Submission to ALRC Financial Services Legislation Interim Report A

Professor Elise Bant
The University of Western Australia

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I welcome the opportunity to make a submission in response to the Australian Law Reform Commission (ALRC) Financial Services Legislation Interim Report A (IRA). In the following, I draw heavily on the work undertaken with Professor Jeannie Marie Paterson (Melbourne Law School) pursuant to Australian Research Council Discovery Grant project DP18010093, entitled 'Developing a Rational Law of Misleading Conduct': see further https://unravellingcorporatefraud.com/developing-a-rational-law-of-misleading-conduct/ . A consistent theme in this work has been the need to map and simplify the statutory regimes that variously prohibit and remedy misleading conduct, to recognise the harmful ramifications of the current legislative 'labyrinth,' and to make suggestions for simplification and reform through articulating principles of better legislative design. In this submission, I identify where the project work provides detailed and independent support for a number of the proposals in the IRA, as well as some further considerations or suggestions that may be of assistance. While the authorship of this submission rests with me, I thank Professor Paterson for her comments on it, the thrust of which she also broadly supports.

The submission also draws upon work undertaken pursuant to my Future Fellowship FT190100475, entitled 'Unravelling Corporate Fraud: Re-purposing ancient doctrines for modern times'. This project aims to examine and model reforms of the laws that currently inhibit corporate responsibility for serious civil misconduct: see further: https://www.uwa.edu.au/schools/research/unravelling-corporate-fraud-re-purposing-ancient-doctrines-for-modern-times .

1. Scope of Inquiry: an holistic approach to overlapping legislative frameworks

Before proceeding to consider the Proposals and Questions the subject of this submission, the Scope of Inquiry adopted by the ALRC merits brief discussion. In my view the ALRC is to be commended for its holistic approach to the Inquiry, using Chapter 7 of the Corporations Act 2001 (Cth) as a lens through which to interrogate the broader issues of legislative design that currently affect financial services legislation in Australia: IRA [1.6]. Without this approach, there would be a significant risk that reforms would exclude related and relevant statutory schemes and regulatory issues, thereby exacerbating rather than reducing incoherence and complexity across our legislative landscape. As the IRA notes at [1.5] and [1.19] key statutes to bear in mind here include the Australian Securities and Investment

Commission Act (ASIC Act) and the National Consumer Credit Protection Act 2009 (Cth), including the National Credit Code, which forms Schedule 1 to that Act. These major legislative frameworks sit alongside numerous additional statutes, as noted in IRA [1.20], which also regulate financial services. Finally, there are parts of the Corporations Act beyond Chapter 7 that also regulate certain forms of financial products, such as debentures, managed investment schemes and so on.

While these are rightly captured by the broad net cast by the ALRC, future reform programs should be mindful that the financial services legislation builds on patterns and regulatory strategies found – indeed generated – elsewhere in the statute books. In particular, the Australian Consumer Law, which forms the second Schedule to the Competition and Consumer Act 2010 (Cth), provides many of the consumer protection principles that underpin (often in slightly altered form, an issue to which I return below) those adopted in the main financial services legislation.

Changes to one body of law without regard to the other will quickly fracture the patterns of statutory principle that currently enable efficient and coherent reasoning across a swathe of statutes: see, for example, the patterns of reasoning employed in the civil penalty context, discussed in detail in JM Paterson and E Bant, 'Intuitive Synthesis and Fidelity to Purpose?: Judicial Interpretation of the Discretionary Power to award Civil Penalties under the Australian Consumer Law' in P Vines and S Donald (eds) *Statutory Interpretation in Private Law* (Federation Press, Leichhardt 2019) 154; and in relation to the core prohibition on misleading conduct in in Joseph Sabbagh, Elise Bant and Jeannie Marie Paterson, 'Mapping Misleading Conduct: Challenges in Legislative Design' (2022) *UWALR* (in press, annexed to this submission).

I also note, not entirely by way of aside, that the practice of appending major regulatory frameworks as schedules to other Acts is another issue shared across the financial services (eg the National Credit Code) and broader legislative landscape (the ACL being a prime example). This practice can quickly cause trouble in terms of accessibility and coherence. For example, the loss apportionment provisions that affect misleading conduct under s18 ACL are not contained in the ACL, but rather are found in s137B CCA (and not in the state and territory legislative counterparts). For the patchwork application of apportionment considerations in relation to misleading conduct in the financial services sector, arguably leading to similar risks of complexity and incoherence, compare *Wealthsure Pty Ltd v Selig* [2015] HCA 18, relating to s1041H Corporations Act and s12DA ASIC Act.

2. Overlapping legislation and definitions

The overlapping operations of these statutory regimes can serve to make navigation and identification of core obligations tortuous, if not downright impossible. As Professor Paterson and I explain in 'In the age of statutes, why do we still turn to the common law torts?: Lessons from the statutory prohibitions on misleading conduct in Australia' (2016) 23 *Torts Law Journal* 139, 153:

> The general prohibition on misleading conduct is repeated in a number of statutes, primarily the ACL, the Corporations Ac and the ASIC Act. The ACL does not apply to the supply of financial services and financial products and the Corporations Act and the ASIC Act contain highly complex definitions of the products that come within their scope. The most basic financial service, credit, is not a financial product for the purposes of the Corporations Act. Meanwhile securities, including debentures — a basic form of credit — are financial products. The definition of a debenture is itself riddled with uncertainty and has been the topic of sustained analysis in the cases in which it has been raised. (Citations excluded.)

While this discussion serves to reinforce the need for the ALRC to continue to keep firmly in view the range of overlapping statutes in the financial services space, it also supports the IRA observations, relevant to its 'Definitions' focus, that, in many cases, definitions are being used across overlapping legislative frameworks to trigger obligations or statutory operation, rather than to elucidate meaning. Further, as explained in E Bant and JM Paterson, 'Misleading Conduct before the Federal Court: Achievements and Challenges' in P Ridge and J Stellios (eds) *The Federal Court's Contribution to Australian Law: Past, Present and Future* (Federation Press, Leichhardt 2018) ('Misleading Conduct before the Federal Court'), these definitions also offer opportunities for strategic litigation and arbitrage, lead to scatter-gun pleadings, tie up scarce judicial resources and undermine efficient regulation and the law's deterrent aims.

> The eminently predictable outcome of this statutory proliferation is protracted and cripplingly expensive litigation to determine who is covered by what prohibition. As noted by Keane CJ in the Full Federal Court, '[t]he presentation of a range of alternative arguments is not apt to aid comprehension or coherence of analysis and exposition; indeed, this approach may distract attention from the central issues'. Endorsing these observations, Edelman J has similarly criticised the accompanying trend of pleading 'every possible permutation of ' the law relating to misleading conduct, which is likely in most cases to 'do little more than to delay the proceeding and increase legal expenses'.

The scale of this problem is delineated and explored in detail in *Mapping Misleading Conduct*.

This more specialised analysis in the context of misleading conduct provides considerable support for the Interim Report's broader proposals concerning 'When to Define'. Consistency of definitions across statutes, as well as within them (addressed in IRA Chapter 5), is fundamental. But the need to define is significantly reduced if definitions are not used as gatekeeper mechanisms to impose obligations or trigger legislative jurisdiction.

Further, this body of work also supports the view, offered in the IRA (Chapter 4) and underpinning specific questions, such as **A24b**, that definitions should be omitted entirely where the word is one bearing ordinary meaning, which can be elucidated through the ordinary process of statutory interpretation. It shows that omitting definitions allows courts to connect meaning across and within statutes and to

The University of Western Australia
Law School, M253, Perth WA 6009 Australia
T +61 8 6488 2740
E elise.bant@uwa.edu.au

promote more coherent treatment of core norms. This is well-illustrated by the Australian law of misleading conduct, where the use of a broadly-framed and undefined prohibition has enabled courts to draw on and connect relevant statutory and general law principles, while giving effect to the distinctive statutory norm. This arguably has had the beneficial tendency to promote certainty of meaning and a more coherent and integrated legal system (constituting common law, equitable and statutory principles): see, in particular JM Paterson and E Bant, 'Misrepresentation, Misleading Conduct and Statute through the Lens of Form and Substance' in A Robertson and J Goudkamp (eds) *Form and Substance in Private Law* (Hart Publishing, Oxford 2019) 401.

That said, as the field of misleading conduct also well demonstrates, there are limits to what can be achieved judicially, in particular where legislatures choose to employ different terms to govern substantially similar conduct, the subject of extended consideration in *Mapping Misleading Conduct*. Where this has occurred, a process of what the ALRC terms 'consolidation' may be required. I return to this below.

3. Legislative design: principles-based drafting and the role of soft law guidelines

The Inquiry has, as a key aim, the principled simplification of our financial services regulation. A number of its related Questions and Proposals concern the use of principles-based drafting over more prescriptive formats. This approach also finds significant support in the ARC project on misleading conduct. Professor Paterson and I have strongly advocated in a number of publications that there is great merit in expressing general 'safety net' provisions that prohibit conduct in contravention of core standards through principles-based drafting. This is preferably to adopting a rules-based regime in the (illusory) interests of greater certainty: see, eg, *Misleading Conduct before the Federal Court*, 182. We have suggested that a principles-based approach may usefully be coupled with 'soft law' guidelines that show how these core statutory norms operate in different contexts. This combination may well provide a better means of satisfying industry demands for certainty than incorporating this sort of particularised guidance within the legislation itself. For discussion and examples of the sorts of valuable guidelines used in cognate English statutes, see Bant E and JM Paterson, 'Statutory interpretation and the critical role of soft law guidelines in developing a coherent law of remedies in Australia' in R Levy et al (eds), *New Directions for Law in Australia: Essays in Contemporary Law Reform* (ANU epress 2017) 301, available for download at

https://protect-au.mimecast.com/s/2mpEBkUrXVMLfb?domain=press.anu.edu.au

and *Misleading Conduct before the Federal Court*, 181-85.

In considering the merits of principled-based regulation, it may be also helpful for the ALRC to explore and further articulate the methods adopted by courts to interpret principles-based legislation. Principles-based drafting for core statutory norms of conduct may, through sympathetic judicial interpretive methods, serve to promote certainty to a degree impossible for rules-based regimes: see *Misrepresentation, Misleading Conduct and Statute*. This sort of analysis may help to gain industry constituencies for change, away from granular rules-based lists and in favour of principles-based legislative design. Here, our work shows that Australian courts have developed an important and laudable interpretive method, which draws upon common law and equitable principles to the extent that they are consistent with and promote the statutory language and purpose. The consequence of this interpretive method is that the statutory regime is integrated with, yet not collapsed into, its general law context, and statutory and general law principles may cross-fertilise one another. This interpretive method is very important to achieving the sort of principled and coherent regulation which is, arguably, much more difficult through a strict and formalistic rules-based regime: for some interesting comparisons between the English and Australian statutory approaches to misleading conduct, see J M Paterson and E Bant, 'Misrepresentation, Misleading Conduct and Statute through the Lens of Form and Substance' in A Robertson and J Goudkamp (eds) *Form and Substance in Private Law* (Hart Publishing, Oxford 2019) 401 ('Misrepresentation, Misleading Conduct and Statute'). Professor Paterson and I have further argued in *Misleading Conduct before the Federal Court*, 182, that these 'interpretive frameworks developed and applied by courts should be factored in at the point of legislative design.' That is, legislation should be designed with a good understanding of the interpretive method that will inform its application. This sort of *ex ante* consideration may be of interest to the Commission as part of its Inquiry, when thinking about legislative design in the financial services space, but of course is also a broader point.

The emphasis on the merits of principles-based regulation should not be taken as support for the view that there is no place for well-expressed, bright-line rules, where these operate to complement rather than confuse or derogate from other regulatory strategies (such as 'safety net' provisions). An important point here is to identify clearly the purpose of the process of legislative reform and, in particular, to whom the statute speaks. Where the risks of non-compliance are very high (including the spectre of court proceedings and civil or criminal penalty) the careful use of more specific criteria to articulate positive obligations (as opposed to prohibitions on conduct that contravenes core statutory norms) can make good sense. For example, setting out the baseline requirements for responsible business practices on the part of those licenced to provide financial services can provide useful guidance and prevent unwitting breach by stakeholders who, after all, may not all be sophisticated actors or legally advised. The same may apply in cases of overarching positive obligations (such as a 'best interests' duty). Where this is done, it should be carefully considered whether any 'checklist' of obligations should be illustrative/indicative or prescriptive, and if prescriptive should be exhaustive or open-ended. I return to these considerations below.

The University of Western Australia
Law School, M253, Perth WA 6009 Australia
T +61 8 6488 2740
E elise.bant@uwa.edu.au

4. Legislative Design: Exclusions, exemptions and notional amendments

My research conducted with Professor Paterson pursuant to DP18010093 provides strong support for the IRA's identification at [10.3] of exclusions, exemptions and notional amendments as raising acute problems of principle and practice. These are intimately connected to the unhelpful proliferation of similar provisions within and across multiple statutes, and to the use of definitions as gatekeepers for substantive obligations. Our research has questioned, for example, why the core prohibitions on misleading conduct do not attract penalties, see eg *ASIC Act* ss 12 DA(1A), 12DB(2) and, for substantive analysis, *Mapping Misleading Conduct*, *Misleading Conduct before the Federal Court*, and E Bant and JM Paterson, 'Developing a Rational Law of Misleading Conduct' in J Eldridge, M Douglas and C Carr, *Economic Torts and Economic Wrongs* (Hart Publishing, 2001) 275, 288-290. Rather, civil penalty prohibitions are separately imposed, with slightly different and supposedly more restricted operation, to reflect the seriousness of the civil penalty context: *Australian Competition and Consumer Commission v Google LLC (No 2)* [2021] FCA 367 [105]-[120] (Thawley J), analysed in *Mapping Misleading Conduct*.

Whether this separate treatment is required or desirable is open to serious challenge. Courts have shown themselves eminently capable of distinguishing between different levels of culpability through the 'French factors', as elaborated through subsequent decisions: see, eg *Intuitive Synthesis*. There is no reason to think, for example, that a formal and minor error included in a prospectus would attract the same penalty (or even be the subject of regulator proceedings) as more serious contravening conduct. If the Australian Law Reform Commission's recommendations 10 and 11 in its *Corporate Criminal Responsibility* report 136 to legislate strengthened versions of these factors is adopted, there can be no doubt that courts will approach varying circumstances of defendant culpability (the accidental omission of information, minor problems with a prospectus and so on, as compared to a severe or repeated case of misleading conduct) with appropriate sensitivity. But it is also open to conclude that, even without legislative enactment, the French Factors, as developed over time, are entirely capable of responding to different contexts with proper nuance. It is simply unnecessary to repeat and reiterate, in various forms, the core prohibition (some with civil penalty, others without) in order to avoid this phantom menace.

As explained in *Mapping Misleading Conduct*, *Developing a Rational Law of Misleading Conduct* and *Misleading Conduct before the Federal Court*, the costs of this separate treatment are very considerable in terms of complexity, inaccessibility, irrationality and sheer volume of legislation. Concerns by industry constituencies about a 'one size fits all' approach to the core prohibitions may here be better managed through educative means, including the use of soft law guidelines.

The University of Western Australia
Law School, M253, Perth WA 6009 Australia
T +61 8 6488 2740
E elise.bant@uwa.edu.au
CRICOS Provider Code 00126G

5. Rationalisation: Misleading Conduct

Relatedly, as the IRA notes, the proliferation of overlapping legislative frameworks is matched by proliferation of iterations of core statutory principles within these frameworks, supplemented by more specific rules guiding their operation in particular contexts, alongside carve-outs and exclusions, among others. All are relevant to the goal of just and efficient legislative simplification.

Here, as noted in the IRA, a major research aim of DP18010093 has been to map the prohibitions on misleading conduct, as well as their remedial schemes, across commonwealth, state and territory legislation. The survey paints a damning picture of the state of our law. The core prohibition, as expressed in s18 ACL, and its remedial regime, have been replicated, with unexplained variations, across a wide range of statutes. These doppelganger provisions then sit alongside other different legislative provisions also concerned with misleading conduct, but which approach their regulation in quite distinct ways (for example, through specific rules or prohibitions). The raw data has been made available at https://unravellingcorporatefraud.com/publications-drlmc/ . The problems raised through this proliferation are examined in *Mapping Misleading Conduct*.

This body of work, together with other project outputs cited and discussed in the article, see in particular at n 11, provides very strong support for the ALRC's **Proposal A23:**

> In accordance with the principle that terminology should be used consistently to reflect the same or similar concepts, proscriptions concerning false or misleading representations and misleading or deceptive conduct in the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth) should be consolidated into a single provision.

Consistently, I would strongly support return to the form of the core prohibition contained originally in s52 Trade Practices Act and now found in s18 ACL. This prohibition is well-understood and readily applicable across the range of financial service and product areas. Its application in discrete areas is better modelled through worked examples and other appropriate soft law guidelines. Given these sit under an overarching prohibition, there should be illustrative in nature, rather than prescriptive or purporting to provide safe harbours to industry participants.

6. Rationalisation: Unconscionable Conduct

Subject to the further discussion below, the DP18010093 research provides considerable support for **Proposal A22**. This proposes to confine the statutory prohibition on unconscionable conduct to the broad-based provisions contained in ss12CB and 12 CC, removing the more restrictive versions reflecting the equitable doctrine, which are currently found in s991A of the Corporations Act and s12 CA of the ASIC Act (among other places). The problems associated with the multiple iterations of misleading conduct are echoed here, although the scale of the problem is reduced.

There is a question whether removing the concept of doctrine of unconscionability 'within the meaning of the unwritten law' (s12 CA) will sever too sharply the ongoing connection and capacity for principled cross-pollination between the equitable doctrine and its broader statutory counterparts. This may be important, not only because the equitable doctrine may provide useful (non-restrictive) considerations relevant to the statutory doctrine but because the statutory doctrines should, we consider, have the converse potential to inform the development of the equitable doctrine: see E Bant, 'Common Law and Statute: Interaction and Influence in Light of the Principle of Coherence' (2015) 38 *University of NSW Law Journal* 362. However, this possibility has not to date been one to which courts have generally been alive when addressing the relationship between the statutory and equitable norms: see JM Paterson, 'Unconscionable Bargains in Equity and under Statute' (2015) 9 *Journal of Equity* 188. Rather, the consequence of maintaining the more demanding equitable doctrine within the statute has been that it has exerted, arguably, excessive influence over the interpretation of the broader, statutory prohibition. This has been so notwithstanding the clear statutory direction that the statutory prohibition should not be so restricted. Indeed, this excessive influence is one reason why Professor Paterson and I have argued that there is merit in considering a prohibition on 'unfair' trading: see 'Should Australia Introduce a Prohibition on Unfair Trading? Responding to Exploitative Business Systems in Person and Online' (2021) 4 *Journal of Consumer Policy* 1. I return to this possibility below.

There is also the concern (again, shared with misleading conduct) that consolidation of the prohibitions on unconscionable conduct in the context of financial services will not address the many other contexts in which replication of norms occurs. This will need to be borne in mind, however, for very many aspects of the ALRC reform agenda in the financial services space, as noted at the outset of this submission. And rationalisation of the mess of reiterated norms must start somewhere. Accordingly this is not a weighty consideration against the reform.

On balance, I favour the proposal. The broader statutory prohibition should be able to provide all the remedial and expressive benefits of its narrower statutory cousin, while leaving in place the independent equitable doctrine. The latter can continue to evolve, including (in theory) by reference to cognate statutory norms, although the likelihood of this may be diminished with the proposed reform.

The alternative option (not favoured by the ALRC) of removing entirely all statutory prohibitions on unconscionable conduct, relying instead on the licensing obligations to act 'efficiently [or 'professionally', if amended], honestly and fairly', warrants careful attention. While there is no doubt overlap between the concepts of fairness and statutory unconscionability, the two are not currently the same. As explained above, the statutory prohibition has been heavily influenced by the demanding standard of the equitable doctrine. This has, arguably, undermined its capacity to operate more broadly and beneficially, to guide fair trading practices. For example, unconscionable conduct currently connotes a high level of blameworthiness that, on existing authorities, requires proof of a relevantly culpable mindset on the part of the defendant: E Bant and J Paterson, 'Systems of Misconduct: Corporate culpability and statutory unconscionability' (2021) *Journal of Equity* 62, 69-70. The expressive force of a finding of unconscionability over unfairness (or, more accurately, a failure to act fairly) is therefore potentially significant. This will be particularly so if fairness is seen in terms of an objective norm or strict standard of conduct. I note that the same point applies for the licensing concept of honesty, as compared to the concept of dishonesty: see E Bant, 'Culpable Corporate Minds' (2021) 48 *UWA Law Review* 352, 365-366. While the argument can be made that these standards should align, that has not been the case: see, eg *ASIC v ANZ Banking Group Ltd (No 3)* [2020] FCA 1421 [62] (Allsop CJ) in which his Honour distinguished between dishonesty and a failure to act honestly. This means that the statutory unconscionability prohibition may be operating differently from an unfairness standard. This is arguably reflected in the recent 'debarment lists' adopted in WA's new procurement and debarment regime, which adopts the statutory prohibition under the more serious 'Category A' debarment conduct, unlike unfair contract terms and practices, which are included under the lesser Category B, see

https://www.legislation.wa.gov.au/legislation/statutes.nsf/law_s52750.html

Further, the statutory unconscionability provisions have spawned a rich and valuable jurisprudence not only on the nature of this core statutory norm, relevant (as the IRA notes) across multiple statutes, but which also provides important insights and lessons for development of general law and other statutory principles. The introduction of provisions proscribing 'unconscionable systems of conduct and patterns of behaviour' have generated, for example, rigorous guidance on broader issues relevant to corporate attribution and regulation: see, for example, *Systems of Misconduct* which explains the relevance of the provisions for a novel model of corporate attribution entitled 'Systems Intentionality': see further *Culpable Corporate Minds*. It also informed the ALRC *Corporate Criminal Responsibility Final Report* 136, Recommendation 8, recommending introduction of a bespoke corporate offence in cases of systematic misconduct: see further Samuel Walpole and Matthew Corrigan, 'Fighting the System: New Approaches to Fighting Systematic Corporate Misconduct (2021) *Sydney Law Review* 489.

On the other hand, Professor Paterson and I have also argued in *Should Australia Introduce a Prohibition on Unfair Trading* that a prohibition on 'unfair' conduct might have a range of benefits:

> One of these attractions is in prompting Australian courts to move beyond restrictive understandings of unconscionable conduct grounded in equity to address new, systematic forms of market misconduct. Another potential strength is in responding to the use of new methods of data collection and predictive analytics in digital marketing to influence consumer choice in online forums.

As we there explain (at 11), there is arguably an emerging Australian jurisprudence on unfairness in financial services/consumer credit regimes, variously expressed in terms of regulatory powers to respond to unjust contracts (Contracts Review Act 1980 (NSW)), conduct that is not honest (National Consumer Credit Protection Act 2009, Section 180A), and conduct by financial services licences that is not efficient, honest, and fair (Corporations Act 2001(Cth), Section 912A; National Consumer Credit Protection Act (2009), Section 47(1)(a)). Successive Royal Commissions into Misconduct in the Banking, Insurance and Financial Services Industry, and into the Crown Casino (Victorian Government, Royal Commission into Casino Operator and Licence, Final Report 15 October 2021) have emphasised the core obligation to act 'fairly' in trade and commerce. A statutory prohibition on unfair conduct, or conduct that is likely to be unfair, would connect with this broader body of jurisprudence and support its coherent development.

We further argued in that article that a statutory prohibition on unfair trading practices, particularly one framed in terms to capture conduct that is 'unfair or likely to be unfair', might be better able to pick up business practices that are 'predatory by design or implementation, as opposed to being problematic in their application to an individual consumer' (at 8). Equity's traditional focus in the doctrine of unconscionable dealing on the individual conscience of the defendant, and the specific circumstances of particular victim, has here had a deleterious effect on the capacity of the statutory prohibition to pick up and redress these systems of misconduct (best exemplified in *ASIC v Kobelt* [2019] HCA 18). Finally, a prohibition on unfair trading might also be desirable because, unlike a prohibition on 'unconscionable' dealing, the concept of unfairness is 'widely understood, being part of the every-day moral vocabulary of all Australians' (House of Representatives Standing Committee on Industry, Science and Technology (1997), Recommendation 6.1 [6.73].

However, since publication of this article on unfair dealing, courts have addressed more fully the evidentiary and litigation hurdles to proving unconscionable systems of conduct that underpin or constitute predatory business models, with the consequence that many cases of 'unfair' trading practices might now be picked up by the existing statutory prohibition on unconscionable conduct: see *Systems of Misconduct*. The High Court of Australia will shortly be delivering a judgment in a case of unconscionable conduct (*Stubbings v Jams 2 Pty Ltd*), which may clarify and confine the operation of *ASIC v Kobelt*, emancipating the statutory doctrine from its equitable cousin. This would be consistent with the most recent appellate authority examining that issue: *Australian Competition and Consumer Commission v Quantum Housing Group Pty Ltd* [2021] FCAFC 40.

Finally, were the existing core prohibition on statutory unconscionable conduct reformed to prohibit 'unconscionable conduct *or conduct that is likely to be unconscionable'* its ex ante operation and capacity to capture predatory trade practices independently of individual human fault would be further enhanced.

On balance, I consider it undesirable at this stage simply to remove the existing statutory prohibition, leaving all the work to be done by the licensing obligation to act 'efficiently, honestly and fairly' (or, as the ALRC favours, an obligation to act 'professionally, honestly and fairly'.) At the least, this may undermine, if not halt, development of the rich jurisprudence on systems of misconduct, which have started to provide powerful means to regulate predatory and harmful business models. It would be possible to amend the current prohibition to capture conduct that is 'likely to be unconscionable', which would parallel the misleading conduct prohibitions and even more clearly capture predatory business practices. However, reframing the statutory prohibition in terms of 'unfairness' (and in terms that include conduct that is 'likely to be unfair') may be a third option, worthy of consideration. This would connect the prohibition with the broader, emerging fairness standard, underscore its distinctiveness from the equitable doctrine of unconscionable dealing, address problematic business models and be more comprehensible for its Australian subjects.

General Law and Statutory Principles: The 'Best Interest' Duty

Professor Paterson and I have also been examining some of the more unhappy interactions between general law principles and their statutory counterparts as part of our work. Not only is this interaction commonly ignored in legislative design, but reforms can operate actively to undermine existing protections in subtle and opaque ways. This problematic situation is only exacerbated where extensive use is made of non-legislative regulatory mechanisms to alter substantive rights and obligations. Here, our findings suggest that the ALRC is right to emphasise the risks associated with delegated legislation and legislative instruments. As we explain in JM Paterson and E Bant, 'Mortgage Brokers, Regulatory Failure and Statutory Design' (2020) 31 *Journal of Banking and Finance Law and Practice* 7 ('Mortgage Brokers'), 17-18, these instruments can wholly undermine the expressive value of the law, can render the primary statute positively misleading to those it purports to guide and govern, and undermine the original protective purpose of the law. Additionally, these instruments and regulations can be very difficult to find, even for the legally trained. These issues are in addition to concerns that subsidiary legislation may undermine the legislative process of debate and review.

However, even where this subsidiary form of regulation is not in issue, too little attention is paid to the general law context, and the statutory relationship to that general law context, when drafting legislation (see here, for example, *Misleading Conduct before the Federal Court*, 182; *Mortgage Brokers*). It can be argued that, far from expanding general law protections, a number of legislative reforms to financial services have undermined or derogated from the existing common law and equitable protections. A good example, highlighted in the FSRC Final Report and in the IRA, is the safe harbour provided in s961B of the Corporations Act. The named obligations by which the statutory 'best interests' obligation (itself a diluted proxy for the equitable fiduciary principles) will be satisfied clearly reflects a desire to reassure industry constituencies. Another is the statutory obligation to 'manage' (rather than the more strict equitable injunction to 'avoid') conflicts of interest: Corporations Act

2001 (Cth) s 912A(1)(aa); Vince Battaglia, "Dealing with Conflicts: The Equitable and Statutory Obligations of Financial Services Licensees" (2008) 26(8) *C&SLJ* 483; M Scott Donald, "A Servant of Two Masters? 'Managing' Conflicts of Duties in the Australian Funds Management Industry" (2018) 12 *Journal of Equity* 1. Nor do disclosure obligations (the proxy fix-all for conflicts in most statutory contexts) equate to equity's rigorous demands for fully informed consent: *Mortgage Brokers*, 23. These statutory reforms threaten to undermine the equitable principles, which (after all) reflect a profound truth about the capacity of conflicted financial advisors to give independent and hence quality advice: see discussion in *Mortgage Brokers*, 12-13.

Similar problems affect reforms to the statutory obligations regarding 'best interests' and conflicts affecting mortgage brokers: see *Mortgage Brokers*, 19-25. Here, the position is further complicated by the fact that mortgage brokers, through the lens of equity a species of financial adviser, are not subject to the same statutory regime as financial services licensees. This affects the treatments of conflicts of interest and, critically, conflicted remuneration practices (and accompanying disclosure regimes). Professor Paterson and I have elsewhere discussed problematic reform proposals that both prohibit conflicted remuneration for mortgage brokers, while simultaneously permitting the worst forms of it through back-door regulation: *Mortgage Brokers*, 18. These reforms reflect a more generalised legislative failure squarely to grapple with the interaction between statutory reform and existing general law protections. It is a fundamental truth, reflected in the equitable fiduciary principles, that mortgage brokers (or other financial advisers) cannot give unconflicted advice that gives priority to the 'best interests' of the consumer while simultaneously open to the influence of commissions or other forms of reward that prompt it to make recommendations that further its own financial interests.

So, there are substantive differences both between the equitable and statutory treatments of core obligations of financial advisers, and between statutory treatments of (what equity would consider to be) financial advisers. There are real debates over the interactions between these different regimes: see Simone Degeling and Jessica Hudson, "Credit Advisers, Fiduciaries and Equitable Fiduciary Obligations" (2019) 47(1) Federal Law Review 6. It is possible that actors may become subject to multiple obligations, not all of which can simultaneously be met. The consequence, predictably, is increased complexity, uncertainty and costs to all affected. Moreover, the statutory duties arguably offer less protection than the original equitable counterparts. These considerations raise the question whether, notwithstanding these considerable concerns, more specific legislative obligations may still be preferable in some contexts. In what follows, I consider the merits of the various options for articulating the best interests duty.

From the outset, it may plausibly be argued that fiduciary concepts are subtle and difficult for lay stakeholders to understand and obey. So reverting solely to the general law (fiduciary) principles may be undesirable. A broadly framed statutory 'best interests' duty applicable across the field of financial advisers (ie both financial services licensees and brokers) might be supported for its general and expressive force, notwithstanding that it departs from equity's more specific, rigorous and protective fiduciary standards: *Mortgage Brokers*, 20-25. However, this raises the point mentioned previously (section 3) about the consequences of framing statutory norms in positive terms (as opposed from equity's negative injunctions to avoid conflicts and unauthorised profits).

If the positive 'best interests' duty were left undefined, courts would use the usual interpretive methods to develop an understanding of its content. This would likely include consideration of adjacent and relevant statutory rules (eg conflicts and remuneration rules, disclosure rules, responsible lending obligations), other overarching statutory norms, such as the obligations to act 'efficiently (or professionally], honestly and fairly', and the prohibitions on misleading and unconscionable (or unfair) conduct. Courts would also be able to draw on fiduciary and neighbourhood norms found in the general law and elsewhere in the statute books. This option might leave open the possibility that the best interests obligation could develop into a distinctive, overarching statutory norm or principle, reflecting the sort of foundational role articulated by Commissioner Hayne in his six key principles. Indicative behaviours of the 'best interests' duty could be contained in ASIC or other soft law guidelines. They need not be contained in the statute and could be iillustrated through worked examples. That way, they could be drawn on by stakeholders and readily amended in light of curial guidance. This would be consistent with the approach taken to analogous duties in the NCCP and SIS Acts, as noted in the IRA at [13.147].

However, given this is framed as a positive statutory norm, with very significant ramifications for those subject to its direction, stakeholders have traditionally sought greater comfort, through particularisation, of the content of the 'best interests' duty. I agree with the ALRC (and FSRC) that the current 'safe harbour' provisions are undesirable means of achieving that end: the provisions promote formalistic and legalistic approaches to 'compliance' in subject stakeholders, nicely labelled as a 'tick a box' mentality. It also reinforces and casts in stone the gulf between the statutory and equitable standards. Far from enabling development of coherent common law, equitable and statutory standards and rules, it introduces conflicting, lesser standards that undermine the broader protective approaches adopted by the law.

The ALRC has asked (in **A24**) whether the existing list should be re-cast as an 'indicative' list of behaviours, which must be taken into account when determining whether the overarching 'best interests' obligation has been met (similarly, it seems, to the interpretive principles used for statutory unconscionable conduct). As it notes, this may serve to provide valuable guidance on the content of the overarching and positive statutory norm not merely to courts but to stakeholders. This may be conceived of as a 'harder' alternative to the 'soft' law guidelines approach described above.

The University of Western Australia
Law School, M253, Perth WA 6009 Australia
T +61 8 6488 2740
E elise.bant@uwa.edu.au

A final alternative that, in my view, bears consideration, would be to develop a non-exhaustive list of prescriptive obligations that together set the baseline expectations for the 'best interest' obligation. This may be appropriate given the 'best interests' duty is framed as a positive obligation, breach of which would have very serious consequences. Approaching the matter in this way would also send a clear message to stakeholders about the core elements of the requirement, framed in terms of positive core requirements, while leaving room for incremental development by courts of further aspects of the 'best interest' concept.

It must be emphasised, however, that whichever route is adopted, it should be with a clear understanding of the essential and broader relationship between the statutory 'best interests' norm and the more particular (but essentially related) statutory rules, in particular treatment of conflicts, and conflicted remuneration practices. And underpinning all areas is their ongoing effect upon and relationship to their equitable progenitor. These interactions are dynamic and currently significantly unclear.

7. Disclosure duties: a case for wholesale reform?

Finally, sitting alongside the misleading conduct work, more recently, Professor Paterson and I have been considering the relationship between the core norm against misleading conduct and the raft of statutory (and general law) duties to disclose, the subject of examination in the Interim Report: see E Bant and J Paterson (eds), *Misleading Silence* (Hart Publishing, 2019) Chapter 1 and *Mortgage Brokers*, 17, 22-25. This work provides some support for the view, expressed in the Interim Report, that the current statutory continuous disclosure and product disclosure obligations require reconsideration. However, it suggests potentially the need for a more nuanced and multi-layered approach to the role of disclosure obligations.

As the ALRC notes in the IRA, adopting the analysis of Professor Hanrahan in *Misleading Silence*, a primary aim of disclosure rules is to promote confident and informed consumer decision-making. Requiring disclosure of key information respects and enhances consumer autonomy – even in cases where a consumer decides not to take advantage or account of that information. However, disclosure obligations commonly serve a variety of other ends: to prevent misleading conduct, particularly through selective silence or omission of relevant information; to reduce consumer vulnerability to manipulation or exploitation; and to mitigate the dangers of conflicts of interest through facilitating informed consent, among others.

Clear identification of the purpose of the disclosure duties in question, and the target audience for the statutory obligations, are prerequisites for effective statutory design. In some cases, this may support complete removal of disclosure obligations. For example, as we explain in *Mortgage Brokers*, a simple ban on all conflicted remuneration is likely to be far more effective and protective of vulnerable consumers seeking financial advice than imposing detailed obligations to disclose conflicted remuneration on financial advisers. Disclosure does not ensure individual, fully informed consent (particularly against the rigorous standards of equity), nor that a financial advisor is acting in the best interests of their client. It may falsely enhance consumer trust of financial advisers' disinterested service where this trust is unwarranted. Nor does more information necessarily provide even 'in principle' support to consumer autonomy in every case. Thus 'data dumping' may result in cognitive overload and paralysis, be used to exert pressure on another party, squander scarce resources and deflect attention from key considerations. Across the field of statutes, some (perhaps many) disclosure laws may thus be criticised as providing rough proxies, and not very effective ones at that, for achieving their purported ends.

Again, in considering the role of disclosure obligations, there is the familiar high-level issue of the correct mix of principles-based and prescriptive obligations, which may include specific disclosure obligations where these enhance and support broader legislative strategies. For the same reason as set out previously, I would generally support principles-based drafting for disclosure obligations aimed at core prohibitory norms (eg misleading conduct), over very detailed and exhaustive disclosure lists. Consistently, where specific disclosure rules seek to promote statutory 'safety net' principles (such as the norm against misleading conduct, fiduciary norms, and neighbourhood norms that require reasonable care) care must be taken to ensure that they do not stifle the development of statutory principles instantiating and supporting those norms, including through interaction with general law counterparts. Other legislative strategies, such as carefully tailored outcome-based legislation, as contemplated in IRA **Proposal A8**, may be appropriate. Where, however, disclosure obligations are designed to serve distinct ends (for example, ensuring that consumers have the opportunity to understand the nature of the product that they are purchasing, and hence exercise their autonomy in the market place), specific disclosure obligations may remain protective and apt.

8. Conclusion

Overall, my work with Professor Paterson provides substantial support for the proposals and approaches adopted by the ALRC the subject of this submission. Although this submission is authored by me, we would welcome the opportunity to discuss further with the Commission any aspect of it that may be of assistance to its ongoing work.