly concerned with, what I suppose I would call traditional crime, in which a number of people commit property crimes and the like and keep doing it even though they get locked up for longer and longer periods of time. They are usually classifiable in certain classes of the society—males, young, etc. Now in all of the time that I have been involved with the Bureau we have only done one study on corporate crime, and it was quite a long time ago. One of the things which struck me, and I am no expert since I do not know anything about Chinese Walls, was that we are dealing with a very different type of activity from armed robbery and the like because everybody recognises an armed robbery when they see it. There is no dispute about it. Nobody says 'Well I just came in to take some money out or to deposit something' if they are carrying a gun and wearing a balaclava. In this case it is different.

What I think you have to answer as a panel is why it is you are so patently unsuccessful in dealing with the offences which you describe. If you tackle it as if it were traditional crime then you would define these offences. The offences that you have defined are so obscure that it is awfully difficult to know whether they have happened or not. There were examples read from an Act which showed that it was not clear or obvious what had occurred, whereas that is not true of the *Crimes Act* in general, with respect to traditional offences.

What I would suggest is that one of the problems is that there is an assumption which underlies the enforcement approach which has been used, and that is that, somehow or other, what is going on is an ordinary type of activity—an entrepreneural behaviour that you or I or anyone of us could just do if we chose to. Tomorrow we could go out and do all the things that you have described—get involved with the Futures Exchange and so on. That is not true, we can't do that sort of thing. It is not part of normal entrepreneural activity. Sure, I could barter down in the marketplace if there was one. There are some purists say 'Well, that is what *this* is all about, so you have got to encourage entrepreneural behaviour".

I would suggest from the little reading I have done of the *Companies Act* that enormous protections have been developed for people who operate companies. There are special privileges involved with it. It is not a one to one situation which has evolved from simple market dealings. It is something which is quite different—more like driving a car. Where I drive a car and use public roads which have been built at enormous expense and because of the privilege of being able to drive a car on public roads I have to have a licence and submit to a test, etc. I do not think the tests are good enough and, of course, we still continue to kill each other, so there is not enough stringent action with respect to driving. There is even less it seems to me with respect to the companies and their operations. Directors are not required to pass tests, they are not required to submit themselves to periodical examinations, they are not required to participate in disclosure other than that which is specified in Annual Reports and the like which is really not enough to determine whether or not what they have done has been carried out in any sort of any ethical manner. Self regulation is all very well but this is an enormous privilege we have given these people and many of them have run away with it and cost many people who cannot afford a great deal of money. They may be foolish, very foolish, but there are many others who may have been less foolish who have, in total, lost millions of dollars too.

Penalties If somebody walked into a bank and comes out with $25,000 and threatens with an armed weapon, and they are caught they are likely to go down for 15–20 years, something like that. I am not in favour of enormous penalties, the evidence does not particularly support the deterrent effect of very large penalties in the sorts of traditional crime that we deal with. On the other hand, in this area it seems we have got an absurd situation where it is at the other extreme.

I wonder whether or not it is hard for me to get a leverage on this whole debate because I feel I should belong to the Club and then I would all be able to talk like you about the details of things: whether or not there is a Chinese Wall, whether or not somebody is engaging in insider trading, calculated on what must be a model of obscurity in the Act in defining it. But then, I would not be dealing with the overall problem. I would like to put it to you that perhaps the whole thing should be turned on its head. It should be a privilege

to work in the area that you are working in. When people break that privilege they should be put out of it like the Medical Board puts out a practitioner who behaves badly.

Jim Berry

Firstly a Chinese Wall is basically a procedure which is installed in broking or other financial institutions which stops the flow of information from one side of the organisation to the other. It is commonly used for takeover activity whereby, let us say, a bank is advising in a capacity a takeover or advising a person taking over another to ensure information that is gained in that section of the bank's activity cannot flow to other areas. If a bank was advising the BHP board on a takeover and a loan officer out in a Branch approved an application for a loan to somebody who wanted to buy 1000 BHP shares, it must be effective. Essentially it is an ethical barrier to protect both clients of the bank to ensure that the information received on the takeover by the bank is not misused by the bank and also to ensure that the person who is approving the loan to the investor is not aware that there is a takeover offer in process.

Just going back to your points. I would disagree. I would say that the Stock Exchanges have been successful self regulators. Since Patrick Partners in 1975 there really have not been any great scams. Therefore the industry has regulated its own. I would say that in many cases if there is an unsavoury operator he is removed by whatever means. I think it is probably a pity that the public are not made aware of our disciplinary procedures because we are publicity shy. But I am convinced that self regulation is effective because it attacks the problem quickly. It is in the interests of the professionals to do so.

Robert Nicol

I suppose it may fall to me to answer part of the question as I am from Corporate Affairs. You see the whole point of my paper was to draw your attention to the current insider position and the proposed Draft. It has been perceived in the past that s. 128 is not working that is why the N.C.S.C. commissioned this Draft Report and that is why it is here and it is being considered at this particular stage. It does change the whole perspective of insider trading and I believe will make it easier to prosecute.

You drew the analogy with armed robbers. That is easy, but are all armed robbers caught? You know there must be a little bit of spillage. You draw the analogy of the armed robbery and that the *Crimes Act* offences are clear, but there is an offence I believe in the *Crimes Act* around about s. 98 of 'armed robbery with an offensive weapon'. Well, what is an offensive weapon? Is the law on that particular area clear? The law is a fluid thing. You have said that to be a director is a right. You know what questions do you have to answer etc., etc., and then you said well 'Look at a licence you have got to answer questions'. What question really do you have to answer to renew a licence. You do not have to go for another test or a medical test until you are 70. I do not think you will find that the licencing of directors or getting people appointed as directors any different. There are provisions in the Act to have directors disqualified. That is s. 562A, and s. 562A is being actively pursued now. The *Companies Code* was only amended in March last year and this provision was put in place but it is being used. So I believe that the Act is being used and being enforced and I do not think your jaundiced view is quite right.

Terry Griffin

Could I comment on that at general level to develop a little bit. It seems to me that, with respect, there is a classic mistake in what your are saying, and that is that we up here ought to be making the laws so that the naughty or not so naughty directors can be caught. We are not the lawmakers. We are commentators and the lawmakers are the people—all of you—and it goes back to that point of education and getting the laws you want.

But I think there was an even greater flaw and Mr Nicol alluded to it. It seemed to me that you were saying the simple, clear cut matters where the penalties are severe and the crime is obvious are easily controlled. Now, if you make company type law tight and put the death penalty on people for not signing their documents properly, get it really tough, that will change the situation. Of course it is not the case—there are still murderers, armed robbers. The penalties and the description of the crimes has done nothing to stop those crimes. There will be no description or controls that you can draw that will stop these crimes. You can perhaps have different reactions to the crime but it is not going to stop them. I do not think that the analogy of privilege and licence works very well either for the same reasons. You can build in as many tests as you like. Greed which is a driving factor in most of these corporate commerical organised frauds will drive people regardless of the penalties. You see with the drug offences where often, at least in the federal area, there is a life sentence. It does not even slow people down.

John Swan, Crown Prosecutor (Companies)

I might say from the outset that the reason why many of the Crown Prosecutors do not come down from Darlinghurst to our area in A.D.C. House is for the very reason that Dr Sutton has adverted to: that is, it is much easier to prove a crime of armed robbery or assault.

One of the great difficulties in proving a corporate crime case is the difficulty of proof of documents. There is the huge documentation that is amassed in all these corporate crime matters. When we go up to court we take boxes of documents. We literally have to go through the whole history of the operation of the company. We have to prove every entry that is relevant in the books. We have to call not only the investigators of Corporate Affairs Commission but the accountants who have been through the books for the purposes of identification, etc., etc., and by the time we try to explain all this to the jury half of them have gone to sleep because it is very, very difficult to try and explain to them various entries, to trace what was misappropriated by company directors or other officers and where the money went and for what purpose etc., etc. Now the difficulty in these cases really is not 'What is fraud?'. 'What is fraud?' is very easy to explain to the jury because as has been stated in many authorities of the Supreme Court, fraud is nothing more than dishonesty, and it is very easy for the jury to see whether there has been dishonesty in any corporate crime case. Where the difficulty lies is where technical objections are taken, and where delay after delay is almost, I would say, 'orchestrated' by defending counsel. The longer the case takes the better. The more often the jury are trotted out by the trial judge the more annoyed they get and they lose track of what the case is about. What we really need for the purposes of simplifying the process is to get the legislation, the *Evidence Act,* amended. Nothing more. Where we can, we should obtain an expert who

could go through the books and records of the corporation and give his expert view as to the entries and the results (and that should take probably about half an hour to an hour) rather than go through masses of documentation and get everybody bored with the case from the first couple of days.

One other comment I have with regard to directors and that is in the context of the need to amend the legislation. I realise that it is difficult to put a test to prospective directors because if you make it too hard they would probably find someone who would be prepared for a fee to become a director subject to meeting the qualifications of the new test. But the real deterrent factor would be to impose personal liability on the directors if the company has failed after, say, it being in operation for 18 months; and you usually find that people who set up these fly by night companies only set them up for 18 months—never bother to file a return, transmit the assets overseas and they go after the assets themselves.

Paul Byrne, New South Wales Law Reform Commission

My question will be brief. It is really directed towards Brian Rowe and Terry Griffin, because it derives from a comment in the paper which they presented, but it may be something which Anne Lampe might wish to comment about.

I have got some reservations about one thing Brian Rowe and Terry Griffin have said, namely that the only effective answer lies in ensuring that the public are aware of the facts '—for what it is worth we believe the media have the power and a responsibility to provide those facts'. It seems to me that that is a matter for some concern because, particularly in this sort of area, what are the facts will very much be a question of a subjective nature. What are put forward as facts may not be anything more than opinions. I wonder whether you have any comment as to how you can reconcile the approach that you have put forward with the traditional right of an accused person to be protected against prejudicial influences prior to trial. I wonder in particular whether the experience that we have had in this country with the Costigan Commission and its comments in relation to Kerry Packer might lead you to temper the comments that you have made on this point?

Bryan Rowe

I think I should say that Terry and I are not saying publicity in the sense of putting the face of Brian Maher and whoever else on the front of the papers. We are saying publicity to let the public know that corporate fraud is here, does exist and is costing a lot of money, and you ought to get off your backsides and do something about it rather than just quoting figures from the Australia Card debate that we used. I do not think either Terry or I would like to prejudice in any way the right of an accused to a fair trial. Whatever our views are, that can only be counterproductive in the long term because if it is found that there was prejudice there will be a re-trial and these cases take months to prepare, months to run, so I do not think we really advocate that sort of publicity, the police taking the media with them to the search warrants and that sort of thing. What is needed is really an awareness to elevate the public's consciousness so that they will then demand that proper laws are introduced, or proper resources are given. Then it is a matter of balancing what rights you give, what rights you take away and that will come about by the public deciding how far they want to go.

I do not think I have a problem once people are convicted and their appeal processes are finished and they are in gaol. Somebody can run an article about them. I do agree with you that it is a very difficult problem. How you ever run a bottom of the harbour article for example over the last 4 years when there have been trials and committals going on at some stage virtually the whole time is difficult. It is a very fine line to draw and you know it takes a great balancing act but I do think the public has a certain right to know.

Anne Lampe

I think the defamation laws in fact protect people fairly well. We have to run through hoops and rings to say the sorts of things that we would like to say about people's activities. You have also got to remember that once people are charged there is very little we can say. We can say nothing until they get into court and then we can only report on what is said in court until such time as they are convicted, and then we can give some background. But we face fairly tough restrictions on what we can say.

What I would like to add is that I think everybody focuses on the rights of the individual who is charged until he is proven guilty. There are a whole lot of innocent people out there who lose money and were victims, and who also have a right to information and have a right to airing their grievances.

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