

# The Developing Importance of White-Collar Crime to the Insolvency Practitioner

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## **I: Introduction**

White-collar crime involves the misappropriation of money or property, usually by executives, professionals, entrepreneurs and their corporations. Contrasted with so-called 'blue-collar crime', white-collar crime has long been seen as the province of the wealthier, professional classes, rather than the working classes. Partly a myth, partly a sociological fact, this perception has meant that historically at least, white-collar crime has received less media and political attention than, more traditional, blue-collar crimes. The distinction is part myth, because it is a truism that people from all walks of life commit crimes of violence and theft (traditional blue-collar crimes). The distinction is partly sociological fact however because of the types of theft and misappropriation that tends to be categorised as 'white-collar'. White-collar theft and fraud centres around business and commerce – and it is this identifying feature, rather than the social class or education of the offender that informs our modern understanding of what constitutes white-collar crime. White-collar crime is business and commercial conduct that is criminal, irrespective of who perpetrates it.

Critics, especially from the left, have traditionally argued that the limited focus on white-collar crime is largely informed by a protectionist approach by those in power – the wealthy and powerful protecting their own. To the extent such a view ever had merit, it is clear that such a mindset does not exist in this country in any significant way. Significant resources are now dedicated to the investigation and prosecution of white-collar crime. The establishment of the Serious Fraud Office (SFO) in 1990, and of dedicated company fraud and organised crime sections of the New Zealand Police, reinforce the serious approach that this country now takes to white-collar crime. The absence of a genuine class structure in New Zealand society, and the impact of significant overseas events also adds to a climate whereby it is arguable that white collar-crime is now as vigorously pursued as traditional blue collar, non-violent, crime. There are still concerns about overall resources available to detect and investigate crime. Recent media coverage of the inability of the Police to fully investigate a significant proportion of household burglaries and minor blue-collar thefts serves as a timely reminder that law and order resources are not limitless. That said, to the extent resources are available, white-collar crime is increasingly getting its share. There have been significant funding increases by successive governments in the area of white-collar crime, including in the area of serious fraud, money laundering, and organised crime. Of particular note is the increase in both resources, and workload, of the SFO. In 1997, the SFO had an annual budget of approximately \$4m, and had 12 active prosecutions. Today that budget has increased by more than 25%, and their current workload includes nearly 40 cases either pending, or before, New Zealand courts.

The traditional conception in New Zealand of white-collar crime as limited to fraud is also changing. In many ways, New Zealand is following in the footsteps of overseas jurisdictions such as the United States and Australia. The United States has considered a broad range of business conduct to be illegal for a long time. Insider trading and cartel conduct are just two examples of broader conduct which has been criminal in the United States for some time. Whilst at present, both offences carry only civil liability in New Zealand, there is evidence to suggest a change in focus on these two areas in this jurisdiction. In the case of insider trading, criminal provisions are likely to be introduced this year (as part of the proposed Securities Legislation Bill amendments to the Securities Markets Act 1988 (formerly the Securities Amendment Act 1988)), whilst the Commerce Commission has recently introduced a new leniency policy designed to increase the effectiveness of the current civil liability regime targeting cartels.

The purpose of this paper is twofold. First, to serve as an introduction to white-collar crime: to introduce the concept of white-collar crime, and to address the question of why it is that lawyers and financial advisers should be interested in the area. This introduction, coupled with the following section of the paper on the increased focus on white-collar crime in New Zealand targets this purpose. Secondly, the paper is designed to give guidance to those practicing in the area of liquidations and receiverships as to how they should approach instances of suspected white-collar crime. Part three of the paper, looking at the reporting obligations of liquidators and receivers, together with part four of the paper, discussing some of the strategic issues associated with white-collar crime, explore this second purpose.

This paper is designed to serve as a primer; a starting point, for you to consider white collar crime issues as they might arise in your practice. As always, a paper can never be a substitute for legal advice and

professional guidance on how to approach instances of suspected white-collar crime. When you are confronted with such a situation, the best advice the writer can give is for you to seek independent advice as to your obligations and options. As an administrator it is essential that you be seen to act professionally and independently in such circumstances. There can be no room for the suggestion that you have turned a blind eye to suspected offending, or worse, helped cover it up or been complicit in its execution. Independent, objective, advice, is oftentimes the best protection you will have against the possibility of such accusations.

## **II: The increased focus on white-collar crime in New Zealand**

There is an increased focus on the criminalisation of business conduct in New Zealand. A number of factors have brought about this trend, not the least of which has been overseas influences.

In the United States, the spectacular business collapses of Enron and WorldCom, and the consequent decline of Arthur Anderson, have increased focus upon issues of corporate governance, and the immense harm that can be caused by white-collar crime. The United States has long treated a broad range of business conduct as criminal, but even that jurisdiction was shaken by the impact of these collapses and their associated frauds.

The Sarbanes-Oxley Act 2002, passed in the wake of these collapses, brought into existence the Public Company Accounting Oversight Board (PCAOB). This private sector non-profit organisation registers and inspects firms that issue securities to the public, implements disciplinary proceedings and sanctions as well as establishing audit standards which have the force of law. Legislative reforms also include new "whistle blower" provisions which provide for confidential communication corridors so those who have reason to suspect something is amiss can report their suspicions.

Sarbanes Oxley has been a world changing legislative move. Not only has it impacted immensely upon United States-based corporations, but it has also influenced similar change in other jurisdictions (such as in Australia where the Auditing and Assurance Standards Board (AUASB) is now under the guidance of the Financial Reporting Council (FRC) with the status of a statutory body corporate whose auditing standards have the force of law) and has impacted upon the corporate governance requirements of non-United States-based corporations with business connections to the United States.

The impact of the collapses has not been limited to legislative responses however. In both the United States, and other jurisdictions, including Australia, increased public and media attention on white-collar crime has focused attention on prosecutions. Whilst precise figures are difficult to obtain, it is unarguable that the United States and Australian media have drawn increasing attention to white-collar crime prosecutions since the Enron collapse.

In many ways Australia has followed behind the United States in the way it treats white-collar crime, with New Zealand a further distance back. Where insider trading and cartel conduct have been criminal offences in the United States for some decades, only insider trading is currently a criminal offence in Australia. Cartel conduct is under consideration for inclusion on the statute books as a criminal offence in Australia. By comparison, neither constitute criminal conduct in New Zealand, and although insider trading is likely to be criminalised this year, there is currently no plans to criminalise cartel conduct.

That is not to say that New Zealand hasn't increased its focus on white-collar crime and related business conduct in recent years. In addition to the proposed criminalisation of insider trading there are also a number of policy positions taken by statutory bodies in recent years that indicate an increased focus on business conduct:

- The Commerce Commission has markedly stepped up its prosecution of companies, and of individuals, for breaches of the Commerce and Fair Trading Acts (recent examples include action in 2004 against the Ophthalmological Society, on-going prosecutions against credit card issuers regarding disclosure of currency conversion fees, prosecutions of transport companies regarding advertising as to price structures and the use of fuel surcharges, and the successful prosecution of Koppers Arch and an associated senior officer of the company for breaches of the Commerce Act);

- The Commerce Commission's recent introduction of a formal leniency policy is designed to increase their ability to investigate and prosecute cartel conduct under the existing civil regime. That regime already goes further than some overseas jurisdictions with provisions to allow legal action against both companies involved in cartel conduct and their officers, and includes the ability for offenders to receive significant fines (in the case of corporations, fines of up to \$5 million are possible).
- The Securities Commission has forecasted the extent to which criminal insider trading provisions are likely to be used when implemented with the first prosecution under section 18A of the Securities Markets Act 1988 (allowing the Securities Commission to take civil prosecutions itself) in relation to alleged insider trading in Tranz Rail Holdings Limited; and
- The Companies Office has significantly increased its prosecution, in the name of Registrar of Companies, for breaches of the Financial Reporting Act.

Post-9/11 movement against financial resources for global terrorist organisations has added to the increased focus upon illegal business conduct (including by way of the Terrorism Suppression Act 2002), along with miscellaneous amendments to various existing criminal statutes, including the addition of an offence governing the bribery of foreign officials to the Crimes Act (again, following a similar amendment to the criminal statutes in Australia), and the recent announcement that the SFO will take over prosecution responsibilities under the Proceeds of Crimes Act 1991.

In the writer's opinion, the trend is clear. New Zealand is becoming increasingly concerned with criminal and quasi-criminal business conduct. Such an increase in attention should not be ignored, and administrators should be more conscious than ever before, of their obligations to report suspected white-collar crime, and what to do from a strategic/practice management point of view, when it is encountered.

### **III: Reporting Obligation of Liquidators and Receivers**

Liquidators have positive statutory obligations under section 258A of the Companies Act 1993 to report to the Registrar if they consider that an offence that is material to the liquidation has been committed against either of the:

- (a) Companies Act 1955 or 1993;
- (b) Crimes Act 1961;
- (c) Securities Act 1978;
- (d) Financial Reporting Act 1993; or
- (e) Takeovers Act 1993.

A failure to report may itself result in a criminal prosecution, with a maximum fine of \$10,000.

Receivers have the same obligations under section 28 of the Receiverships Act 1993. In both cases, reports to the Registrar are confidential.

In addition to positive statutory obligations to report, there also exist arguable discretions to report suspect criminal conduct that does not fall within the prescriptive statutory provisions. To some extent, such a discretion might be considered to be prudent to ensure that a Liquidator or Receiver acts in accordance with their general obligations and powers, although there is additional weight to the argument that there is somehow a moral, or professional, obligation upon administrators to report suspected criminal conduct where they find it.

The writer is not convinced that this is necessarily so. There will be plenty of instances where an administrator may uncover evidence suggesting criminal conduct which does not fall within the prescriptive sections noted above, and where to report it might run contrary to the administrator's obligation to obtain the best outcome for the interested party(ies) they represent. In such circumstances it is essential that the administrator establish that a decision not to report is consistent with any such obligations. As noted earlier, it is crucial to ensure that there can be no credible allegation or suggestion that an administrator has acted anything other than independently and professionally in such a case.

So what sorts of white-collar activity might one uncover as an administrator? Common examples include:

### *1. Money laundering*

Section 243 of the Crimes Act 1961 criminalises the offence of money laundering, which involves the misappropriation of money or property derived from illegal activity by converting it into another form or concealing or disguising its nature, source, location, disposition, ownership or any interest in the property. Professionals, including lawyers and administrators need to be aware that an offence of money laundering is committed if they "assist any other person, whether directly or indirectly" to disguise the source of any property.

The Financial Transactions Reporting Act 1996 is also aimed at preventing money laundering. The Act requires financial institutions to verify the identity of customers when new bank accounts are opened and when certain transactions are conducted, and to report suspicious transactions to the Police's Financial Intelligence Unit. The Act also requires those arriving or leaving New Zealand to declare to customs cash in their possession exceeding \$10,000.

### *2. Insider trading*

Insider trading is presently a strict liability offence under Part 1 of the Securities Markets Act 1988. As earlier noted, the Act imposes civil liability on a public issuer who, while in possession of inside information about the public issuer, trades in its securities. It also prohibits "tipping" or passing on inside information, or encouraging a third party to deal with shares on the basis of the inside information. It is of note that insider trading, at present, does not fall within the prescriptive reporting requirements imposed upon administrators, although that is likely to change once it is criminalised.

### *4. Improper trading in securities*

The Securities Act 1978 puts in place a regime of promotion and accountability upon companies and directors who issue securities to the public. A breach of the requirements of the Act can lead to companies and their senior officers being held liable for fines, and the repayment of void allotments.

### *5. Failure to keep adequate accounts*

The Financial Reporting Act 1993 imposes strict financial reporting obligations upon companies and senior officers. Listed companies, overseas influenced private companies, and issuers of securities are just three examples of companies with strict reporting obligations under the Act. A failure to adequately prepare, audit, complete and/or file company accounts in breach of the Act constitutes a quasi-criminal offence, punishable with a fine upon conviction.

### *6. Fraud*

The Serious Fraud Office will investigate cases where there are reasonable grounds to believe that an offence involving serious or complex fraud may have been committed. Other instances of fraud are investigated and prosecuted by the Police. The Summary Offences Act 1981, and the Crimes Act 1961, provide a plethora of theft and associated criminal charges that capture fraudulent activity, including section 228 (formerly section 229A) of the Crimes Act 1961, which makes criminal the dishonest use of a document to obtain a pecuniary advantage.

The actual number of statutory provisions that capture criminal and quasi-criminal conduct are, of course, very broad - taxation legislation drawing the fine line between tax avoidance and tax evasion, telecommunications and criminal law provisions governing the legal limits of surveillance and eavesdropping, election law provisions governing the legal limits on elections campaign expenditure and conduct, and complex fisheries quota rules governing the obtaining of quota and its exchange are all examples of laws which could potentially be involved in a white-collar investigation.

In many ways an administrator must be on the look out for suspicious conduct, rather than necessarily be expected to identify specific breaches of the law. To that extent, notice should be given to any

conduct, or business records, which indicate an intent to present one story, when the reality is quite different. Deceitful conduct is often the smoke that indicates a criminal fire burning further below.

#### **IV: Strategic Issues Surrounding White-Collar Crime**

In many cases, white-collar conduct can give rise to civil, as well as criminal, liability. Accordingly, two important questions for an administrator to consider when they uncover evidence of white-collar conduct are:

1. Should I pursue this matter civilly as well as, or in preference to, laying a criminal complaint (subject to any mandatory obligations to report)? and
2. What are the strategic implications to consider where white-collar conduct is suspected?

When white-collar conduct is uncovered, there are generally four options open to an administrator. First, they might choose to pursue the conduct as a criminal matter only. Secondly, they might choose to pursue the matter solely as a civil matter. Third they might choose to pursue the matter concurrently, or finally they might elect not to pursue the conduct at all.

Generally speaking, if your goal is to maximise recovery of monies lost due to white-collar conduct, it will be necessary to take civil action of some kind. Provisions of the relatively new Sentencing Act 2002, along with the Proceeds of Crime Act 1991 and associated legislation, do enable private parties (including administrators on behalf of companies and shareholders) to recover some losses by way of restitution/repairation, however, it is rare that such recovery would ever amount the full value of the loss suffered.

The benefit of allowing recovery to become a by-product of a criminal prosecution is the cost – assuming the prosecution is taken by a government agency and is not required to be taken as a private prosecution. A downside, in addition to the likely lower recovery, is the time frame, with some prosecutions taking many months, perhaps even years to be concluded.

If you do decide to pursue the matter criminally there are two options. The first is to lay a complaint with the appropriate government authority, usually the SFO, Police, IRD, Customs or other similar agency. When this occurs you will take on the role of the 'complainant', relinquishing control of the matter from that point on. An alternative route, and sometime necessitated due to a lack of resources at the government agency level, is taking a private prosecution. Under New Zealand law anyone is entitled to take a prosecution of any alleged breach of a criminal or quasi-criminal legal obligation (with a few exceptions). When that occurs, the private citizen (or corporation) steps into the role of prosecutor that would otherwise be filled by the state agency. In many ways this will be the least desirable option for a party seeking redress. It is generally as costly, if not more so, than civil litigation, with onerous obligations that attach to the prosecutorial nature of the exercise.

In many ways, running concurrent civil and criminal cases in the area of liquidations and receiverships is easier than with respect to many instances of concurrent liability. In most cases, the most significant barrier/strategic consideration, to concurrent cases, is the effect a criminal case will have upon the ability to gather evidence, and compel testimony, for a civil case.

In the employment arena for example, the existence of a criminal case can jeopardise an employers ability to conduct an investigation into alleged employee misconduct, due to the employee's ability to invoke their 'right to silence' stemming from the concurrent criminal proceedings (see for example the Employment Court's decision in *Wackrow v Fonterra Co-Operative Group Limited*). Similarly, the Evidence Act 1908, as it currently stands, allows for parties in civil litigation to exercise their right to silence in circumstances where they might expose themselves to potential criminal or civil liability. There are provisions in the current Evidence Amendment Bill to alter this shield to remove the instance of potential civil liability, however, the shield from exposure to criminal liability is likely to remain.

These problems are, however, are of less concern to administrators. A number of statutory provisions (including section 70 of the Insolvency Act 1967) compel testimony when called upon as part of a financial investigation. Such an approach is consistent with an overarching public policy theme that favours compelling disclosure in circumstances where it would otherwise be exceedingly difficult to get to

the heart of complex and often difficult to detect white-collar conduct. Prosecutorial agencies, including the SFO, Customs and IRD, have similar statutory provisions that vary, or remove completely, the right to silence, however administrators are in a rare, if not unique position, of having comparable powers to compel testimony available to them as private citizens.

Ultimately the decision for an administrator as to whether or not to pursue civil, as well as (or in place of) criminal liability, will often come down to an availability of resources, and the likely level of recovery. Civil litigation, if it can be pursued, increases the chance of settlement, increases the overall rate of recovery, and will often allow the administrator more control over the proceeding, however, ultimately, mandatory reporting obligations, and a lack of available resources, may mean that civil recovery is not possible.

A further strategic issue that should be considered is the preservation and presentation of evidence. Much could be said about the importance of carefully identifying, preserving and collecting evidence for future analysis and use in a criminal, or civil, case. Documentary evidence, electronic evidence and oral evidence all need to be identified, preserved and collected in different ways. The collection of evidence is something, which if not done correctly at the outset, can taint a whole case. If a case goes off the rails later on, one can always return to the initial starting point, the evidence, to resurrect it. If the evidence, the foundations of a case, are flawed, then the case may be irretrievable from the outset. Electronic evidence requires particular care when it is collected and preserved. The act of powering up a computer alters the data contained on that computer in numerous ways, some of which might mean that evidence that would have been significant to a case, is destroyed. The copying of electronic data from a computer without corruption from powering the computer up is just one of many best practices involved in the collection and preservation of evidence which is essential to follow in order to preserve as best as possible evidence for future analysis.

## **V: Conclusion**

There has traditionally been a reluctance, especially amongst commercial lawyers and financial advisers, to work in the area of white-collar crime and prosecutions. However, with the increased focus on the criminalisation of business conduct, it is a field that professional advisers cannot afford to ignore.

In the case of liquidators and receivers, there are positive obligations to identify and report such conduct, and any administrator who fails to do so risks not only professional criticism and potential legal action directed against them, but also potentially limits their ability to properly investigate, track and recover for any mismanagement in the organisation under investigation.

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