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Corruption: A Problem for the Public and Private Sector?

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The increased outsourcing and privatisation of public services has made engagement by the public sector with the private sector less a matter of choice than it once was. The origins of this phenomenon can be traced to the budgetary pressures that attended the global economic recession of the late 1970s and 80s, as well as the ascendancy of political ideologies that favour a more limited role for government.¹ In 1996, one pro-free market commentator predicted that “[b]y the turn of the century the boundaries of government will have become so blurred that we will have trouble knowing whether we are really being served by a public servant or a private employee”.²

The insight inherent in that remark becomes more apparent by the day. The Commonwealth Government was the first to embrace competition in the public sector, on the recommendation of the 1976 Coombs Royal Commission on

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¹ Carla Michler, “Government by Contract – Who Is Accountable?” (1999) 15 *Queensland University of Technology Law Journal* 135; S Domberger and C Hall, “Contracting for Public Services: A Review of Antipodean Experience” (1996) 74 *Public Administration* 129, 131; Honor Friggis and Gareth Griffith, *Outsourcing in the Public Sector*, New South Wales Parliamentary Library Research Service, November 1997, Briefing Paper No 22/97, 2–3.

² Gary Sturgess, quoted in Frank Theophile, “Direct Service Provision Contracts” (1996) 81 *Canberra Bulletin of Public Administration* 15, 15.

Australian government administration.³ State Governments followed suit in the 1990s. It has become commonplace for government departments to expose even their core or operational functions to competitive tendering.⁴ The New South Wales Government has outsourced many of the services used by commuters and recipients of government-funded housing, home care and disability services. In July, the O'Farrell Government announced that non-government agencies would progressively take over the monitoring and care of the thousands of children in foster care, whose welfare is currently the responsibility of the Department of Community Services.⁵ Such is the extent of the phenomenon that the Legislative Assembly recently launched a parliamentary inquiry into the outsourcing of community services to non-government agencies. Its terms of reference extend to “[t]he development of appropriate models to monitor and regulate service providers to ensure probity, accountability and funding mechanisms to provide quality assurance for clients”.⁶

Collaboration between the public, private and not-for-profit sectors makes good economic sense.⁷ But leaving the delivery of vital services to the invisible hand of the market, or to not-for-profit organisations, is not without potential pitfalls. Outsourcing carries with it an increased risk of corruption, waste and inefficiency, be it in the form of preferential treatment of contractors, poor performance monitoring, or the susceptibility of contractors to bribes.⁸ The High Court, in the context of considering

³ *Royal Commission on Australian Government Administration* (Australian Government Publishing Service, 1976).

⁴ Friggs and Griffith, above n 1, 6–10.

⁵ Imre Salusinszky, “Foster Care to be Outsourced by State”, *The Australian* (12 July 2012).

⁶ New South Wales Parliament, *Outsourcing Community Service Delivery (Inquiry)*, available at <<http://www.parliament.nsw.gov.au/Prod/parliament/committee.nsf/0/C6782566488D8117CA2579B90006B615>> (accessed 8 November 2012).

⁷ Graeme Hodge, *Contracting Out Government Services: A Review of International Evidence* (Montech Pty Ltd, 1996) 26.

⁸ Independent Commission Against Corruption (ICAC), *Corruption Risks in New South Wales Public Sector Procurement* (Consultation Paper, July 2010); “Outsourcing ‘Exposing NSW Government to

whether judicial review extends to private bodies, has discussed the conflicts of interest that are bound to arise when such bodies are vested with public functions and must balance their obligations to the community with their commercial self-interest.⁹ These dilemmas will remain with us for as long as governments feel obliged to obtain maximum value for the taxpayer dollar – most likely, forever. With an increase in privatisation and outsourcing, it might be time for a conversation about whether private actors should be subject to the same anti-corruption framework that currently applies to government instrumentalities.

Beyond issues of accountability raised by outsourcing and competitive tendering, private actors are now capable of affecting the interests of the public at large, even as they pursue what are ostensibly private activities. To quote Murphy J: “There is a difference between public and private power but ... one may shade into the other ... [Public power] may be exercised in ways which are not so obvious”.¹⁰

Examples abound. Many private entities carry on the business of investing significant sums of money, the misappropriation or misuse of which can affect the financial security of large numbers of the general public. The 1990s ushered in economic reforms that have given the financial markets access to the compulsory superannuation contributions of virtually everyone of working age.¹¹ At the structural level, the Global Financial Crisis of 2008 proved that unscrupulous or incompetent

Graft”, *The Australian* (8 May 2012); Jerrold Cripps, “Corruption Issues: Procurement Can Pose a Real Risk of Fraud” (2008) 1 *Government News* 4. See also in the American context Jonathan Boston, “Inherently Governmental Functions and the Limits to Contracting Out”, in Jonathan Boston (ed), *The State Under Contract* (Bridget Williams, 1995) 105.

⁹ *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277.

¹⁰ *Forbes v New South Wales Trotting Club Ltd* [1979] HCA 27; (1979) 143 CLR 242, 275 (Murphy J).

¹¹ Peter McClellan, “White-Collar Crime: Perpetrators and Penalties”, Speech delivered at the Fraud and Corruption in Government Seminar, University of New South Wales, Sydney, 24 November 2011, 5–6.

dealings in financial markets could have far-reaching effects on ordinary people by, for example, leading to a surge in unemployment, reducing household wealth, and placing significant strain on the providers of social services.¹² The Crisis has shown that changes at the macroeconomic level extend far beyond the rarefied world of stock traders and into the lives of millions of people. In other areas, it is more difficult to put a price on the intrusion of the private sector into people's lives, but the effects are no less real for that. Governments have long recognised that corporations acting in the pursuit of their self-interest can have both positive and negative impacts on the natural and built environment enjoyed by all Australians.¹³ As the capacity of private actors to influence the prosperity of the general community grows, it is reasonable that they should be expected to meet standards of governance, transparency and accountability that are commensurate with those of the public sector.¹⁴

In New South Wales, the Independent Commission Against Corruption (ICAC) does not have jurisdiction to investigate private-sector misconduct, unless it bears some direct connection with the provision of government services.¹⁵ In a 2007 investigation

¹² See, for example, Access Economics, *The Impact of the Global Financial Crisis on the Providers of Social Services* (November 2008) 2.

¹³ Ian Thomas, *Environmental Policy: Australian Practice in the Context of Theory* (Federation Press, 2007) 427.

¹⁴ As was pointed out by Sir William Deane: "Incorruptibility, accountability and fairness ... are basic values underlying public administration. They are in no way inconsistent with the processes of desirable change or the search for greater efficiency": Address on the Opening of the National Conference of the Institute of Public Administration Australia, Melbourne, 20 November 2006.

¹⁵ Under section 8 of the *Independent Commission Against Corruption Act 1988* (NSW), the ICAC has jurisdiction only in cases relating to the dishonest conduct of public officials, or the conduct of other persons to the extent that such conduct "could adversely affect, either directly or indirectly, the honest or impartial exercise of official functions by any public official, any group or body of public officials or any public authority". The need for some relationship between the individual concerned and a public official or public authority is clear. During debate on the ICAC Bill in 1988, Premier Greiner recognised as much when he said: "The commission's jurisdiction will cover all public officials. The term public official has been very widely defined to include members of Parliament, the Governor, judges, Ministers, all holders of public offices, and all employees of departments and authorities. Local government members and employees are also included. In short, the definition in the legislation has been framed to include everyone who is conceivably in a position of public trust. There are no exceptions and there are no exemptions": New South Wales, *Parliamentary Debates*, Legislative Assembly, 26 May 1988, 676 (Mr Greiner, Premier).

into RailCorp, the ICAC was able to make findings of corrupt conduct against individuals associated with two private companies only because their misconduct related to bribes for the allocation of government contracts.¹⁶ In contrast, private actors whose activities indirectly affect the broader public are subject to a patchwork of laws that address anti-competitive conduct, bribery, fraud on the Commonwealth, environmental damage, and conduct that has the potential to undermine the integrity of the market.¹⁷ They are also, of course, subject to civil actions for negligence, breach of contract and breach of fiduciary duty. These laws might be called in aid where private-sector corruption has misled consumers or investors, resulted in the receipt of a “corrupt commission”, diminished competition, or distorted the market. But for the most part they do not specifically target unethical practices or corporate cultures within the private sector. Private-sector corruption is addressed through a combination of education, criminal law enforcement, and oversight by government audit agencies, including the Australian National Audit Office.¹⁸

In several crucial areas, the level of oversight that applies to private entities is less rigorous than that which applies to government agencies. No authority has the power to investigate and make findings of “corrupt conduct” against the agents of private corporations, unless government has directly enlisted their services. The differential treatment of public and private bodies in this respect is significant. The labelling of a

¹⁶ ICAC, *Report on an Investigation into Corrupt Conduct Associated with RailCorp Air-Conditioning Contracts* (June 2007).

¹⁷ *Competition and Consumer Act 2010* (Cth) Part IV (“Restrictive Trade Practices”); *Criminal Code 1995* (Cth) Part 7.3 (“Fraudulent Conduct”); *Crimes Act 1900* (NSW) Part 4A (“Corruptly Receiving Commissions and Other Corrupt Practices”); *Australian Securities and Investments Commission Act 2001* (Cth) Part 2 (“Australian Securities and Investments Commission and Consumer Protection in Relation to Financial Services”); *Corporations Act 2001* (Cth) Part 7.10 (“Market Misconduct and Other Prohibited Conduct Relating to Financial Products and Financial Services”); *Environment Protection and Biodiversity Conservation Act 1999* (Cth).

¹⁸ Commonwealth Attorney-General’s Department, *The Commonwealth Approach to Anti-Corruption* (Discussion Paper, March 2012) 12–15.

person or corporation as “corrupt” sends a powerful message to the corruptor and the community that unethical behaviour is unacceptable. Moreover, findings of “corrupt conduct” are generally made to the civil standard of proof, informed by the decision in *Briginshaw v Briginshaw*,¹⁹ whereas findings of guilt in criminal prosecutions for fraud or bribery must be made beyond reasonable doubt. For this reason, it is usually easier to prove that a public official or public body has engaged in corrupt conduct than it is to prove like conduct by persons who are not affiliated with government. I suspect that many in the community would think the criminal standard of proof too onerous a standard to meet before public opprobrium attaches to dishonest conduct that lacks a formal relationship to government.

In other areas, the law currently holds the private sector to less robust standards of accountability than government agencies. Section 11 of the *Independent Commission Against Corruption Act 1988* (NSW) obliges the principal officers of public authorities, among other persons, to notify the Commission of “any matter that the person suspects on reasonable grounds concerns or may concern corrupt conduct”. Analogous duties to report are on the statute books of other jurisdictions.²⁰ These “statutory whistleblowing” laws are designed to put a stop to corrupt practices at the earliest possible moment, before their corrosive effects can spread throughout government. The principal officers of corporations are not subject to the same obligation to “blow the whistle” on corruption. This is despite the fact that many put

¹⁹ [1938] HCA 34; (1938) 60 CLR 336. Dixon J explained at 361–62 that even where the civil standard of proof applies, “[t]he seriousness of an allegation made, the inherent unlikelihood of an occurrence of a given description, or the gravity of the consequences flowing from a particular finding are considerations which must affect the answer to the question whether the issue has been proved to the reasonable satisfaction of the tribunal. In such matters ‘reasonable satisfaction’ should not be produced by inexact proofs, indefinite testimony, or indirect inferences”.

²⁰ *Crime and Misconduct Act 2001* (Qld) ss 38, 39; *Corruption and Crime Commission Act 2003* (WA) ss 28, 29.

their hand up for government contracts that are paid out of the public purse, or otherwise engage in activities that have ramifications for the broader community. In this age of interaction between the public and private spheres, is there a principled reason to allow high-level officers of private entities the opportunity to conceal knowledge of misconduct, conflicts of interest or dishonesty?

Some recent cases reveal the potential for private actors to impinge on public interests. A case decided by Rares J in the Federal Court only two months ago is instructive.²¹ In the lead-up to the Global Financial Crisis, local councils for Wingecarribee Shire, the City of Swan and Parkes Shire invested many millions of ratepayer dollars in highly complex financial instruments known as “synthetic collateralised debt obligations”, or SCDOs. They are as incomprehensible as their name suggests. For the economically illiterate among us, they can be thought of as a “sophisticated bet” on the occurrence of loan defaults, or “credit events” in banking parlance.²² When investing in SCDOs, the local councils acted on the advice of the Australian arm of the now-defunct Lehman Brothers, then trading as Grange Securities Limited. Grange earned significant fees and commissions from structuring and selling SCDOs - \$1 to \$2 million per SCDO sold, according to Rares J’s findings.²³ It failed to make full disclosure of this fact.²⁴ The investment products were “triple A” rated, though we now know that such ratings had to be taken with a pile of salt, not merely a grain. The councils were spending public money on high-risk, “junk” investments.

²¹ *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028.

²² *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028, [888] (Rares J).

²³ *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028, [305] (Rares J).

²⁴ *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028, [248] (Rares J).

Justice Rares held that the investments were not suitable for unsophisticated, risk-averse investors such as the local councils, each of which had “a responsibility to act as a prudent person investing public money”.²⁵ His Honour concluded that Grange had breached various contractual, statutory, fiduciary and tortious duties in recommending that the councils invest in the SCDOs. More than that, Rares J found that Grange’s concern with its own bottom line had put it directly at odds with the public interest. He said:

Grange put itself forward to the Councils as a financial adviser cognisant of their needs, [and] statutory and policy requirements. And because it was aware that the Councils trusted its advice and recommendations, it was able to exploit their significant access to large amounts of public money to finance Grange’s business of promoting and selling SCDOs for its own profit.²⁶

The case points up the falsity of any assumption that private transactions in financial markets are devoid of consequences for ordinary people – in this case, the ratepayers concerned. If the principal officers of investment firms and other corporations were required by law to report when they suspected unscrupulous practices within their organisations, the interests of the broader public – who have no means of assessing for themselves the integrity of any corporation or organisation – might be better protected. The suggestion may be radical, but it might also become irresistible as the role of private actors in the delivery of public facilities and services increases.

²⁵ *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028, [192] (Rares J).

²⁶ *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028, [474] (Rares J).

Another case, recently decided by Jagot J in the Federal Court, is worth mentioning.²⁷ It deals with one of the most notorious practices, perhaps malpractices, that precipitated the Global Financial Crisis: the credit-rating agencies' inaccurate certification of complex securities as "triple A" standard. As you are no doubt aware, the potential for conflicts of interest in this area is particularly acute given that credit-rating agencies are paid not by the investors who rely upon their ratings, but by the issuers of the securities.

As with the Lehman Brothers case, the plaintiffs in the case before Jagot J were local councils that had invested public funds in derivatives. The 13 councils concerned invested in financial products known as Constant Proportion Debt Obligations, or CPDOs. The products were marketed by the more seductive name of "Rembrandt notes". They were created by ABN Amro Bank, rated by Standard & Poor's, and sold to the local councils by Local Government Financial Services Pty Ltd (LGFS). The councils relied upon Standard & Poor's certification of the Rembrandt notes as triple A. As it turned out, the councils lost almost the whole of the \$16 million in capital they put up for the notes.

The Rembrandt notes were described in evidence as "grotesquely complicated", a characterisation with which Jagot J agreed.²⁸ I can attempt only a brief explanation of their operation here. The CPDO is a unique iteration of the credit default swap contract, whereby an investor sells to an opposing party protection against the risk of a credit event, such as a third party's default or bankruptcy. As Jagot J put it, the CPDOs "involved a form of zero sum game because the interests of the investors as

²⁷ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200.

²⁸ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [1072] (Jagot J).

protection seller and the counterparty as protection buyer were necessarily opposed”.²⁹ It was in the investor’s interest for the third party not to default for the duration of the contract, in which case there would be no need to make the credit default payment. The investor would in this way make a tidy profit from the premium paid by the counterparty. On the other hand, it was in the interests of the counterparty for a default to occur, as only then would they receive the credit default payment.³⁰ The CPDO mirrored this basic structure, but it took the credit default swap contract to a new level of complexity by tying it to the occurrence of credit events within an ever-changing pool of entities based in the US and Europe.³¹ The CPDO was, according to Jagot J, “a new structured financial product which the market had not previously seen and which no ratings agency had previously rated”.³²

In a judgment longer than *War and Peace* – the length being a product of the complexity of the case – her Honour traversed a number of statutory, common law and equitable causes of action. Jagot J found that S&P had engaged in misleading and deceptive conduct by rating the notes triple A and publishing information about the notes that was false in material particulars and otherwise involved the making of negligent misrepresentations to the class of potential investors in Australia, including the councils. Jagot J concluded that a reasonably competent ratings agency could not have given the notes a triple-A rating.³³ The Court also held that ABN Amro Bank was knowingly concerned in S&P’s misleading and deceptive conduct, and had itself

²⁹ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [5] (Jagot J, Judgment Summary).

³⁰ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [57] (Jagot J).

³¹ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [60] (Jagot J).

³² *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [61] (Jagot J).

³³ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [2669] (Jagot J).

committed misleading and deceptive conduct by openly touting the triple-A rating. As well, LGFS was found to have engaged in misleading and deceptive conduct when marketing the notes to the councils.

S&P argued that at no time did it assume a duty of care to the councils or make misrepresentations to them. The rating agency drew the Court's attention to the various disclaimers buried in the fine print of its documents. The S&P rating letter upon which the security issuer and the councils relied expressly said that it was not "investment, financial, or other advice".³⁴ In another disclaimer, S&P said that it was not responsible for any error in its ratings because it relied upon information provided by the security issuer.³⁵ And in the broadest of its disclaimers, S&P rather audaciously declared:

The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold or sell any securities or make any other investment decisions. Accordingly, any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision.³⁶

S&P argued that these disclaimers were important in light of the 2001 High Court decision in *Tepko Pty Ltd v Water Board*.³⁷ In *Tepko*, the majority emphasised that a person making a representation assumes a duty of care to the party relying on the statement only if in the circumstances it was reasonable so to rely. Employing this

³⁴ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [2528] (Jagot J).

³⁵ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [2536] (Jagot J).

³⁶ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [2532] (Jagot J).

³⁷ [2001] HCA 19; (2001) 206 CLR 1.

reasoning, S&P submitted that it merely provided an “opinion” about the profitability of the investments, the accuracy of which it did not guarantee, and upon which it was unreasonable for the councils to rely. In America, the credit-rating agencies have used similar reasoning to fend off lawsuits. They have argued, with mixed success, that the First Amendment’s guarantee of freedom of speech protects them from being sued for the expression of an opinion about financial products.³⁸ An Australian might respond that although you are free to speak, you are also responsible for whatever damage you cause in the exercise of that freedom. This is especially so when you speak in the knowledge that another is relying upon your vaunted expertise.³⁹

Jagot J rejected S&P’s arguments. In relation to one of the disclaimers, her Honour said:

It is common ground in these proceedings that ratings involve S&P’s opinion (albeit expert opinion) as to the creditworthiness of, in this case, an instrument ... It may also be accepted that a rating is not itself a recommendation to buy, hold, or sell any security. LGFS and the councils did not treat the AAA rating as such. They treated it as S&P’s expert opinion, based on an application of its expertise with reasonable care, that S&P considered the instrument warranted the highest possible rating of

³⁸ See, for example, *Abu Dhabi Commercial Bank v Morgan Stanley & Co*, 651 F Supp 2d 155 (2009), where Judge Shira Scheindlin said at 175–76 that in cases where ratings are widely disseminated and are “a matter of public concern”, a First Amendment defence might apply. But the position is otherwise “where a rating agency has disseminated ... ratings to a select group of investors rather than to the public at large”.

³⁹ The Attorney-General for Connecticut has spoken scathingly of the rating agencies’ First Amendment argument: “The very nature of [rating firms’] so-called speech is very different from the classic First Amendment-protected expression. It’s much more akin to an advertisement that misstates the price of an item on sale than a political candidate on a soapbox”. Quoted in Ashby Jones, “A First Amendment Defense for the Ratings Agencies?”, *Wall Street Journal* (21 April 2009), available at <<http://blogs.wsj.com/law/2009/04/21/a-first-amendment-defense-for-the-rating-agencies/>> (accessed 8 November 2012).

AAA. The statements in this disclaimer are consistent with S&P anticipating such use of its rating.⁴⁰

Her Honour also gave short shrift to S&P's arguments against liability for negligent misstatement. In deciding that S&P owed a duty of care to potential investors, Jagot J noted that "[t]he councils ... were vulnerable in that they could not reasonably protect themselves from any lack of reasonable care by S&P in the assigning of the rating".⁴¹ In reference to S&P's arguments against the imposition of a duty of care, her Honour said:

It might be said that immunity from any such duty of care would encourage the type of practices that distinguish the legitimate pursuit of one's own commercial interests (whether or not it be at the expense of another) from the "sharp or ruthless conduct" that McHugh J described as a potential indicator of the need for such a duty in *Perre v Apand* ... Insofar as policy considerations about what the community can and cannot tolerate are concerned it might be asked whether the ... conduct of S&P in the rating of the CPDO notes to be issued in Australia constituted nothing more than a legitimate pursuit of its own commercial interests.⁴²

Her Honour answered that question adversely to S&P. The evidence indicated that the rating agency was under significant pressure from the bank issuing the Rembrandt notes to rate them triple A, despite most of the objective data pointing to a much less favourable rating, possibly as low as A minus.⁴³ S&P's internal correspondence on the matter was troubling, to say the least. Its New York office said that market participants were aware of the Rembrandt notes and were "in no

⁴⁰ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [2531] (Jagot J).

⁴¹ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [2816] (Jagot J).

⁴² *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [2800] (Jagot J).

⁴³ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [301] (Jagot J).

hurry to stay in front of the truck”. One analyst expressed the view that S&P was dealing with “a crisis in CPDO land”.⁴⁴ This same analyst was concerned that the ratings were made “under pressure”.⁴⁵ In an email to a colleague, he referred to the triple-A rating as “analytical bs at its worst. I know how those ratings came about and they had nothing to do with the model!”⁴⁶ A senior S&P analyst based in New York expressed the slightly more charitable view that the analysts involved in the rating had been “sandbagged a little” at a time when S&P’s model “was a work in progress” and ABN Amro “simply bulldozed [the rating] through”.⁴⁷ Debate raged within S&P about the veracity of one of the assumptions that ABN Amro had instructed S&P to make when rating the CPDO. One analyst had serious concerns, concluding:

The important thing to highlight from this exercise is that the whole deal is extremely sensitive to an assumption that we do not know much about, and neglecting it entirely gives us results that go from AAA to sub investment grade.⁴⁸

These cases point to the problems inherent in the issuer-pays model, which creates incentives for corner cutting and malpractice by the ratings agencies. Many investors, governments included, rely upon the credit-rating agencies to offer objective and reasonably accurate information about potential investments. When credit-rating agencies fall short of the mark, the consequences are felt by the public at large – including those whose rates and income tax payments provide the capital for government investments. Placing a positive and enforceable obligation on senior

⁴⁴ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [302] (Jagot J).

⁴⁵ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [303] (Jagot J).

⁴⁶ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [305] (Jagot J).

⁴⁷ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [306] (Jagot J).

⁴⁸ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, [331] (Jagot J).

management to blow the whistle on dubious rating practices could serve as a powerful deterrent.

The United States has adopted an alternative approach. The *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (US) was enacted after the dust from the Global Financial Crisis and Bernie Madoff's Ponzi scheme had started to settle. It makes specific provision for the regulation of credit-rating agencies in Title IX. Various recitals in s 931 of the Act recognise the public-interest dimension of the credit-rating agencies' work. The section provides:

Congress finds the following:

(1) Because of the systemic importance of credit ratings and the reliance placed on credit ratings by individual and institutional investors and financial regulators, the activities and performances of credit rating agencies, including nationally recognized statistical rating organizations, *are matters of national public interest*, as credit rating agencies are central to capital formation, investor confidence, and the efficient performance of the United States economy.

(2) Credit rating agencies, including nationally recognized statistical rating organizations, play a critical "gatekeeper" role in the debt market that is functionally similar to that of securities analysts, who evaluate the quality of securities in the equity market, and auditors, who review the financial statements of firms. *Such role justifies a similar level of public oversight and accountability.*

...

(5) In the recent financial crisis, the ratings on structured financial products have proven to be inaccurate. This inaccuracy contributed significantly to the mismanagement of risks by financial institutions and investors, which in turn adversely impacted the health of the economy in the United States and around the world. Such inaccuracy necessitates increased accountability on the part of credit rating agencies. (Emphasis added.)

The *Dodd-Frank Act* empowers the US Securities and Exchange Commission (SEC) to suspend or revoke a rating agency's registration, as well as to penalise misconduct by individual employees. The Act also mandates reduced reliance by US financial regulators on credit ratings as an indicator of risk, and requires the rating agencies to consider all credible information from sources other than the security issuer.⁴⁹ However, in a reflection of the influence that Wall Street continues to wield in America, the Act does not put an end to the practice of credit-rating agencies being compensated by security issuers.⁵⁰

Most significantly for the purposes of our discussion, the *Dodd-Frank Act* does strengthen whistleblower-protection laws in the securities-law context. Taking a characteristically American approach, the Act offers financial rewards to whistleblowers whose information leads to monetary sanctions of \$1 million or more being imposed for a breach of securities law. Such rewards are significant, ranging from 10 to 30 per cent of the funds recovered through enforcement action.⁵¹ The Act also bolsters the protection that whistleblowers enjoy from retaliation by their employers under the *Sarbanes-Oxley Act*, passed shortly after the collapse of Enron in late 2001. I note in passing that the *Corporations Act 2001* (Cth) provides similar protections, absent the largesse, to company officers, employees and contractors who blow the whistle on breaches of that Act or the *Australian Securities and*

⁴⁹ *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (US) ss 932, 935, 939, 939A.

⁵⁰ But see *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (US) s 939F ("Study and Rulemaking on Assigned Credit Ratings"). The so-called "Franken Amendment" directs the SEC to carry out a study of "the credit rating process for structured finance products and the conflicts of interest associated with the issuer-pay and the subscriber-pay models", with a view to assessing "the feasibility of establishing a system in which a public or private utility or a self-regulatory organization assigns nationally recognized statistical rating organizations to determine the credit ratings of structured finance products".

⁵¹ *Dodd-Frank Wall Street Reform and Consumer Protection Act 2010* (US) s 922.

Investments Commission Act 2001 (Cth).⁵² I note also that the federal government is currently mulling over the enactment of comprehensive protections for public-sector whistleblowers.⁵³ Whether there is a need to extend similar protections to the private sector remains conspicuously absent from the conversation.

The US approach involves the carrot rather than the stick. Instead of placing an affirmative duty on senior management to report breaches of securities law, the *Dodd-Frank Act* creates incentives for the reporting of such breaches, which range from market manipulation and insufficient corporate disclosure to misleading practices adopted by credit-rating agencies. There is evidence to suggest that the rewards program is proving useful in bringing violations of securities law to light. The SEC reports that it is receiving eight or so tips per day. It claims that the tips are more detailed and actionable than ever before, saving investigators substantial time and resources. The Commission paid out its first award under the program this August, to an unidentified informant who provided documents and other information that allowed the SEC to act quickly against an ongoing multi-million dollar fraud, preventing further victims from being caught in its net. Based on the US experience, one could be forgiven for thinking that the most potent weapon against corporate self-interest is individual self-interest. Indeed, the SEC openly touts the “what’s in it for me” appeal of the program. To quote the Chief of the Office of the Whistleblower, the rewards program is “open for business and ready to pay people who bring us good, timely information”.⁵⁴

⁵² *Corporations Act 2001* (Cth) Part 9.4AAA (“Protection for Whistleblowers”).

⁵³ Chris Merritt, “Talk with Andrew Wilkie to Form Law, Says Community and Public Sector Union”, *The Australian* (2 November 2012).

⁵⁴ SEC Press Release, *SEC Issues First Whistleblower Program Award* (21 August 2012), available at <www.sec.gov/news/press/2012/2012-162.htm> (accessed 8 November 2012).

Despite the evidence of enhanced reporting in the *Dodd-Frank* era, we should perhaps be wary of opening the public pursestrings for whistleblowers. When governments offer financial rewards for doing what is right, they inadvertently diminish the development of an anti-corruption culture in the private sector. Providing tangible reward for reporting wrongdoing is at odds with the idea that reporting unethical practices should be its own reward – especially when it averts the perpetration of a fraud on investors, superannuants or taxpayers, or otherwise has some socially beneficial consequence. Moreover, removing the ethical imperative from whistleblowing might have the unintended effect of deterring conscientious informants, who fear that they will be perceived as opportunists looking to make a “quick buck”. And where a conscientious whistleblower would have come forward anyway, irrespective of any windfall coming his or her way, a rewards program squanders public money and dilutes the social merit of the whistleblower’s actions. Commentators have noted that where laws “are likely to trigger strong internal ethical motivation, offering monetary rewards may be unnecessary or, worse yet, counterproductive”.⁵⁵ One critic of the *Dodd-Frank* law has argued that a more effective and socially responsible approach to whistleblowing is to “impose affirmative duties on the employees, supported by fines for non-compliance. Doing so enhances the social position of whistleblowers and reduces the negative stigma associated with rewards and legal protections”.⁵⁶ I incline to that view.

One provision of the *Dodd-Frank Act* is of particular relevance to the present discussion. Section 934 requires the rating agencies to “refer to the appropriate law

⁵⁵ Yuval Feldman and Orly Lobel, “The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties, and Protections for Reporting Illegality” (2010) 88 *Texas Law Review* 1151, 1155.

⁵⁶ Michael Neal, “Securities Whistleblowing Under *Dodd-Frank*: Neglecting the Power of ‘Enterprising Privateers’ in Favor of the ‘Slow-Going Public Vessel’” (2011) 15 *Lewis & Clark Law Review* 1107, 1131.

enforcement or regulatory authorities any information that the ... rating organization receives from a third party and finds credible that alleges that an issuer of securities rated by the ... rating organization has committed or is committing a material violation of law that has not been adjudicated by a Federal or State Court". This "duty to report" obliges the rating agencies to blow the whistle not on their own corrupt conduct, but rather that of the security issuers. One wonders what the outcome of the case before Jagot J would have been had S&P been under a similar obligation at the time it rated the ABN Amro CPDO.

In Australia, the interdependence of the public and private sectors has long been a topic of interest among administrative lawyers. The High Court grappled with the issue of public-private partnerships in its 2003 decision in *NEAT Domestic Trading Pty Ltd v AWB Ltd*, to which I alluded at the beginning of my remarks.⁵⁷ The case merits close consideration. It concerned the statutory power vested in the Wheat Export Authority (WEA) to authorise the export of wheat other than through the "single desk" arrangement, whereby all wheat exporters were required to contribute to pools of wheat earmarked for export. The legislation provided that the Export Authority could not consent to the bulk export of wheat, other than through the pools, unless a private corporation, Australian Wheat Board (International) Ltd (AWBI), had given the applicant prior approval in writing. The intention of this scheme was to prevent buyers from playing Australian exporters off against one another, and in that way maximise returns for all exporters. AWBI was itself an exporter of wheat. It alone among exporters did not require the Export Authority's approval to circumvent the single-desk system. The appellant, NEAT, was a wheat exporter that had been

⁵⁷ [2003] HCA 35; (2003) 216 CLR 277.

refused authorisation by AWBI to export wheat other than through the pools, on the ground that an approval would have disadvantaged the growers who sold wheat through the single desk. That the enabling legislation put AWBI in the unusual position of having to rule upon the fate of its competitors was not lost on the Court. Gleeson CJ observed:

AWB and AWBI are trading corporations, operated for the benefit of their corporators. However, the Act gives each a statutory role which may affect the interests of members of the public, such as the appellant. A question arises as to the extent to which that role is circumscribed [by administrative law principles].⁵⁸

Gleeson CJ accepted that AWBI's decision to refuse NEAT's request was "a decision of an administrative character made ... under an enactment", thus attracting judicial review under the *Administrative Decisions (Judicial Review) Act 1977* (Cth) (*ADJR Act*).⁵⁹ His Honour was persuaded to this conclusion by the fact that Parliament had entrusted AWBI with a statutory monopoly so that it might promote the national interest in an equitable wheat export trade, not just its own commercial interests.⁶⁰

However, the Chief Justice rejected NEAT's complaint that AWBI, in refusing the applications outright, had fallen into error by acting "in accordance with a rule or policy without regard to the merits of the particular case".⁶¹ His Honour held that AWBI's general policy of refusing consent was consistent with its constitution, which obliged it to maximise returns to growers who sold wheat through the single desk. In

⁵⁸ *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277, [11] (Gleeson CJ).

⁵⁹ *Administrative Decisions (Judicial Review) Act 1977* (Cth) s 3.

⁶⁰ *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277, [29] (Gleeson CJ).

⁶¹ *Administrative Decisions (Judicial Review) Act 1977* (Cth) ss 5(2)(f), 6(2)(f).

his Honour's view, AWBI's constitution formed a necessary part of the background to the enabling legislation, and the achievement of its objects was, accordingly, a relevant consideration.⁶² Conversely, the appellant's financial interests were not relevant to the decision to be made.⁶³ Gleeson CJ held that the appellant had otherwise failed to put any material before AWBI that might have compelled it to deviate from its policy.⁶⁴ Importantly, however, the Chief Justice accepted that AWBI's power of veto could be reviewed by the courts.

The plurality took a different view. McHugh, Hayne and Callinan JJ denied that AWBI's decision was one to which the *ADJR Act* applied. They preferred to classify the company's power to make the decision as one deriving from its constitution, read together with the applicable corporations law.⁶⁵ Their Honours were driven to this conclusion partly by "the 'private' character of AWBI as a company incorporated ... for the pursuit of the objectives stated in its constituent document", and partly by their view that it was "not possible to impose public law obligations on AWBI while at the same time accommodating pursuit of its private interests".⁶⁶ Of this reasoning, the authors of a leading text on administrative law have bluntly said: "It seems that for the joint judgment, AWBI escaped review because it was set up to behave selfishly if it wanted, in disregard of any wider public interest".⁶⁷

⁶² *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277, [15] (Gleeson CJ).

⁶³ *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277, [19] (Gleeson CJ).

⁶⁴ *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277, [26] (Gleeson CJ).

⁶⁵ *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277, [54] (McHugh, Hayne and Callinan JJ).

⁶⁶ *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277, [51], [59] (McHugh, Hayne and Callinan JJ).

⁶⁷ Mark Aronson et al, *Judicial Review of Administrative Action* (3rd ed, Thomson Reuters, 2004) 131.

Kirby J dissented. His Honour said of the question of private-sector accountability presented in the case:

Given the changes in the delivery of governmental services in recent times, performed earlier and elsewhere by ministries and public agencies, this question could scarcely be more important for the future of administrative law.⁶⁸

Kirby J followed English authority in holding that private bodies are amenable to judicial review to the extent that the nature of the power they wield is public.⁶⁹

According to his Honour, AWBI's "statutory veto on the decisions of a public authority" gave its decision an "administrative character" for the purposes of the *ADJR Act*. The decision was thus open to judicial review.⁷⁰ Kirby J went on to hold that AWBI could not adhere to a blanket policy of refusing to approve applications for the bulk export of wheat, without engaging in a case-by-case consideration of the merits. In arriving at this conclusion, his Honour said the following of the intersection between public and private power:

It may be that the statutory conferral of monopoly status on AWBI as a private corporation, in itself ... could impose obligations to observe the norms and values of public law, adapted by analogy, in particular instances of its decision-making. In such circumstances, quite apart from administrative law, *it has sometimes been viewed as appropriate to impose duties to the community upon such corporations out of recognition of the particular powers they enjoy.*⁷¹

⁶⁸ *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277, [68] (Kirby J).

⁶⁹ *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277, [113] (Kirby J).

⁷⁰ *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277, [115] (Kirby J).

⁷¹ *NEAT Domestic Trading Pty Ltd v AWB Ltd* [2003] HCA 35; (2003) 216 CLR 277, [134] (Kirby J). Emphasis added.

Kirby J referred in his judgment to the well-known 1987 decision in *Datafin*.⁷² The English Court of Appeal held that public law remedies were available against the Panel of Take-overs and Mergers, though it was neither established by statute nor a repository of statutory powers. Among the factors that led the Court to this conclusion was the Panel's de facto responsibility for regulating the financial markets.⁷³

Central to the reasoning in the *Datafin* decision, and to the reasoning of Gleeson CJ and Kirby J in the *NEAT* decision, is the idea that judicial review should extend to whomever has the power to affect community interests or exercise public power, irrespective of their “private” or non-governmental character. To my mind there is much to be said for this view. And there is much to be said for the adoption of a similar test for oversight of the private sector in the formulation of anti-corruption law and policy. Just as the public-private distinction has a diminishing role in the administrative law context, it is inadequate in the fight against corruption. One of the lessons of the recent history of the private sector in developed societies is that, when left to its own devices, it does not always play by the rules. The “oil for wheat” scandal, which involved the payment by AWBI of kickbacks to Saddam Hussein’s regime, in circumvention of the United Nations oil-for-food program, is a case in point. That the scandal was revealed soon after judgment was delivered in the *NEAT* case lends Kirby J’s dissent a kind of poetic justice. This was not lost on his Honour, who in 2006 had this to say in extra-curial remarks on the subject:

⁷² *R v Panel on Take-overs and Mergers, Ex parte Datafin* [1987] QB 815.

⁷³ *R v Panel on Take-overs and Mergers, Ex parte Datafin* [1987] QB 815, 834–39 (Lord Donaldson MR).

I cannot forbear to mention that, events since the High Court's decision was handed down, and the present inquiry by the Hon Terrence Cole AO into the governance of the Australian Wheat Board, lend weight to the suggestion that accountability of AWB and AWBI to the standards of lawfulness, reasonableness and interest in public administrative law might not have been such a bad thing. Arguably, more rather than less judicial supervision in this area was needed. But that is another thing.⁷⁴

Arguably, more quasi-judicial supervision would not go astray either. The ICAC's work has in recent years been consumed by investigations into the private sector. Of the 3,000 or so complaints received by the ICAC each year, approximately 12 per cent relate to allegations of corruption in government procurement. About 30 per cent of the Commission's public inquiries result in a finding of corrupt conduct that in some way relates to government procurement.⁷⁵

Some recent high-profile investigations illustrate the nature and extent of the problem. In 2007, the ICAC made findings of corrupt conduct against a RailCorp engineer and two individuals associated with private companies who had paid the engineer bribes so as to secure preferential treatment for their companies in the allocation of air-conditioning contracts.⁷⁶ The corrupt conduct was brought to the ICAC's attention by the principal officer of RailCorp, acting on the obligation to report created by s 11 of the *ICAC Act*.⁷⁷

RailCorp and its contractors were again the subject of adverse findings in 2008. In a series of eight reports, the ICAC found corruption in RailCorp to be entrenched and

⁷⁴ Michael Kirby, "Public Funds and Public Power Beget Public Accountability", Speech delivered at the University of Canberra Corporate Governance ARC Research Project Corporate Governance in the Public Sector Dinner, High Court of Australia, Canberra, 9 March 2006, 11.

⁷⁵ ICAC, *Corruption Risks in NSW Government Procurement* (June 2011) 4.

⁷⁶ ICAC, *Report on an Investigation into Corrupt Conduct Associated with RailCorp Air-Conditioning Contracts* (June 2007).

⁷⁷ *Ibid* 9.

widespread.⁷⁸ Findings of corrupt conduct were made against 31 individuals in all, including the staff of 16 private firms.⁷⁹

In 2008, the ICAC made findings of corrupt conduct against two individuals contracted by NSW Fire Brigades as project managers. The individuals concerned were found to have manipulated the Fire Brigades' tendering process for capital works by submitting false tenders and quotes, with a view to securing lucrative contracts for companies under their control. Their scheme was successful, resulting in contracts valued in the millions of dollars being awarded to companies controlled by them.⁸⁰ Once again, the ICAC was alerted to the corrupt conduct by the principal officer of the public authority concerned.⁸¹

In 2009, the ICAC made findings of corrupt conduct against individuals associated with a private organisation on which government relied to assess the qualifications of persons working in the private-security industry. The Commission found that the security training organisation under investigation had issued certificates of competency to individuals in return for bribes, and without a proper assessment of their ability to carry out security work. The public authority responsible for security licensing in NSW had in turn relied upon these certificates of competency.⁸² The public-interest dimension of this problem is obvious. I quote from the ICAC's report:

⁷⁸ ICAC, *Investigation into Bribery and Fraud at RailCorp – Eighth Report – Corruption Prevention* (December 2008) 5.

⁷⁹ *Ibid.*

⁸⁰ ICAC, *Investigation into Tendering and Payments in Relation to NSW Fire Brigades Capital Works Projects* (December 2008) 6.

⁸¹ *Ibid.* 10.

⁸² ICAC, *Report on Corruption in the Provision and Certification of Security Industry Training* (December 2009) 14.

The security industry in New South Wales is responsible for providing security in significant ways – for example at airports, hotels and concerts, and also at government facilities, including army bases. The Commission’s investigation found that corrupt conduct in connection with the certification of security officers resulted in a significant number of those officers engaging in security activities, some of which posed risks to their own and public safety, without having undertaken appropriate levels of training.⁸³

In each of these cases, the ICAC was able to make findings of corrupt conduct against the private individuals concerned by virtue of their formal role in the provision of public services. Many of these corrupt practices were reported to the ICAC by the principal officers of the public authorities against which they were perpetrated, in accordance with the statutory duty to report. One wonders how many instances of private-sector corruption have gone undetected for want of any formalised relationship between the organisation concerned and a public authority. Murphy J’s observation that public power can be exercised in ways which are “not so obvious” remains true. The challenge lies in harnessing, perhaps even reshaping, the present anti-corruption framework to accommodate this reality. The extension of duties to report to the private sector may assist in meeting this challenge.

⁸³ Ibid 10.