

## **‘Systems Intentionality’: laying bare the culpable corporate mind**

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### **1. The corporate mind**

Assessment of the defendant’s state of mind is a critical component of both general law and statutory doctrines that regulate commercial fraud. Common law and equitable doctrines include deceit, fraudulent misrepresentation, injurious falsehood, knowing receipt and assistance, and unconscionability. For example, the tort of deceit requires that the defendant has made a misrepresentation knowingly or recklessly, intending to induce reliance on the part of the victim. Unconscionable conduct requires the defendant to have ‘taken advantage’ of the plaintiff’s special disadvantage: here knowledge is key to the enquiry, but courts commonly also reference defendant dishonesty, a ‘predatory’ intention, recklessness and deliberateness.

As under the common law, state of mind is invoked directly or indirectly in a number of statutory prohibitions and enforcement responses to commercial misconduct, particularly those subject to criminal sanction. Eg s1041G Corporations Act 2001 (Cth), which prohibits conduct that is dishonest and imposes criminal and civil sanctions for contravention. But even when a statutory prohibition is *strict*, state of mind may play a role in remedial relief, for example, when determining the defendant’s scope of liability, or through defensive or mitigating considerations such as good faith change of position, honest and reasonable mistake, or apportionment of loss. Perhaps most importantly, as a matter of regulatory practice, the ongoing relevance of culpability is particularly apparent where civil pecuniary penalties are in play. Here, drawing on the ‘French factors’, courts commonly look for indicia of the defendant’s blameworthiness through state of mind criteria, such as the defendant’s knowledge, intention, regret or contrition.

We might also note that state of mind enquiries are also key to much *ex ante* regulation – for example, determining whether a party is a ‘suitable’ to hold a licence (such as gambling, but also financial services, consumer credit etc licences etc).

The pervasive role for state of mind requirements arguably reflects the ancient roots of the common law and equitable doctrines that regulate commercial fraud, dating from 14th-18th centuries in England. While these laws aimed or operated to regulate serious commercial wrongdoing, courts were also concerned to protect natural individuals from unmerited and overly crushing personal liability. This was particularly apposite given the real potential for incarceration, and the profound and often irreparable damage to commercial and personal reputation, consequent on a finding of fraud. Thus, courts demanded clear evidence of high levels of personal culpability on the part of defendants accused of fraud, sometimes compendiously expressed as a ‘fraudulent state of mind’. The law’s development was, it seems, heavily premised on the paradigm of the individual rogue.

Yet modern, commercial miscreants are far more likely to be massive, massively complex, multi- and trans-national corporate institutions that sit within a web of related entities. Modern corporations are often structured to create information ‘silos’, and to keep relevant knowledge below Board level. Knowledge about the corporation’s activities will often be dispersed through its lower-level employees (the corporation’s ‘arms and legs’) who carry out its activities. Employees may number in the thousands. And they may well have no idea of how their individual role contributes to what is, overall, unlawful conduct. They are just doing their job. This ‘diffusion of responsibility’ poses a range of challenges to the law’s effective regulation of commercial misconduct.

In searching for the (necessarily) artificial corporate state of mind, the current rules of attribution are notoriously complex and deficient. As the ALRC report into Corporate Criminal Responsibility shows, the ‘directing mind and will’ approach, *Meridian* gloss and statutory developments (eg ‘TPA model’) all struggle to deal with large corporations and ‘diffused’ responsibility (let alone automated transactions). All require some individual human repository of fault. And concepts or processes of ‘aggregation,’ which could address the diffusion problem, have been met with considerable judicial caution. How, paraphrasing Edelman J, can a corporation be unconscionable, or fraudulent, (or malicious, dishonest, predatory, knowing, reckless...) when none of its employees individually hold the requisite culpable mindset?

## 2. Systems Intentionality: a proposed model

I propose a novel, additional model of corporate culpability, which sees the corporate state of mind manifested *in its systems, policies and patterns of behaviour*, based on:

- The work of philosopher Peter French and other organisational theorists;

[W]hen the corporate act is consistent with an instantiation or an implementation of established corporate policy, then it is proper to describe it as having been done for corporate reasons, as having been caused by a corporate desire coupled with a corporate belief and so, in other words, as corporate intentional.

- The pioneering work of scholars and reformers which led to the introduction of Australia’s unique ‘corporate culture’ provisions (Part 2.5 Criminal Code);

If intention, knowledge or recklessness must be shown on the part of a corporate defendant, it can be done by proving that **a corporate culture existed within the body corporate that directed, encouraged, tolerated or led** to non-compliance with the relevant provision;

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

- Diamantis’ analysis of the ‘extended’ corporate mind and AI. Human use of external decision supports (like maps, recipes or notes) to facilitate recall and decision-making parallels corporate use of systems, policies and processes to facilitate their coordination and management of disparate and rotating humans and other agents, over time. In some cases (as with automated and algorithmic processes) those humans are entirely replaced by self-executing systems. In both (human and corporate) cases, intention and knowledge are manifested through the adoption and operation of a system.

- Professor JM Paterson (Melbourne Law School) and I have examined the decisions of courts addressing statutory unconscionability in the context of exploitative business models and practices. The authorities provide a rich jurisprudence consistent with the model.

### 3. Unconscionable Systems of Conduct or Patterns of Behaviour

*National Exchange* [2005] FCAFC 226; Tamberlin, Finn and Conti JJ. National Exchange had sent unsolicited off-market offers to members of a demutualised company, Aevum Ltd, to buy shares at a price that constituted a substantial undervalue of their true worth. Notwithstanding the fact that a correct range of values for the shares was disclosed, albeit on the second page of the offer document, 257 shareholders accepted the offer. The offer did not target or seek to exploit identified consumers who suffered from known, special disadvantage. ... ‘National Exchange set out to **systematically implement a strategy** to take advantage of the fact that amongst the official members there would be a group of inexperienced persons who would act irrationally from a purely commercial viewpoint and would accept the offer.’ This an important example of where a system was found to have an objective ‘purpose’ of exploiting anticipated disadvantage: that is, a case where the **very design of the system was predatory** and systems intentional, and where knowledge of the presence of disadvantage (albeit not in individual cases) was implicit in the business model.

Approach adopted in section 21 ACL (s12CB(1) ASIC Act, as in *Kobelt*) provides:

A person must not, in trade or commerce, in connection with:

- (a) the supply or possible supply of goods or services to a person; or
- (b) the acquisition or possible acquisition of goods or services from a person;

engage in conduct that is, in all the circumstances, unconscionable.

Section 21(4) contains a set of interpretative principles. These include that the statutory prohibition ‘**is capable of applying to a system of conduct or pattern of behaviour, whether or not a particular individual is identified as having been disadvantaged by the conduct or behaviour**’ (reflecting the earlier decision in *National Exchange*).

*EDirect* [2012] HCA 1045; Reeves J (considering sales scripts): a system is “an assemblage or combination of things or parts forming a complex or *unitary* whole; ... a **co-ordinated body of methods, or a complex scheme or plan of procedure**”: Macquarie Dictionary. To similar effect, Dixon CJ said of the word “**scheme**” that it “**connotes a plan or purpose which is coherent and has some unity of conception**”:

*Lux Distributors* [2013] FCAFC 90: although this was a case of repeated interpersonal unconscionable conduct, the court emphasised the inherent and institutional unconscionable aspects of the business strategy, system or model. The business system was itself unlawful and the law it breached was in place for the very purpose of protecting consumers from being exploited due to a recognised position of situational vulnerability

#### **Vocational education and training scams.**

*Unique International College* [2018] FCAFC 155: a “system” connotes an internal method of working’, and a “pattern” connotes ‘the external observation of events’.

*AGM Markets* [2020] FCA 208 Beach J further explained that a “system” connotes something **designed or intended in its structure**; contrastingly, a pattern may be manifested

without any **design or intentional input.**’ A system relates to the ‘internal structure, for example, internal working, of whatever it is that has produced or reflects the conduct’. Its essence is ‘organisation and connection’ of elements within a complex whole. A pattern, by contrast, looks to ‘the external manifestation of behaviour and whether it can be characterised as a pattern...’. And a pattern is, at base, ‘a regular and intelligible form or sequence discernible in certain actions or situations’; there has to be both repetition and external discernibility’.

On this analysis, a corporation’s internal structures, methods and processes articulate systems that are **inherently purposeful in their nature**. By contrast, **patterns signify externally observable repeated behaviours from which systems (and hence systems intentionality) may be inferred**. The two are closely related, albeit distinct. As Beach J observes: ‘a “system of conduct” could produce a “pattern of behaviour”. Relatedly, evidence of a “pattern of behaviour” could enable you to infer a “system of conduct” in some cases.’

*Get Qualified* [2017] FCA 709: conclusion of unconscionability was largely based on GQA’s ‘training, directions, instructions and incentives’ to its recruiters.

*Cornerstone* [2018] FCA 108: defendant funded free laptops and cash incentives to recruit student and employed recruiters who were practically untrained and remunerated on a commission basis, with no regard to ACL requirements. Gleeson J considered that the system revealed a ‘callous indifference’ to consumer protection considerations

*Professional Education* [2019] FCA 1982 (Bromwich J): [a]n enrolment process that predictably produced, or even encouraged a situation in which such unsuitable consumers became enrolled would invite close scrutiny to see whether that was, in all the circumstances, unconscionable. The conclusion that the conduct overall was unconscionable would be more readily reached if such an outcome was either **intentional or sufficiently predictable or recurrent to require overt steps to be taken to minimise the chance of it occurring**.

Courts’ analysis of unconscionable ‘systems of conduct and patterns of behaviour’ suggest important understandings of systems intentionality. (1) Where a system is designed so as to produce a kind of conduct, the system manifests general intentionality or deliberateness with respect to that conduct. (2) Where the system is of a nature or patently likely (‘predictable’) to produce certain conduct, or that conduct is recurrent, and no positive steps are taken to avoid that result, the system manifests recklessness. (3) Where the system is designed to produce a *specific* harm to specific victims, this manifests a further, predatory mindset. (4) The defendant will have knowledge of the key factors necessary for the adopted system to function.

For full explication, see:

- Elise Bant, ‘Culpable Corporate Minds’ (2021) 48(2) *University of Western Australia Law Review* (forthcoming), available in pre-print state here: <https://www.uwa.edu.au/able/research/unravelling-corporate-fraud-re-purposing-ancient-doctrines-for-modern-times>

- Elise Bant and Jeannie Marie Paterson, ‘Systems of Misconduct: Corporate Culpability and Statutory Unconscionability’ (2021) 15 *Journal of Equity* (forthcoming)