Commercial fraud in New Zealand: contemporary legal and investigative issues

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I INTRODUCTION

> Dramatic headlines cry for attention and yet few people understand fraud, believe that they could be its victims, or take on the responsibilities of prevention and detection ... . Whereas society seems outraged, and rightly so, at overt acts of violence and terrorism and is prepared to devote attention and resources to their solution, covert and possibly in the long term more damaging losses through deceit escape attention and succeed by default.[1]

The introduction by Comer in his treatise on Corporate Fraud encapsulates the twin problems central to the economic and social threat to society posed by devoting only transitory and superficial attention to a very real problem; too few people understand the problem and too few resources are devoted to combatting it.

This paper examines commercial fraud in New Zealand from four perspectives:

The nature and extent of the problem in New Zealand;

The adequacy of the existing law to deal with it;

The relevant proposals contained in the Crimes Bill 1989, the Corporations (Investigations and Management) Act 1989 and the recently released Law Commission Report on Company Law;

The proposal that a Serious Fraud Office be established to investigate a dramatic increase in commercial fraud cases in the wake of the 1987 sharemarket collapse and subsequent economic recession.

II THE PROBLEM

Serious fraud offending is frequently referred to under a variety of names of which "white collar crime" and "corporate fraud" are but two. The problem which is the focus

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1 M J Comer, *Corporate Fraud* (2 ed, 1985) 1.

of this paper is more appropriately described as serious commercial fraud. It can be defined as:

> Large scale dishonesty practised by a commercial enterprise, whether a corporation or not, against an economic victim, or by persons within the enterprise against the enterprise itself. Included are such frauds committed with the aid of computers.

Accurate statistics on the extent of commercial fraud are not available in New Zealand. There are many reasons for this. First, in common with overseas experience, only a minority of such fraud is reported and investigated. Second, police statistics are not maintained in a manner which will permit the extraction of serious commercial fraud statistics from other less serious fraud offences. Third, those statistics which are available are frequently distorted. For example, a company may have collapsed with a loss of over five million dollars to public investors. Fraud is suspected and during investigation may be reported as a five million dollar fraud. The investigation may reveal that only part of the loss was due to fraud. Due to logistical and legal constraints associated with the prosecution process, only a proportion of the established fraud may be the subject of court proceedings. Finally a conviction may be entered on only a few of the charges laid. It is not uncommon for a case such as this to result in conviction for offences totalling only some half a million dollars, one tenth of the original sum suspected. To take either the five million or half a million dollar figure as the true indication of the fraud is equally misleading. Because investigators and prosecutors face large and increasing workloads, analysis of the real extent of the fraud is seldom made and still less frequently recorded.

Informed and reportedly conservative estimates from experienced Police and Justice Department investigators have put the amount of reported commercial fraud in recent years as around 10 to 15 million dollars annually. In 1988 and 1989, however, the incidence has burgeoned to a present figure of suspected fraud offences totalling between 50 and 70 million dollars, involving more than 30 commercial enterprises, either under, or awaiting investigation.

A number of New Zealand case studies are outlined below which both illustrate these problems and highlight some deficiencies in present fraud law. All have been extracted from police files over the last decade.

Case 1

A chartered accountant formed a group of companies specialising in two activities. First, the formation of farming syndicates to operate at a tax loss (the so called "Queen St" farmer) and second, term investment of funds in the group's finance companies. Proceeds of both types of investment were misappropriated by the group founder who dissipated, over a four year period, in excess of a million dollars maintaining an opulent lifestyle. He was able to hide his offending by a continuing flow of new investment and by preparing false accounts for investors and creditors. One investor lost in excess of one million dollars, including several farms he had owned prior to seeking investment advice from the accused. As private limited liability companies there was no requirement for audited accounts. A total of more than two million dollars was lost

in the collapse of the companies and the accused was convicted of theft and false accounting charges involving more than $750,000.

Case 2

A very successful former insurance salesman established a financial advice and investment partnership which he advertised nationally seeking funds for investment in property and related investments. Over a twelve month period over $600,000 was received for investment. No funds were ever invested but were used by the principal for his own purposes including a heavy gambling habit. He was a first offender whose appearance and manner inspired trust and confidence, as did his glossy brochures, advertisements and executive office. He was convicted on charges of theft by misappropriation totalling $275,000. This case contained a further, rather bizarre feature. The accused, who had formerly led an exemplary family and business lifestyle, became determined to prevent his conviction at all costs. He resorted to hiring a "hitman" in order to threaten serious injury to witnesses, including police investigators, who were to be called against him. After the trial commenced, he ordered similar threats against the selected jurors hearing the case. In addition to the fraud convictions, he was also convicted on a charge of attempting to defeat the course of justice. These unusual circumstances resulted in the longest sentence ever imposed on a fraud offender in New Zealand of seven years imprisonment, later reduced to five and a half years on appeal.

Case 3

A formerly successful deer recovery operator established a helicopter and aircraft importation company to service rural farmers and second tier airlines. He established offshore finance facilities with two major New Zealand merchant bankers to finance aircraft purchases pending on-sale. In order to avoid imminent liquidation through mounting business losses, in part due to his own extravagant drawings, he created a series of fictitious aircraft purchases in respect of which he sought finance from one of his bankers. The security for advances was to be the aircraft in the first instance and ultimately the proceeds of on-sale. Because the funds were only available offshore the accused had to invent an elaborate "paper trail" to induce the bank to part with its funds. False commercial invoices and sales documentation were produced by an accomplice in the United States and eventually funds totalling 1.2 million dollars were remitted to this accomplice and subsequently back to the accused. No aircraft were purchased. The funds were applied to settle outstanding debts of the company, including one of $50,000 to the accused, and were totally lost to the bank. He was subsequently convicted on charges of false pretences and theft by omitting to account in respect of one of the transactions.

The case highlighted jurisdictional problems in both obtaining evidence from overseas and the subsequent admission of documents in evidence in the absence of the relevant witnesses who could not be compelled to travel to New Zealand to give evidence. The charges failed in respect of two of the transactions partly as a result of legal technicalities in the charges of theft by omitting to account but partly also because the absence of overseas witnesses and evidence prevented alternative charges of false

pretences proceeding which would not have been subject to the same legal argument. There was ample evidence of dishonesty in respect of all three transactions.

Case 4

A contributory mortgage company sought and received two million dollars from public investors for investment in mortgage securities. The company shared a common board of directors with a number of property development companies who were the principal borrowers of the funds in return for mortgages over properties owned by them. The latter companies experienced difficulties in completing developments with the funds invested. Among the reasons for these liquidity problems was a share swap between companies, at a significantly inflated value, in favour of the directors. Further funding from institutional investors was sought but the group had insufficient equity in properties owned by it to secure adequately both the proposed advances and those from investments in the existing contributory mortgages. The directors, acting on behalf of both the nominee company and the mortgagors, discharged mortgages securing the public investors in favour of the institutions who proceeded with the mortgage advances sought. Alternative securities subsequently assigned to the public investors proved to be substantially worthless, as the total advances "secured" in this way exceeded the known valuations of the relevant properties. The property developments could not be completed and the group was wound up with a loss to the public investors of over one and a half million dollars. The group had operated common bank accounts and the tracing of individual investors' funds became impossible. Hence, the investigation concentrated on the issue of security for the investors' funds. Three of the four nominee company directors were subsequently convicted on charges of conspiracy to defraud in respect of their involvement in the discharge of mortgages without authority and their subsequent inclusion in securities of significantly lesser value.

Case 5

The final case also has an international aspect. An accountant for another multi national company was responsible for investing in "futures trading" on various commodities. In addition to trading on behalf of the company, he also traded on his own behalf but using company funds and diverting any profits to himself. For example, he would draw a company cheque for $1,000,000 to forward purchase a commodity. When the contract closed in 60 days the product may be worth $1,100,000 and a cheque for that amount delivered to the company. In this event he would recredit the original $1,000,000, and divert $100,000 to his own account. Unfortunately, his investment judgment deteriorated and in fact the "futures" purchased lost value. Consequently less than the original amount was returned. In all, he used several million dollars of the company's funds in this manner and stole a total of $1,000,000, either as profits which he took or as losses subsequently borne by the company which he could not repay. After extradition to New Zealand he was convicted of several offences of causing the company to execute valuable securities by false pretences. Guilty pleas obviated anticipated legal argument concerning the admission of evidence from the overseas aspects of the transactions.

III THE LAW

Adequate legal mechanisms are one of the two central components in a strategy to minimise and deal adequately with the incidence of corporate fraud. Efficient and effective use of investigation and prosecution resources provides the second component. In New Zealand the legal framework comprises two elements. The first consists of the fraud provisions of the Crimes Act 1961, Companies Act 1955 and a number of lesser statutes. The second is a wide body of case law from the United Kingdom, Australia and New Zealand which has interpreted and applied these or similar provisions.

A The mental element

Perhaps the dominant issue in any discussion of fraud offending is the intent required to be proved before a conviction on a charge of fraud can be sustained. The appropriate test is that of an "intent to defraud", sometimes expressed as a "fraudulent intent", which, while ultimately a question for the jury, is one which requires careful explanation to a jury in criminal proceedings. The standard the courts have applied before a person can be held to have such an intent is one of dishonesty. Our own Court of Appeal has summarised its view as follows:[2]

> We think that in order to act fraudulently an accused person must ... act deliberately and with the knowledge that he is acting in breach of his legal obligation. But we are of the opinion that if an accused person sets up a claim that in all the circumstances he honestly believed that he was justified in departing from his strict obligation, albeit for some purpose of his own, then his defence should be left to the jury for consideration provided at least that there is evidence that in all the circumstances his conduct, although legally wrong, might nevertheless be regarded as honest. In other words the jury should be told that the accused cannot be convicted unless he has been shown to have acted dishonestly.

This test, while useful, begs the question of what conduct a jury may consider is a dishonest, as distinct from an "honest" breach of legal obligation. There are two distinct situations where such a question arises. The first is where the conduct is both antecedent and contemporaneous to funds being advanced. The second is where the accused has received funds honestly pursuant to a genuine business arrangement but subsequently while entrusted with those funds engages in conduct which could be regarded as dishonest. A practical example illustrates this distinction. The first involves a company which solicits investments pursuant to false representations presented both in a prospectus and verbally. The company has no intention of applying the funds to the purposes stated. The second involves a company which at the outset honestly solicits funds for investments and for a period treats those funds in accordance with the directions and authorities given. Subsequently, however, without further recourse to those investors the funds are applied in breach of authority and lost.

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2 *R* v *Coombridge* [1985] 2 NZLR 381, 387.

The following cases enunciate tests and examples for both situations:

> ... the offence is that of making or publishing a false statement or account, or a false or fraudulent entry with intent to deceive or defraud. To deceive is, I apprehend, to induce a man to believe that a thing is true which is false, and which the person practising the deceit knows or believes to be false. To defraud is to deprive by deceit: it is by deceit to induce a man to act to his injury.[3]

> If the defendant made statements of fact which he knew to be untrue, and he made them for the purpose of inducing persons to deposit with him money which he knew they would not deposit but for their belief in the truth of his statements, and if he was intending to use the money so obtained for purposes different from those which he knew the depositors understood from his statements that he intended to use it, then, gentlemen, we have the intent to defraud, although he may have intended to repay the money if he could, and although he may have honestly believed, and may even have had good reason to believe, that he would be able to repay it.[4]

Where a person intends by deceit to induce a course of conduct in another which puts that other's economic interest in jeopardy he is guilty of fraud even though he does not intend that actual loss should ultimately be suffered by that other.[5]

These tests have been applied in the High Court in New Zealand.[6]

The New Zealand and English authorities have differed in their application of the appropriate test to be applied by a jury when deciding whether an accused person has been dishonest.

The UK Court of Appeal expressed the test thus:[7]

> It is no defence for a man to say, "I knew that what I was doing is generally regarded as dishonest; but I do not regard it as dishonest myself. Therefore I am not guilty". What he is, however entitled to say, is "I did not know that anyone would regard what I was doing as dishonest". He may not be believed ... but if he is believed, or raises a real doubt about the matter, the jury cannot be sure that he was dishonest (and it must find him not guilty). In determining whether the prosecution has proved that the defendant was acting dishonestly, a jury must first of all decide whether according to the ordinary standards of reasonable and honest people what was done was dishonest. If it was not dishonest by those standard, that is the end of the matter and the prosecution fails. If it was dishonest by those standards, then the jury must consider whether the defendant himself must have realised that what he was doing, was by those standards dishonest. In most cases, where the actions are dishonest by ordinary standards, there will be no doubt about it. It will be obvious that the defendant himself knew that he was acting dishonestly. It is dishonest for a defendant to act in a way which he knows ordinary

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3 *In re London and Globe Finance Corporation Limited* [1903] 1 Ch 728, 732-733.

4 *Rex* v *Carpenter* (1911) 22 Cox CC 618, 624.

5 *R* v *Allsop* (1976) 64 Cr App R 29, 32.

6 *Queen* v *Connell* Unreported, 10 October 1984, High Court, Auckland Registry T 51/84, 21.

7 *R* v *Ghosh* [1982] 2 All ER 689, 696.

> people consider to be dishonest, even if he asserts or genuinely believes that he is morally justified in acting as he did.

This approach represents a mixed objective and subjective test. It is objective from the perspective that it sets a concept of dishonesty according to the standards of ordinary people. It is subjective from the perspective that the accused must know both of that standard and that he or she is in breach of that standard.

The New Zealand Court of Appeal appears to have adopted a narrower view. In *R* v *Williams* the test in *Ghosh* was analysed and not adopted, the Court preferring its own test in *Coombridge*. After restating the test the Court continued:[8]

> In deciding whether the accused was acting dishonestly at the material time, the jury are entitled to look at all the facts and statements disclosed in the evidence from which inferences as to the honesty or otherwise of his belief may be drawn. In other words, the jury in deciding on the accused's state of mind - honest or otherwise - [a subjective state] are entitled to ask themselves whether on the evidence it was reasonably possible that he was acting honestly, however mistakenly, [a subjective test] and if this is reasonably possible they must acquit him.

The Court did not however, consider the trial judge's summing up, which specifically referred to the *Ghosh* objective element, to be inappropriate or misleading to the jury, noting that it did not leave the jury to make an "objective appraisal of guilt".

What the decision in *Williams* still leaves unclear is the crucial issue of whether it is the accused's knowledge of ordinary standards of dishonesty which is relevant, or whether it is his or her own belief as to what constitutes dishonesty. This issue will be discussed further in the context of the Crimes Bill 1989.

B Substantive fraud offences

Although there are a wide variety of techniques used by fraud offenders, there are limited categories of offences within which the fact situtations must fall before criminal liability can ensue. The majority of these offences are contained in the Crimes Act 1961 and fall into three broad categories.

The first group is what may be regarded as the covert fraud offences. The major offence is that of theft, either with the fiduciary element found in the "misappropriation" and "omitting to account" sections, or the more straightforward theft, by either taking possession of, or converting property with the required intent. Also included here are offences allied to theft, such as conversion of property held under a security (either a hire purchase agreement, instrument by way of security or debenture). A secondary offence is that of false accounting where, as the name applies, books of account are falsified to disguise other offences. In these cases stealth is used to disguise from the true owner or

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8 *R* v *Williams* [1985] 1 NZLR 294, 308.

person having a legal interest in property, the fact that their interest in that property has been fraudulently diminished or extinguished.

The second group includes those offences which require the overt practice of deceit on a vicitm by means of verbal or written falsehoods or the production of false documents to induce a victim to part with either ownership or a legal interest in property. Offences such as false pretences, credit by fraud, forgery, circulating false statements and fraudulent use of documents fall within this category.

The third category involves those offences commonly known as bribery and corruption. The essence of these offences is the use of a position as an agent to profit from third parties with whom the agent deals on behalf of his or her principal, to gain an advantage at the expense of that principal. The most common example is the rigging of contracts by bribing the person responsible for receiving and evaluating tenders.[9]

Some offences may be committed either overtly or covertly. For example conspiracy to defraud where the deceit which is the basis of the fraud may take a variety of forms and may or may not be communicated to the victim.

Specific offences as they relate to companies or bankrupts are contained within the Companies Act and Insolvency Act but essentially contain the same ingredients.

C Problems inherent in contemporary law

(i) Property capable of being stolen

There is no doubt that technological changes over the last three decades have outstripped the ability of the criminal law to cope with modern fraudulent practices.

The most serious deficiency is the definition of "property" which may be the subject of an offence of theft or false pretences. The Crimes Act 1961 requires such property to be tangible and either moveable or capable of being made moveable.[10] This is clearly a relic of pre-electronic days when the essence of a person's property was tangible and possession could be physically taken of it. This concept fails to address modern commercial reality where millions of dollars daily are transferred in seconds by computers using electrical impulses and circuits. In no sense can these be regarded as tangible property. It is not therefore possible to steal or obtain by false pretences bank credits, funds electronically transferred, choses in action and a variety of valuable property.[11]

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9 Secret Commissons Act 1908.

10 Crimes Act 1961, section 217.

11 See *R* v *Bennitt* [1961] NZLR 452.

(ii) The definition of a "document"

A second limitation relates to the manner in which "document" is defined under that Act. The definition under section 263 does include computer stored and transferred data and is therefore adequate but its application is restricted to a very few sections[12] of the Act and it is not available for offences of theft, false pretences and fraudulent use of documents which are routinely used to combat fraudulent behaviour. The High Court was recently required to address this problem. In the course of a lengthy judgment it was held that, despite the fact that the section under consideration (section 253) fell outside the ambit of the broad statutory definition of document, data on a computer disk was an "account" for the purposes of false accounting. To reach this conclusion the Judge took the unusual step of applying a "fair, large and liberal interpretation" to a penal statute in order to give effect to it.[13] Such interpretations may not always be forthcoming and it is submitted the legislature should remedy this defect in the new Bill.

(iii) Computer abuse

A third problem is the lack of any specific offence related to the fraudulent use of computers to facilitate crime. New Zealand is not immune to computer assisted crime and modern fraud experience is that the majority of fraud offences at some stage of their perpetration involve the use of a computer. The problem is exacerbated by the restrictive definition of property discussed above. Computer crimes are presently prosecuted under a variety of provisions of the Crimes Act 1961 but investigators have been precluded from pursuing some complaints because of legal restrictions. For example, computer based information cannot be stolen or otherwise fraudulently appropriated. It is not "property capable of being stolen" and the extended definition of document does not extend to the fraudulent use of document provisions under section 229A of the Act. Such information, especially computer software and other types of "trade secrets" can be extremely valuable. An imaginative application of the provisions of section 266A(1)(b) of the Crimes Act 1961 offers some scope to impose criminal liability for the fraudulent acquisition of computer based information. The section makes it an offence to:

> with intent to defraud, by any means make a document which is a reproduction of the whole ... of another document.

The argument is that, as this section specifically adopts the broader definition of document under section 263 the reproduction of data from one computer disk to another falls within its ambit, provided the necessary fraudulent intent can be established. The proposition has, however, yet to receive judicial scrutiny and while both the *Nicholson* decision referred to above and the provisions of section 266A(1)(b) may be of assistance

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12 Sections 274-279 being principally those of forgery and counterfeiting.

13 *Nicholson* v *Police* Unreported, 10 November 1986, High Court, Napier Registry M148/85, 14-15.

with this problem, it is submitted that only specific legislation will adequately cope with the complexities posed by modern technology.

(iv) "Consent" and the corporate structure

A fourth limitation and one specifically related to fraud involving the corporate structure is the rule in *Craig* v *Police*.[14] This relates to the restrictions on the applicability of the law of theft or false pretences to a company director who holds substantially all the share capital of a company. The rule is that the director cannot steal from that company or obtain property by false pretences for no matter how fraudulent the conduct, the company, through the director, has consented to the appropriation of its property. Craig was the sole director and beneficial owner of all the shares in an insurance company. Immediately before the company went into receivership, Craig transferred the ownership of a Jaguar car from the company to himself in what can only be considered a fraudulent scheme. He falsely reported to the company that the vehicle had been involved in a motor accident and severely damaged. At the time the car was valued at $17,000. He then tendered for the car in a personal capacity and verified to the company that his tender for $800 was the highest. He then had the car repainted and registered in his own name. He was charged with theft and convicted at first instance. The Court of Appeal, however quashed the conviction concluding:[15]

> We cannot avoid the conclusion that the company in the person of the defendant genuinely consented to his actions; and that must be regarded as fatal to the charge of theft from the company, for the company's consent is inconsistent with the conversion from it - just as indeed his knowledge of that consent is inconsistent with an intent to deprive the company, in the natural and ordinary sense of the word 'deprive'.

The Court referred to its earlier judgement in *R* v *Daemar*[16] which involved a charge of theft of a cheque from the company by the accused, who was in a similar relationship vis-a-vis the company as Craig. The Court held:[17]

> ... we think this charge to have been misconceived. As sole director of the company with the widest sort of authority to control its activities, and in particular to draw cheques, the appellant could not have been guilty of stealing a cheque drawn on the company account and cashed by himself.

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14 *Craig* v *Police* Unreported, 10 June 1977, Court of Appeal CA 20/77. See also [1977] NZ Recent Law 309.

15 Above n 14.

16 *R* v *Daemar* Unreported, 6 October 1976, Court of Appeal CA 65/76.

17 Above n 16, 6-7.

The English authorities have adopted a different approach and the English Court of Appeal has expressed the following view:[18]

> Where all the shareholders and directors of a company acted illegally or dishonestly in relation to the company their knowledge of, or consent to, the illegal or dishonest acts was not to be imputed to the company. Accordingly the issue of whether the defendants had 'dishonestly' appropriated funds from the company should have been left to the jury ... . Furthermore, unless the defendants had had an honest belief that they had been entitled to appropriate the company's funds, they could not have honestly believed that the company had truly consented to the appropriation.

The Companies Act 1955 creates an offence for an officer of member or a company to:[19]

> Fraudulently take or apply property of the company for his own use or benefit, or for any use or purpose other than the use or purpose of the company.

Whether the *Craig* rule would also be applied to this section has yet to be the subject of judicial decision. The section bears remarkable similarity to the theft definition in the Crimes Act 1961 and the likelihood is that the rule, unless changed legislatively, will protect many dishonest acts committed by company officers with significant majority control.

(v) Admissibility of evidence

Finally there are two problems associated with the admissibility of evidence in respect of commercial fraud offences. The first relates to the present uncertainty in respect of the admissibility of computer produced business records. This has been the subject of a Law Reform Committee report and a draft Bill[20] but there is to date no sign of amending legislation. The principal problem relates to whether or not computers are inherently reliable enough for a court to accept evidence produced or stored in electronic form where no "person" can be subjected to court scrutiny to assess the reliability of that data. The approach recommended by the Law Reform Committee, namely that such evidence should be admissible provided evidence is available to prove the reliability of the system, is eminently sensible, reflecting as it does both commercial reality and legal precedent in the United States and Britain. Legislation should, however, be given some urgency to prevent the potential loss of important evidence in commercial fraud proceedings.

The second problem arises from the international nature of fraud offending where complex business transactions regularly cross international frontiers. There are limitations in both the jurisdiction of New Zealand investigators to search for and seize evidence in other countries and in its admissibility in New Zealand courts if a competent

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18 *Attorney-General's Reference (No 2 of 1982)* [1984] 2 WLR 447.

19 Companies Act 1955, section 461A.

20 Evidence Law Reform Committee *Report on Business Records and Computer Output* (1977).

witness is unwilling to travel to give evidence. Unlike the computer evidence problem above there are no legislative proposals designed to alleviate potential difficulties and reliance must be placed on the exceptions to the hearsay rule in respect of business records contained in the Evidence Act.[21]

IV THE FRAUD PROVISIONS OF THE CRIMES BILL 1989

A "Dishonesty"

The most radical component of the Bill is the attempt to define legislatively the term "dishonesty". The definition is lengthy and complex but is reproduced in full as several aspects are analysed in some detail.[22]

> ... A person dishonestly does any act or dishonestly omits to do any act in each of the following circumstances:
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> (a) In respect of any act or omission requiring the authority of any other person and for which that authority has not in fact been given, where he or she-
>
> (i) knows that no such authority has been given; or
> (ii) does not believe that any such authority has been given,-
>
> and has no reasonable grounds for believing that the other person would have given that authority had he or she been asked;
>
> (b) In respect of any act or omission requiring the authority of any other person and for which that authority has in fact been given, where he or she knows or suspects that the authority has been obtained through any deception;
>
> (c) In respect of any act or omission, or the continuation of any state of affairs, requiring the authority of any other person to whom he or she owes a fiduciary duty and for which that authority has in fact been given, where he or she had, in breach of that duty, knowingly or recklessly failed to disclose to that other person any material particular that might have caused that other person to refuse to give or to revoke that authority;
>
> (d) In respect of any representation or statement that is false in any material particular, whether made orally or in writing, where he or she-
>
> (i) knows the statement or representation is false in that material particular; or
> (ii) does not believe the statement or representation is true in that material particular; or
> (iii) is reckless as to whether the statement or representation is true or false in that material particular.

The definition, which is exclusive, represents a radical step in the development of the criminal law by the introduction of two new concepts. The first is the proposal for

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21 Evidence Amendment Act (No 2) 1973, section 3.
22 Crimes Bill 1989, clause 178.

an objective test to be applied when assessing a defendant's belief that he or she would have had the consent of the other person to act, had the latter been asked (clause 178(a)(ii)).

This, in effect, introduces a strict liability test to dishonesty which is without precedent in the United Kingdom or Australia. The test was introduced in the latest draft of the Bill in substitution for an earlier subjective test which required under the equivalent subsection proof that the person:

> ... has no reason to believe that the other person would have given that authority had he or she been asked.

It is the writers view that neither test is appropriate to a codified dishonesty definition.

A purely objective definition can be opposed on two grounds. First, it violates one of the basic principles of the criminal law requiring proof of intent in respect of serious criminal charges. Second, there is increased potential for injustice by requiring a defendant to displace prima facie proof of an absence of reasonable grounds for belief.

The principal problem forseen in respect of the subjective test is that the use of the words "no reason to believe" are open to several interpretations. First, it is not clear that the accused must have turned his or her mind to the question of whether or not a person would have authorised a particular act. It is submitted that this aspect must be clarified by the legislature. An accused should not be able to claim retrospectively that he or she could have had a number of good reasons to believe that consent would have been forthcoming but did not give them conscious thought at the time and deliberately acted without authority.

Second, how fanciful yet genuine can the scope of that belief be? It is submitted that, in view of the uncertainty surrounding the various tests for dishonesty discussed in *Williams* and *Ghosh*, it should also be made clear which should be applied.

Two alternative approaches are possible. An argument based on *Ghosh* would say that an accused could only avail himself of the defence of belief that authority would have been forthcoming if the test was viewed partially objectively and partially subjectively. In other words:

> Would an ordinary person have believed that in the circumstances, authority would have been given to the accused's actions (objective) and was the accused aware that applying this test that authority would not have been forthcoming (subjective)?

An argument based on *Coombridge* and *Williams* would require only that an accused honestly believe that, according to the accused's standards, authority would have been given. Expressed, more accurately, it would require the prosecution to exclude the existence of such an honest belief. This is a very different situation than analysing a series of events to draw inferences concerning an accused's state of mind. The broad

assertion that "I believed that had I asked, I would have been authorised to act as I did" will be very difficult for a prosecution to refute particularly to a criminal standard.

Third, the lack of consent test may not catch some acts which would be dishonest according to the tests outlined earlier in this paper. For example, the thrust of the test in *Allsop*[23] is some form of deceit accompanied by a risk to the proprietary rights of another. This would not be the main issue under the authority test. Argument will inevitably centre on the issue of whether or not the victim would, had he or she been asked, have authorised the act or acts done. A major difficulty in this respect is ascertaining and presenting a fair "hindsight" view of the relevant facts upon which such consent may or may not have been forthcoming and the extent of authority already held by the accused. This problem will be particularly acute in cases of corporate fraud involving company directors or professional advisers making investment decisions on behalf of investors who may have signed some general type of authority.

The second major concept is the introduction of "recklessness" as a test of dishonesty. Reckless is itself defined in clause 22 and may be summarised as the state of mind of a person who puts his or her mind to a possibility of an unintended consequence occurring but then proceeds with a course of action with the knowledge that there is a risk that the particular unintended consequence may occur where in the known circumstances it was unreasonable to take that risk.

Two of the four alternatives in the definition include the recklessness test. The first relates to transactions where a fiduciary relationship exists and authority to act has been given, but there has been a failure to disclose a material particular that might have caused the other person to refuse to give, or to revoke that authority.

The second refers to recklessly making false statements but not in the context of authority either given or refused.

The third alternative introduces a test analogous to recklessness but defined as a suspicion that authority has been obtained through deception.

The fourth alternative relates to all cases, whether a fiduciary duty exists or not, where not authority has been sought or given.

A recklessness test can be supported in the context of serious commercial fraud on the basis that it does not offend against the requirement to prove a specific intent but closes the door to some of the more fanciful defences presently available based on a purported lack of knowledge. Thus, both the interests of justice and the wider public interest of reducing opportunities for fraud, would be served.

It is submitted, however, that there is no justification for distinguishing between dishonesty in relation to fiduciary and non-fiduciary relationships in respect of a reckless failure to disclose a material particular that might cause another person to refuse to give,

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23 Above n 5.

or to revoke authority given (clause 178(c)). Accordingly, clause 178(b) should be amended to add:

> ... or has knowingly or recklessly failed to disclose a material particular that might have caused that other person to refuse to give or to revoke that authority.

Before leaving the question of a definition of dishonesty, three further issues are relevant.

The first is that the defence of "colour of right" under the Crimes Act 1961 is abolished and replaced with the specific definitions of dishonesty and recklessness.

The second is the effect of the present drafting of the definition on the rule in *Craig's* case. The position would appear to be that it would entrench the rule and provide a defence to Company directors with exclusive control to "consent" on behalf of the company to their own fraudulent appropriation of property from the company. The potential here is to exclude criminal liability even when such actions prejudice the economic interests of either unsecured creditors or minority shareholders, the consent of neither being required.

The third, is the approach to this question by the UK Law Commission in its recent Draft Code (1989). Instead of an exclusive definition, provision is made for exceptions to dishonesty expressed as follows:

> .... A person's appropriation of property belonging to another is not dishonest -
>
> (a) if he appropriates the property in the belief that he has in law the right to deprive the other of it, on behalf of himself or of a third person; or
>
> (b) or he appropriates the property in the belief that he would have the others consent if the other knew of the appropriation and the circumstances of it .....[24]

While such a defence suffers from many of the defects earlier identified concerning the question of "consent" it is a preferable approach from two perspectives.

First, it is not exclusive and permits existing definitions of dishonesty developed by the courts to continue.

Second, it is drafted and would operate within the mixed subjective/objective test of dishonesty outlined in *Ghosh* and further, would not permit the *Craig* definition of "consent" to be a defence. The provisions, while offering some advantages, should not, therefore, be adopted in New Zealand without accompanying amendments to ensure consistency with the underlying tests of dishonesty.

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24 Law Commission, *Criminal Law: A Criminal Code for England and Wales* (Law Comm No 177, 2 vols, 1989) clause 141.

It is submitted therefore that the mixed objective/subjective test in *Ghosh* be specifically adopted in the new legislation and the rule in *Craig's* case abolished and replaced with the test laid down in the UK Court of Appeal.

B "Property"

The Bill defines "property" for the purposes of theft and obtaining by false pretences as:[25]

> "Property" includes all things, animate or inanimate, in which any person has any interest or over which any person has any claim; and also includes money and things in action.

Also defined are interests which may be the subject of a criminal appropriation:[26]

> Matters of ownership - (1) ..., a person is to be regarded as the owner of any property that is stolen if, at the time of the theft, that person has -
>
> (a) possession or control of the property; or
> (b) any interest in the property; or
> (c) the right to take possession or control of the property.

Both provisions extend the present law. The problems identified earlier in respect of the restrictive definition of property, have been substantially overcome. The nature of the legal interest necessary to be able to invoke the theft provisions has also been extended. The Crimes Act 1961 recognises that theft may be committed by the owner against a person having a special property or interest in a chattel.[27] The extent of such "special property or interest" was the subject of judicial consideration in *Police* v *Hawthorn*.[28] Hawthorn was the sole director and beneficial shareholder in a company which was the owner of four vehicles. Shortly before the appointment of a receiver the vehicles were transferred from the company to Hawthorn and advertised for sale. Charges of theft were laid alleging that Hawthorn was depriving the debenture holder of the "special property or interest" in the vehicles pursuant to that debenture. The principle in *Craig's* case already discussed precluded charges of theft from the company. In the court of first instance the charges were dismissed on the grounds that no special property or interest existed under the debenture unless there was also possession on the part of the person holding the special property or interest. On appeal it was held that actual possession was not necessary, but a right to possession under a special property or interest could be the basis of a theft charge.[29] Thus, mortgagees and debenture holders, who have a right to possesion on default, can invoke theft proceedings providing the necessary intent is established. The Court drew a distinction, however, between such an interest and one which was pecuniary only, in the sense that it

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25 Crimes Bill 1989, clause 176.
26 Clause 177.
27 Crimes Act 1961, section 225.
28 *Police* v *Hawthorn* [1981] 2 NZLR 764.
29 Above n 28, 767.

involves merely a debt, concluding that the taking or conversion of the latter could not amount to theft.

The Crimes Bill appears to extend the *Hawthorn* rule by including the words "any interest in the property" in addition to a provision dealing with "the right to take possession or control of the property". It also makes it clear that either actual, or a right to control, as distinct from possession of property can support a charge of theft.

It is submitted that this is a proper approach to take as modern commercial interests in property may exist independent of a right to possession. For example, a floating charge under a debenture does not, prior to a default and therefore crystallisation, involve the right to possession of the goods secured under it. Nevertheless, it is possible for the borrower to prejudice the debenture holder's interest significantly by, for example, reducing the value of trading stock to a point where the debenture may be virtually worthless. Similarly credit balances in bank accounts or book debts assigned under a debenture are examples of property where the concept of possession makes little sense, yet the interest in them is very real and may be of significant value.

What is not made clear in the new definition is whether the definition is broad enough to include intangibles such as bank credits or electricity which are not necessarily a "chose in action".

C *Definition of theft*

The Crimes Bill provides a new definition of theft,[30] which incorporates two central concepts. The first is the dishonest assumption of rights of ownership as discussed above. The second is the mens rea requirement of either an intent to permanently deprive any owner of that property or "being reckless" whether or not the act permanently deprives any owner of the property. The recklessness dimension is new to our law and is discussed in more detail under the "dishonesty" definition above.

A similar approach is adopted in the false pretence provision.

D *Definition of document*

The Bill now applies the extended definition of document to all property offences,[31] thus overcoming the problems identified in the existing law.

V LEGISLATIVE PROPOSALS TO REDUCE FRAUD

Two items of proposed legislation will have an impact on the problem of corporate fraud as distinct from the broader area of commercial fraud. The first is the Law

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30 Clause 176.
31 Clause 177.

Commission's report on Company Law Reform released in June 1989.[32] The second is the Corporations (Investigation and Management) Act 1989.

A The Law Commission proposals

Those with potential to reduce the incidence of fraud are:

1 Directors' duties are clearly stated and although primarily directed towards the company and its shareholders the interests of creditors and employees may also be considered. The two primary duties are:

> ... to act in good faith and in a manner that he or she believes on reasonable grounds is in the best interests of the company.[33]
>
> ... not ... act or agree to the company acting in a manner that unfairly prejudices or unfairly discriminates against any existing shareholder of the company.[34]

2 Shareholders have enhanced access to company records and information.[35]

3 A shareholder or director of a company may require that an auditor be appointed to audit company accounts.[36]

4 Provision is made for shareholders to bring civil actions against the directors for breach of any duties under the Act and for the whole or part of any of the costs of such actions to be paid, at the discretion of the court, to the shareholder(s).[37]

5 The Attorney-General may act in place of shareholders.[38]

6 A fund and a board to supervise the fund are established to finance post-liquidation investigations and actions by a liquidator of an assetless company "for the purpose of recovering, retaining or realising the company's assets".[39]

7 Provisions for the disqualification of directors are strengthened in two respects. First, the period of disqualification is extended to ten years. Second, the criteria for disqualification are extended to include; reckless or incompetent performance of duties as a director, and being a director of two unrelated companies which have gone into liquidation within five years of each other, provided conduct rendering that person unfit to be a director can be established.[40]

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32 Law Commission, *Company Law Reform and Restatement* (NZLC R9, 1989).
33 See clause 101 of the Draft Companies Act included in the report.
34 Clause 102.
35 Clauses 138-139.
36 Clause 167.
37 Clauses 127-133.
38 Clause 134.
39 Clauses 243-249.
40 Clause 282.

8 The penalty for serious offences has been substantially increased. Making false statements, fraudulently taking company property and falsification or destruction of records all carry fines of up to $200,000 or terms of imprisonment for up to five years. In this respect the Law Commission has stated that:[41]

> Where an act or omission is an offence under the Crimes Act or some other general enactment, or is covered in the recently introduced Crimes Bill, that provision should not be replicated in the Companies Act.

There will inevitably be some overlap between the law of theft and that of fraudulent application of company property by a director, employee or shareholder. This is particularly so as "fraudulently" under the Companies Act is interpreted as actual dishonesty.[42]

The solution to the dilemma created by the *Craig* decision may well be best dealt with under proposed company legislation which could specifically adopt the UK approach in respect of consent imputed to the company.

B Corporations (Investigation and Management) Act 1989

The wide-ranging powers of inspection granted the Registrar of Companies in the 1955 Companies Act, are not replicated in the Law Commission's proposed legislation. The emphasis in that legislation is on shareholder remedies. In contrast, the Corporations (Investigation and Management) Act grants extensive powers to the Registrar to intervene in the affairs of companies considered to be "at risk". It repeals the Companies Special Investigations Act 1958.

The principal provisions of the Act are:

1 The Act applies to any corporation:[43]

(a) That is or may be operating fraudulently or recklessly; or
(b) To which it is desirable that this Act should apply -
  (i) For the purpose of preserving the interests of the corporation's members or creditors; or
  (ii) For the purpose of protecting any beneficiary under any trust administered by the corporation; or
  (iii) For any other reason in the public interest, if those ... interest(s) cannot be adequately protected under the Companies Act 1955 or in any other lawful way.

Operating "fraudulently or recklessly" is further defined.[44]

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41 Above n 32, para 729.
42 *Re Day Nite Carriers Ltd* [1975] 1 NZLR 172, 174.
43 Corporations (Investigations and Management) Act 1989, section 4.
44 Section 7.

2 The powers available under the Act are:

(a) To require information from a corporation or associated person and require that the information be audited.[45]
(b) To obtain information by notice or by warrant if there is a failure to supply information or there is suspicion that the information supplied is "false or misleading in a material particular".[46]
(c) To demand answers to questions put by an authorised person, providing that any statements made are not admissible against that person in criminal proceedings.[47]
(d) To restrain publication of the fact of and details surrounding any investigation conducted under the Act.[48]
(e) To declare a corporation "at risk" and restrain it from certain actions.[49]
(f) To appoint statutory management of corporations and associated persons with broad powers to manage the business.[50]

3 A number of offences are created under the Act including:

(a) Obstruction or hindering an investigation directed by the Registrar.[51]
(b) Refusal to answer questions.[52]
(c) The supply of false or misleading information.[53]
(d) Failing to deliver books and property to statutory manager.[54]
(e) Destroying, altering or concealing records of a corporation subject to statutory management.[55]

4 The Act is, therefore, a potent weapon in both the discovery of, and early intervention to prevent fraudulent conduct by companies and their officers. The one weakness in the legislation is the laborious procedure necessary before a warrant to seize company records can be obtained. The conditions precedent to the issue of a warrant are:

(a) A demand in writing for information served on the company.[56]

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45 Sections 9-10.
46 Sections 17, 18, 24, 25.
47 Sections 19-20.
48 Section 23.
49 Sections 19-33.
50 Sections 37-61.
51 Sections 20(1)(a), 34.
52 Section 20(1)(b).
53 Section 20(1)(c).
54 Section 66.
55 Section 67.
56 Section 9.

(b) In the event of a failure to comply the Registrar may appoint a person to enter upon, search, inspect and remove specified documents.[57] It is an offence to hinder or delay such an inspection but seizure is only possible either by consent or pursuant to a warrant issued by a Judge of the High Court.[58]

(c) It is possible to go direct from the demand in writing to the warrant application procedure, but only after a reasonable compliance time has elapsed.[59]

The concern is that if a company is on notice of an investigation, incriminating documents may be destroyed or hidden. Corporate fraud investigators and liquidators alike share the frequent frustration of records mysteriously disappearing or being "accidentally" destroyed. The police can, and invariably do, resort to the warrant option under section 198 of the Summary Proceedings Act 1954 in the first instance, and without prior notice, when investigating suspected fraud. Spectacular results in respect of incriminating documents have resulted. Suspects have been caught shredding or setting fire to documents, wiping computer disks or throwing vital records in rubbish bags. This is not to say that it will be appropriate for the Registrar to react in every case by immediately obtaining a warrant but it is submitted that this option should be available when circumstances justify its use.

VI INVESTIGATION RESOURCES

The two major agencies responsible for the investigation of serious fraud, the Police and Department of Justice, agree that over the last decade resources applied to this problem have remained largely static while the incidence of such offending has increased dramatically. The result has been that many offences which should have been investigated have not been. This development has resulted in two potentially serious problems. The most obvious is that criminal offending which has occured is not subject to oversight of the criminal justice system and thus to the procedures available to deter and punish such offending and provide rehabilitation for offenders. In turn this can lead to a loss of credibility of the criminal law, leaving it vunerable to an accusation of inconsistent application.

A The Police

The police presently investigate and prosecute substantially all serious fraud offences which come before the courts in New Zealand. Preliminary investigations are undertaken by other government agencies, receivers and liquidators.

(i) Resources

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57 Section 17.
58 Sections 17-18.
59 Section 43.

To undertake this task, the police have fraud squads in the main centres. There are two components in this investigative structure. One is a group of experienced detectives, sergeants, senior sergeants and inspectors. They are trained extensively in investigation techniques, law and accounting to enable them to undertake and manage complex fraud inquiries. The second is a number qualified accountants and legal advisers. Further ad hoc specialist assistance is available from receivers, liquidators, other government departments and crown counsel to supplement this expertise.

The police estimate that nationwide a total of 35 staff are employed in serious fraud investigation. This number fluctuates according to demand, which is dictated by the relationship between the incidence of fraud complaints and the incidence of and priority accorded to other serious crimes which the police must respond to.

(ii) Limitations

There are two factors which limit the ability of the police to increase their response to serious fraud. First, there is the resource intensive nature of fraud investigation. A case which can be broadly described in a paragraph or two may have taken three to four people one to two years to investigate and guide through the prosecution and appeal process. Alternatively a similar case could be dealt with more expeditiously if the parties involved are more co-operative in terms of evidence supplied and if guilty pleas are forthcoming at trial. It is, however, very difficult to foresee and estimate with any accuracy the potential demand in resources in respect of a particular case. The very nature of the criminal trial requires that investigations be thorough and all relevant evidence presented to the court. The extent of data stored, either manually or on computer, by a medium sized company over several years' operation can be daunting. All must be sifted, analysed and categorised with continual further investigation and analysis until the full facts are known. Interviews with witnesses and suspects must be carefully prepared and relevant documents compiled for reference. Any defect in the credibility of the investigation process can be fatal to a subsequent prosecution. It is easy to see, therefore, that only a few cases can be thoroughly investigated with currently available resources.

Second, the police have a legal obligation to respond to a wide range of activities. These vary from service functions associated with mobile patrols, through to large scale investigations of serious crimes against the person, most notably homicides, sexual assaults and aggravated robberies. In assigning scarce police resources, serious fraud investigations are frequently interrupted and, on occasions, not commenced or continued due to investigative commitments to serious crimes against people as distinct from property.

B The Department of Justice

Whereas the police role emphasises investigation and prosecution in appropriate cases, the role of the Department of Justice is that of preliminary investigation, diagnosis and referral to the police of serious fraud cases coming to its notice. It also investigates and prosecutes less serious cases within the ambit of the Companies and Insolvency Acts.

(i) Resources

These consist of two components. The first is the Commercial Affairs Division in each main centre which has the responsibility for preliminary investigation and diagnosis of serious fraud which comes to notice in the course of carrying out their primary role of oversight of bankruptcies and liquidations. The second is the Corporate Fraud Unit situated at the Auckland Justice Department Offices. Both components are staffed by accountants and lawyers as well as non-specialist office staff.

(ii) Limitations

Justice shares with the police the problems associated with the personnel intensive nature of fraud investigations. The Department simply has too few resources to be able to cope adequately with all matters which deserve scrutiny. A second limitation is that only relatively few staff possess either a legal or accounting qualifications and fewer have any significant investigative training.

VII A SERIOUS FRAUD OFFICE FOR NEW ZEALAND?

It is readily discernible from the above that there are major deficiencies in the present system in New Zealand leading to an inability to investigate and prosecute efficiently and effectively serious fraud offences. The roles of the police and Department of Justice should complement each other but this has not been the norm in recent years. While resources seem to be at the heart of the problem, other issues including the availability of relevant skills and a reluctance to use resources flexibly from one agency to another have contributed.

In response to this the Department of Justice has proposed that an independent "Serious Fraud Office" should be established both to co-ordinate fraud investigations among different government agencies and to undertake specific investigations itself. The model is based on a similar office in the United Kingdom and to a lesser extent Australian precedents. The proposal is presently before Cabinet. Its principal characterstics are:

To consist of 25 permanent staff based primarily in Auckland with a smaller office in Wellington.

Staff to be predominantly lawyers and accountants with some investigators.

To be under the control of a director and be accountable directly to the Attorney-General.

The emphasis will be on fraud investigation involving corporate entities with appropriate cases selected by the director based on three criteria; magnitude of the sum involved; legal and factual complexity; and relevant public interest considerations.

Cases selected from those reported to the police and Departments of Justice, Customs and Inland Revenue. Secondment of staff from those agencies to the "Serious Office" is envisaged in individual cases.

Sufficient funding to be available to contract expert advice when required and to ensure appropriate prosecution resources are available.

Specific legislation is proposed to grant similar authority to the director as is currently available to the Registrar of Companies pursuant to the Corporations (Investigations and Management) Act 1989.

The police, while supporting the need for further resources to combat serious fraud, have questioned the requirement for a separate agency. They have highlighted two issues. First, that it is of significant constitutional importance to establish a new agency to enforce aspects of the criminal law. The police are, they argue, the appropriately trained agency for this role and a new agency should not be established unless it can clearly be shown that the existing agency cannot perform that function. Second, that the police already have an investigative and prosecution infrastructure nationwide and that the only limitation on an expanded fraud role is a question of resources. Further funding of the police, specifically targeted to this function, would, it is claimed, be a more efficient expenditure of government funds.

Despite the differences in approach between the police and Department of Justice, it is clear that both recognise that significant further resources and closer co-operation between the agencies are now long overdue. The Serious Fraud Office proposal offers a framework to achieve this and its establishment, either independently, or within a police environment, is advocated as a matter of urgency.

VIII CONCLUSION

"It's not until the tide goes out that you can see who has been swimming naked" is a recently coined saying on Wall Street. It is very appropriate to the issue of serious fraud in the New Zealand commercial environment. The twin factors of economic deregulation and the 1987 sharemarket collapse have focussed considerable attention on this problem. Defects in the legal framework and investigative systems and strategies have been exposed. The proposals discussed in this paper will, if adopted, significantly enhance the present capability to both reduce the incidence of fraud and to provide an effective response when it occurs. The tide went out some time ago leaving us with a backlog of problems on the beach. It may go out considerably further in the near future.

EDITORS NOTE

Since this article was written the proposed Serious Fraud Office has been set up and a director appointed. The Serious Fraud Office Bill, currently before the House, includes the powers of search proposed above. It is likely to be passed in early 1990.