PERSONAL LIABILITY FOR CORPORATE FAULT

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Issue 3.4:

The rationale for derivative liability, including in what circumstances, if any, is it necessary as a matter of public policy to go beyond accessorial liability and impose individual derivative liability.

This submission makes three points on this issue:

- The imposition of criminal liability on directors should not depend on classification as direct, accessorial or derivative. Instead, the degree of fault which should attract criminal liability should be determined as a question of public policy.

- Where the aim of the imposition of liability is to provide incentives to obey the law, the place of civil liability and a civil penalty regime as a deterrent where appropriate also needs to be considered.

- If possible, the issue of criminal or civil liability of corporate officers should not be looked at in isolation. This results in the piecemeal and inconsistent approach which characterises much of the law concerning directors' liability under the *Corporations Act 2001* (Cth), and adds to confusion and therefore compliance costs.

1. Why do we need to impose liability?

As a matter of public policy it is of vital importance that companies comply with the legislative provisions that are the subject of this review. The question is how to best ensure that companies comply with this legislation. Can compliance be secured by placing liability on the corporation alone or it is necessary to also impose liability on the directors and managers of those corporations? If so, what type of liability should be imposed on those managers?

2. Reasons why corporate liability is not sufficient

Corporate criminal liability alone may be an insufficient incentive for directors to implement adequate strategies for the avoidance of breaches of the law. In addition to the reasons stated in paragraph 3.2 of the Discussion Paper, there is a risk that a monetary fine on a corporation will not be an adequate deterrent if the company is undercapitalised. This is especially so, if it is the undercapitalised subsidiary of a larger company, deliberately set up to engage in a dangerous activity. In addition, it should be noted that the vast majority of companies – nearly 99% - are proprietary companies. Where directors are often the dominant or sole shareholders, the fear of removal from office or the commencement of a statutory derivative action by shareholders will not provide a sufficient incentive to directors of proprietary companies to obey the law.

Therefore imposing liability on a company's directors and managers where appropriate serves a useful function in providing an incentive for them to act in accordance with the law. Derivative liability, by definition, derives from the company's own liability, hence the need to establish first that the corporation is liable and cannot avail itself of defences, before looking at the director's own liability.

As the company is an inanimate artificial entity, its liability derives, either by statute or common law rule, from the actions or omissions of its directors, servants or agents. However, it is somewhat artificial to say that a director or agent's liability is attributed to the company, because generally the company is found to have breached the particular piece of legislation and then the inquiry becomes whose actions or omissions brought about the liability.

The current legal position is illustrated in Figure 1 below.

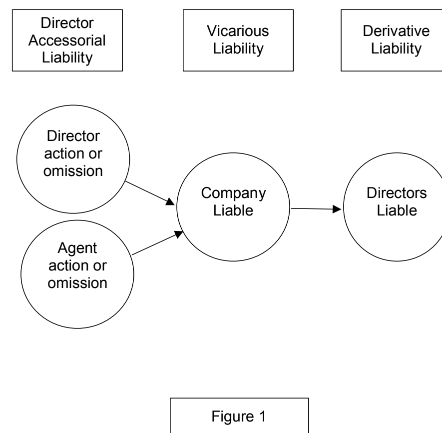

Figure 1

3. Advantages/Disadvantages of imposing personal liability on directors and managers

The benefit of imposing any form of liability on company directors and managers is obvious – providing an incentive to comply with the law and therefore to avoid behaviour which damages the company, its stakeholders, and the environment and society as a whole.

The disadvantages are more subtle. Liability should not be so onerous, either in form or in substance, that directors' and managers' behaviour becomes too cautious. This is referred to in the economic literature as risk aversion, and its effect can be damaging to the company and society if directors and managers are deterred from undertaking activities that might bring a net positive benefit. The fear that liability would 'result in a disincentive for persons to accept or continue to hold directorships or engage in entrepreneurial but responsible risk taking' was noted in the terms of reference from Senator Campbell to CAMAC.

In addition, liability should not be so harsh that it deters non-executive directors, who serve a useful oversight function, from taking up board positions. Moreover, imposing liability on executive directors may cause them to delegate, perhaps inappropriately, to those more junior in the enterprise, so that they can claim not to be 'knowingly concerned' in various types of undesirable activities. It is noted here that CAMAC has also issued a Discussion Paper on 'Corporate Duties Below Board Level' to address the issue of liability of delegates, but this highlights the central contention here – the issue needs to be looked at in its totality, rather than addressing the liability of each corporate actor in a piecemeal fashion, and without an awareness of the possible consequences of each imposition of liability.

<u>4. Given that we need to impose liability on directors and managers personally, what type of liability is appropriate ie derivative or liability connected to fault?</u>

The purpose of the imposition of criminal or civil liability should be not merely retributive. As the CLERP *Directors' Duties and Corporate Governance* 1997 paper noted at paragraph 6.6, the purpose of liability is 'to provide a significant incentive for directors to put in place effective risk-management arrangements to ensure the corporation complies with its obligations'.

Therefore the problem is not with directors and managers who do the right thing – who put in place adequate safeguards to ensure that the companies they control comply with their obligations. It is submitted threfore that there should be no 'pure derivative' liability, that is, liability that is unrelated to any act or omission on the part of the director. If the aim of the imposition of liability is the modification of directors' behaviour, liability should always be related to fault, and the issue then becomes how widely that fault is defined.

Figure 1 above shows that there are four possible types of liability which can presently be imposed – the direct or accessorial liability of the person whose actions or omissions are to be attributed to the company, the company itself either vicariously or via the identification doctrine, and finally the director or manager who bears responsibility derivatively because he or she holds a particular position in the company.

However, when direct, accessorial and the various forms of derivative liability outlined at paragraph 6.2.1 of the Discussion Paper are examined, it is clear that liability depends on the culpability of the actions or omissions of the particular person on whom the law, for policy reasons, considers it appropriate to impose liability. For example, 'positional/managerial liability' might appear to denote a strict liability provision. But the example of positional liability, given at paragraph 6.3.2, speaks of knowledge, recklessness or negligence as to contravention of the law, as well as the requirement that the person failed to take all reasonable steps to prevent the contravention despite being in a position of influence in relation to the contravention.

The emphasis therefore needs to be on the degree of fault that attracts personal liability, rather than the categorisation of that liability as direct, accessorial or derivative, and within derivative, as positional, managerial, responsible officer or participatory. The original reference from Senator Campbell to CAMAC referred to inconsistent compliance burdens and increased costs for business. These can be addressed by having a more simple model for the imposition of liability.

The suggested legal position is illustrated in Figure 2.

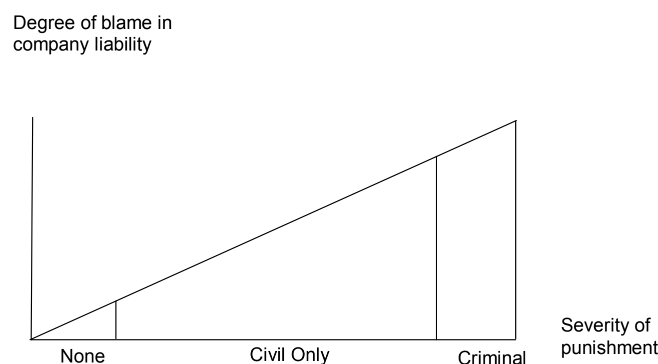

Figure 2

5. Liability should not be derivative but should be consequent upon fault. When should that liability be criminal, civil or a civil penalty?

A more fundamental question is where the line should be drawn – what degree of fault should attract personal criminal liability for the directors of companies? The stated aim of imposing liability is to provide an incentive to comply with the law, or more accurately, to deter directors and others from breaching the law.

Deterrence of undesirable behaviour can be achieved in a variety of ways, and it is submitted that it is not possible to say where the line should be drawn on criminal liability without considering the role played in deterrence by the imposition of civil penalties and civil liability where appropriate.

Civil liability has a number of advantages over criminal liability – for example, the civil burden of proof and shifting the cost and risk of enforcement onto plaintiffs. A fear of a civil judgement, possibly in the millions, may also prove to be a more

effective deterrent than a criminal penalty, such as the maximum penalty for breaches of the *Environmental Protection Act 1970* (Vic). Under s 67 of that Act, it is 120 penalty units, or $13,200.

Criminal liability has a role to play in overcoming the deficiencies of civil liability. A plaintiff claiming damages for a negligence will commonly face obstacles when dealing with corporate groups, and the present law is reluctant to lift the corporate veil on the directors of the holding company, or to overlook the limited liability and separate legal entity doctrines to impose liability on the holding company itself . Criminal liability can be imposed in such as way that it overrides these obstacles to ensure that a person in a position of responsibility is held to proper account.

These advantages are also present for a third type of liability, the civil penalty. It is a very useful device because it combines the punitive aspects of criminal liability with the civil burden of proof, and therefore should be considered in any discussion of the means of deterring breaches of the law. Civil penalties were considered an appropriate means of regulating breaches of directors' duties, and it is submitted that the type of corporate misconduct that is the subject of this CAMAC Discussion Paper is similar to the directors' duty provisions that are contained in the *Corporations Act (Cth)* 2001.

In 1989 the Senate Standing Committee on Legal and Constitutional Affairs conducted an enquiry into the duties and obligations of company directors. The committee issued a report entitled 'Report on the Social and Fiduciary Duties and Obligations of Company Directors' (the Cooney Committee Report). One of the matters considered by that report was whether or not criminal penalties should be imposed for breach of the directors' duty provisions.

The committee recognized that the directors' duties could be contravened at different fault levels. Therefore, criminal penalties would not be appropriate in every circumstance. At paragraph 13.12 of the Cooney Report, the committee recommended that criminal penalties apply only where the conduct in question is genuinely criminal in nature. It is submitted that in relation to the types of corporate misconduct that are the subject of current review, criminal penalties should apply only where the conduct in question is genuinely criminal in nature

Apart from the policy reasons for not extending criminal liability beyond situations where the defendant knowingly or intentionally participates in the breach there are practical reasons for not doing so. Prior to the introduction of the civil penalty regime in 1993 directors who contravened the directors' duty provisions contained in s 232 of the *Corporations Act* 1989 were subject to a range of sanctions including a criminal prosecution. It has been argued by academics that that these provisions did not provide an effective enforcement regime because criminal convictions for these corporate criminal offences were difficult to obtain. A number of commentators have referred to the difficulties associated with the enforcement of corporate criminal offences.[1] Corporate criminal offences are difficult to enforce because of the

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[1] See H Bosch, 'Bosch on Business' (1992) *Information Australia* 1 at 1, S Miller, 'Corporate Crime, the Excesses of the 80's and Collective Responsibility: an Ethical Perspective' (1995) 5 *Australian Journal of Corporate Law* 139 at 162, R Tomasic, *'Corporate Crime' The Australian Criminal Justice System The Mid l990s,* Chappell, P and Wilson, P (Eds) Butterworths, Sydney, 1994, p 263 and R

evidentiary requirements and criminal standard of proof. In many cases offenders are powerful and well resourced and are able to take advantage of the vagaries of the criminal law. A further problem is the apparent reluctance of the courts to convict white collar or corporate offenders. It has been argued that in many cases juries do not perceive business people as "candidates for gaol".[2]

If these same difficulties arise in relation to the derivative criminal enforcement regime proposed in the CAMAC Discussion Paper it will not achieve its aim of ensuring compliance with the relevant legislation. A criminal enforcement regime will not provide a significant level of deterrence if there is limited prospect of a criminal conviction being obtained.

5. Other advantages of adopting a simplified scheme

This point goes to the *form* of the law – that a simple scheme for imposing liability makes compliance cheaper and easier because all parties know what their legal rights and obligations are.

Looking at the bigger picture necessarily is a huge endeavour, and the recent history of corporate law reform has been to deal with small individual problems separately. But this has lead to the proliferation of legislation[3] and the problems of inconsistency identified by the Discussion Paper and elsewhere.

This problem has been shown in relation to the actions available to liquidators and creditors against directors to recover compensation where their actions prejudice creditors. For example, Part 5.7B of the *Corporations Act* allows creditors to initiate action for insolvent trading subject to liquidator or court consent, but breach of s588G as a civil penalty provision under Part 9.4B only provides remedies for ASIC and the company. Section 598(2) of the Act, which deals with more morally repugnant behaviour such as fraud, breach of trust or breach of duty, does not permit creditor action, with or without liquidator permission. Section 593(2), which deals with fraudulent conduct, allows creditor action but with the remedy going to the company. Section 1324(1) of the Act, on the other hand, is very broad and appears to allow creditors the standing to apply for damages or an injunction for breaches of the Act, including insolvent trading and breaches of directors' duties.

Tomasic, 'Corporate Crime in a Civil Law Culture' (1994) 5 *Current Issues In Criminal Justice* (3) 244 at 251.

[2] R Tomasic, 'Corporate Crime in a Civil Law Culture' (1994) 5 *Current Issues In Criminal Justice* (3) 244 at 251.

[3] This was noted recently in the report of the Business Council of Australia, entitled 'Regulation Blowout Risks Economic Growth and Prosperity', dated 23rd May, 2005.

Issue 9.8

Should some other general derivative liability template be adopted?

The following section of the submission contains a recommendation as to the enforcement template that should be adopted. This recommendation recognizes the following:

- As a matter of public policy it is of vital importance that companies comply with the legislative provisions that are the subject of this review. Therefore the purpose of the imposition of liability in this case should be not merely retributive. The enforcement strategy adopted should provide a significant level of deterrence so that directors and managers take action to ensure that the corporations they control comply with the relevant legislation.

- As noted previously corporate criminal liability alone may be an insufficient incentive for managers to implement adequate strategies to ensure that contraventions of these provisions are avoided. There is a need to sheet home personal liability to those persons who control the corporation to ensure that those persons alter the corporation's behavior.

- The enforcement strategy adopted should provide that directors are found to be criminally liable only in situations where their behavior is truly criminal.

- Civil liability and civil penalties should be available to provide an alternative enforcement mechanism when the conduct of the director in question cannot be described as being truly criminal.

The proposed regime provides that directors will be criminally liable where there is presently accessorial liability. This ensures that criminal liability is imposed only where criminal conduct has occurred. The regime provides for civil liability in situations where a director fails to prevent the company committing the relevant criminal act. Directors will not be liable if they can satisfy certain defences. Civil liability recognises the importance of ensuring that managers comply with these provisions and allows for non criminal liability to be imposed in situations where criminal behaviour does not exist.

The proposed regime would overcome many of the difficulties that are experienced in enforcing corporate criminal offences. Civil penalties are attractive enforcement mechanisms because they allow the relevant regulator to obtain an enforcement order on the civil standard of proof. The increased likelihood of a civil penalty order being made against managers should provide an increased deterrent to encourage them to ensure that the corporation complies with the relevant legislation.

In addition, the proposed regime can be justified on the basis that it provides an enforcement regime that complies with strategic regulation theory. Strategic Regulation theory is an economic theory of regulation under which a regulator's goal is defined as being the need to secure compliance with the law. This theory offers

guidelines as to how that compliance may be best secured. It requires the regulator to be equipped with a range of sanctions that are ordered from the least to the most severe.

Usually strategic regulation theory is represented graphically by the pyramid model. The pyramid model was developed and expanded by John Braithwaite, Brent Fisse and Ian Ayres.[4] The pyramid model requires the regulator to be armed with a range of sanctions that escalate in severity from education and persuasion at the base, through various other stages in the middle to incarceration of individuals or winding up of companies at the apex. The regulatory agency should move from one level to another, commencing at the lowest level in the majority of cases.

The suggested model allows criminal penalties to be preserved for criminal cases and civil penalties to be introduced for non criminal contraventions. The criminal and civil penalties are supplemented with education and persuasion strategies at the base. If those strategies do not work the regulator is able to escalate its enforcement activities to civil penalties and then criminal in the more extreme cases. This is in keeping with an enforcement strategy supported by the pyramid model. This is shown at Figure 3 below:

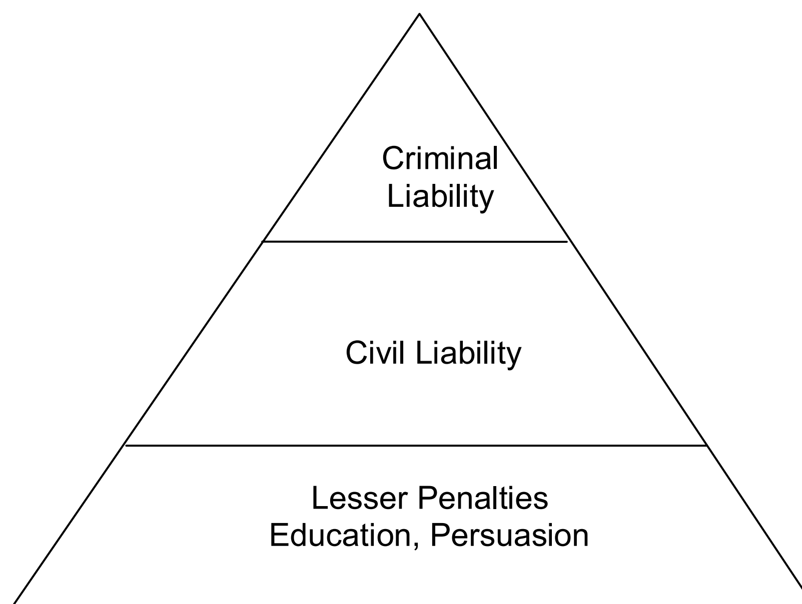


Figure 3

[4] B Fisse and J Braithwaite, *Corporations Crime and Accountability* (1993) Cambridge University Press, Cambridge.

First Tier - Criminal liability.

For the reasons outlined above it is submitted that criminal liability should depend on the culpability of the actions or omissions of the particular manager in question. Criminal penalties should apply only where the conduct in question is genuinely criminal in nature. Conduct will be genuinely criminal in nature where the manager intentionally or knowingly participates in a corporate breach.

Second Tier - Civil Liability

A second tier of liability should be introduced. The proposed second tier would provide civil liability enforced by a civil penalty regime. The proposed regime is similar to the civil penalty regime contained in Part 9.4B of the *Corporations Act*. The civil penalty regime could provide for a form of derivative liability but the consequences flowing from that liability would be civil, not criminal.

It is submitted that a duty should be imposed on directors and managers to ensure that the corporations that they control do not commit an offence under the relevant Act. Therefore, by definition, if the corporation is convicted of an offence, the director or manager must have breached his or her duty to prevent the company from committing that offence. However, to ensure that liability is not unfairly harsh with resultant risk aversion and the other adverse conequences outlined above from the imposition of liability, the proposed regime would provide defences. The proposed defences would include a due diligence defence and a reasonable director or manager defence.

The proposed civil template is similar to the State and Territory representative template detailed in paragraph 9.3 of the Discussion Paper. The main difference between that template and the template proposed in this submission is that the liability flowing from the template in paragraph 9.3 is criminal whereas the liability flowing from the template proposed in this submission is civil.

The template proposed in this submission provides that:

> *any director or other person who is concerned, or takes part, in the management of the corporation is under a duty to prevent the corporation contravening the relevant legislation;*
>
> *where a corporation contravenes the relevant legislation any director or other person who is concerned, or takes part, in the management of the corporation has breached his or her duty and is liable to a civil penalty order unless the person proves:*
>
> - *that they were not in a position to influence the relevant conduct,*
> - *or that they*
>   i. *exercised all due diligence to prevent the relevant conduct, or*
>   ii. *took all reasonable steps to prevent the relevant conduct.*

The first of these defences - that they were not in a position to influence the relevant conduct – is important to safeguard the position of non-executive directors. As noted above, they serve an important oversight function in companies and should not be deterred from accepting such positions by the fear of excessive liability.

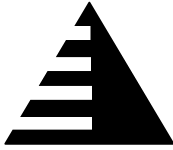
The standard of proof proposed is the civil standard. The civil penalties orders available under the proposed regime would be those orders that are available under Part 9.4B Corporations Act (Cth) 2001. They are pecuniary penalties, banning orders and compensation orders. Pecuniary penalties would allow the courts to impose a punitive order on directors and managers who fail to prevent the company committing the contravention. Banning orders would protect third parties from future contraventions as well as being punitive. Compensation orders would be appropriate in situations where there is no other compensatory scheme available.

These orders, while containing a punitive element, fall short of criminal penalties. Directors and managers who breach the proposed duty would not face the stigma that is associated with the conviction of a criminal offence, nor would they face the possibility of incarceration. It is submitted that this is an appropriate outcome when the behaviour of the manager concerned could not be described truly as criminal.

The duty proposed in this submission is similar to duty of care contained in s 180(1) Corporations Act (Cth) 2001 and common law negligence, both of which give rise to civil not criminal liability. It is submitted that the same liability should flow from the proposed duty. If a director or manager is involved in the commission of the relevant offence and possesses the relevant criminal intention he or she should be charged under the criminal provisions as an accessory. If not, the director or manager should be treated in the same way as one who has contravened s 180(1) Corporations Act (Cth) 2001 or has breached the duty of care under common law negligence. The relevant liability should be civil, not criminal.

Third Tier - Lesser penalties, education and persuasion.

It is proposed that a third tier of liability should be introduced. Where corporations commit relatively minor contraventions, directors and managers should face this type of personal liability. It could involve the manager being warned, minor pecuniary penalties being imposed or orders being made that the manager undertake a relevant education program or implement a relevant compliance program.



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22 July 2005

Submission from Alan du Mée
Personal Liability for Corporate fault

Dear Mr Kluver,

I was the CEO of Tarong Energy Corporation from February 1998 to February 2003. Tarong Energy is a Government owned utility with some $2 billion in assets and turnover of over $600 million per annum.

During my career, I have worked in more than 15 countries and about the same number of industries. I have developed a passion for and commitment to ethical dealings and for Governance which I very successfully deployed within Tarong Energy. I have demonstrated that outstanding business outcomes and ethical and transparent dealings are feasible and deliver outstanding shareholder value.

It is my contention that there is a consistent and systemic failure of Governance and Management processes within many private sector and Government businesses and in Government Departments that are the central cause of not earlier uncovering and responding to these business and administrative failures. Many of these failures have had extensive media exposure and regrettably this exposure will continue until additional measures are put into practice (viz. Bundaberg Base Hospital and more recently Vizard).

This submission supports and should be read in conjunction with my previous submission on **Corporate Duties Below Board Level** dated 6 June 2005.

If we are to prevent incompetent and illegal acts within companies, it is essential that the people involved or those who are on the periphery but who know what is going on, are able and encouraged to tell what they know honestly, easily, quickly and without fear of recrimination. This requires unambiguous Whistleblower Protection legislation that prohibits the naming of people who speak out and also prohibits other retribution of any kind. In addition, the encouragement of speaking out should be clearly and unambiguously reinforced by extending liability for Corporate Fault to individuals who do

not support this form of regime. This liability should extend to the perpetrators of these acts but most importantly also those who know but say nothing.

In all of the corporate failures in recent times many more people knew what was going on but were too afraid to act. In the FAI/HIH case a company had to fail before these acts were exposed, even though many other people inside both organisations knew what was going on.

The tendency to avoid bad news, vilify whistleblowers and to generally avoid facing issues that may reflect badly on performance is endemic in private and Government businesses. The Vizard case is just another most recent example. Several other people knew of these transactions and said nothing and should also have been held directly to account..

From my experiences in Queensland, Government business owners, their representatives and their advisors routinely seek to avoid facing issues reported to them concerning a lack of competence and ethics, even when, as in my case, these issues were brought to their attention by a CEO.

This issue is so serious that I have written a book on the subject of governance. The book is called *Crooks, Hoods and Vagabonds in Business*. The stories in this book are all true, based on my experiences, many of them involving Australian private sector companies and Government entities and departments. These experiences are most relevant to this discussion paper and your deliberations.

As CEO I did not expected to be treated like a pariah for seeking to expose incompetent and illegal acts. As an outstandingly competent and honest person with more than five years of exceptional performance and integrity, I was greatly disturbed when I myself was mistreated and vilified for trying to expose incompetent and illegal acts, in spite of being legally obliged to disclose those events and facts. In Government businesses in particular, the blatant politicization of Boards has only encouraged this abuse.

People who should have known better did nothing and faced no consequences for ignoring these unethical and illegal activities.

My experience suggests that not only whistleblowers, but the people associated with them are victimized and isolated. A climate of fear is thus created whereby other employees are discouraged from voicing their concerns about incompetent or illegal acts. This feudal and hierarchical approach to accountability pervades many areas of corporate responsibility.

It is therefore essential to enact appropriate protection for whistleblowers (such as legislation to protect careers, income and reputation and also to remove Parliamentary privilege for naming whistleblowers or their associates), together with appropriate regulations that necessitate an independent investigation once a formal submission is made. Without such protection we cannot really expect employees or other stakeholders to help us uncover incompetent or illegal actions. For instance in Queensland politicians have made an art form out of naming whistleblowers in Parliament that actively discourages whistleblowing and the Queensland Whistleblower Legislation is patently inadequate.

The CLERP 9 provisions for whistleblower protection are too narrow and only focus on direct financial impacts. In most of the HIH failings, many more people knew what was going on and would have been prepared to speak out sooner, probably soon enough to prevent the failure, if they had had protection from potential retribution.

Unless we instill a broad ranging corporate and administrative culture of transparency and open management within private sector and Government companies, supported by legislation and insist on a consistent framework of ethical practices that include trust, honesty, integrity and accountability, we will perpetrate the very failures that have led to this discussion paper.

My contention is that Governments and their agencies should be setting the example for good governance and management practices for others to follow. Clearly the continuing systemic failures have confirmed that this is very far from being the case. I also believe that as Government owned businesses still represent so much of the wealth of the nation, they should not be exempt from Corporations Law provisions, especially after the changes you are pondering for personal liability and that I am commenting upon come into effect.

My book *'Crooks, Hoods and Vagabonds in Business'* sets out the issues and stories relating to just such events and also details the kind of solutions that can be successfully implemented. I have put these into practice and they work. In such an environment we can all sleep at night knowing that our investments and futures are safe.

A significant extension of personal liability is definitely required but this needs to be linked to much stronger Whistleblower Protection, preferentially enshrined into Corporations Law, so that not only the threat of personal liability and penalty is increased but also that the threat of being exposed by others for such acts is significantly greater than it is today.

Page 19 Section 3.4 – Rational for derivative Liability - Issues for consideration

Respondents are invited to comment on any aspect of the discussion in this Section on:-

- the rationale for derivative liability, including in what circumstances, if any, is it necessary as a matter of public policy to go beyond accessorial liability and impose individual derivative liability.

Response: There is ample evidence in public cases recently that many individuals (Directors, Managers and employees) knew or should have reason to know of illegal or incompetent acts by others but did nothing to prevent them or to report such acts to an independent body. It is patently inadequate for these individuals to only be subject to accessorial liability provisions. They should be subject to legislative and criminal sanction for not reporting their suspicions providing they have the means and protection for so doing. This protection is generally referred to as Whistleblower Protection.

Extensive Whistleblower Protection provisions should be embedded in the Corporations Law for all Directors, Officers (interpreted in the broadest possible context to include all supervisors of people) and also for individual employees.

Government enterprises should be subject to exactly the same provisions as private sector companies. Government enterprises are today almost immune from external scrutiny and subject to review only 'at a Minister's pleasure' other than for External Audit of financial data. With more than A$100 billion in Government owned businesses within Australia, they should face identical review and sanction as their private sector counterparts.

Page 38 Section 7.2 – Implications of the Current Law - Issues for consideration

Respondents are invited to comment on any aspect of the discussion in this paper on the means by which statutes impose individual derivative liability, including:

- Have respondents encountered in practice any problems with disparate Commonwealth, State and Territory statutes that impose individual liability and provide for various defences?

Response: Yes. The difference between State legislation and Corporations Law has meant that Directors of State owned business almost completely ignore their Directors responsibilities to act independently and impartially of the owners and in the interests of the corporation as defined under Corporations Law.

- If so, what have been the practical effects of these differences in approach, for instance, the impact on compliance programs?

Response: Compliance programs for various aspects of a Corporation's activities deliver partial and differential impacts on officers and employees because they see several different and unequal standards of responsibility in place. For Safety and Trade Practices they as officers and employees face severe penalties themselves for not telling the truth. By comparison Directors of Government Owned businesses, can and do act with impunity and face almost no consequences whatsoever for not telling the truth and for not carrying out their responsibilities as Directors. This differential liability has resulted in a cynical outlook from employees and officers of these Corporations.

Page 40 Section 8.4 - Developing a Derivative Liability Template - Issues for consideration

Respondents are invited to comment on any aspect of the discussion in this Section on developing a derivative liability template, including:

- are the criteria for assessing the alternative templates appropriate?

Response: No.

- should there be additional or different criteria?

Response: Yes. The extent to which Corporations have embedded Whistleblower protection, Whistleblower support facilities and educated their workforce on how to deliver transparency in custodial management if its assets should be a prime component or activity to be able demonstrate transparency and openness in management practices. The establishment of 1900 hot lines and such similar facilities should be a prerequisite for demonstrating transparency in management Practices.

It is my contention, that such steps, adequately supported by legislative penalties would have prevented most if not all of the corporate failures in recent years, or at the very least exposed them earlier so that the consequences were mitigated.

Response

Page 49 Section 9.8 Alternative General Templates - Issues for consideration

Respondents are invited to comment on any aspect of the discussion in this Section on developing a general derivative liability template, including:

- should the Australian Law Reform Commission template be adopted,

Response: No, the onus is on the prosecution and not on the defence, as is now the case for say Safety in many States.

- either as proposed by the Commission or with any of the following possible modifications, namely:

  - modify the category of individuals liable by adding a specific reference to directors

Response: Yes

  - require the prosecution to prove that the individual knew that, or was reckless or negligent as to whether, the contravening conduct might (rather than 'would') occur

Response: No

  - impose an evidential onus on a defendant to provide admissible prima facie evidence of having taken one or more reasonable steps, which the prosecution would then have to negate beyond reasonable doubt

Response: Yes. For instance the Whistleblower access and protection steps implemented within the Corporation set out in the previous response above. The extent to which Corporations have embedded Whistleblower protection, Whistleblower support facilities and educated their workforce on how to deliver transparency in custodial management of its assets should be a prime component or activity to be able demonstrate transparency and openness in management practices. This could be

independent of the legislative base for Whistleblowers. The establishment of 1900 hot lines and such similar facilities should be a prerequisite for demonstrating transparency in management Practices.

- should the State and Territory representative template be adopted, either:
  - as set out, or

Response: No

  - modified to impose only an evidential, rather than a legal, burden on the defence in relation to the defences?

Response: Yes. The extent to which Corporations have embedded Whistleblower protection, Whistleblower support facilities and educated their workforce on how to deliver transparency in custodial management of its assets should be a prime component or activity to be able demonstrate transparency and openness in management practices and be submissable as a defence. The establishment of 1900 hot lines and such similar facilities should be a prerequisite for demonstrating transparency in management Practices.

- should the alternative State template be adopted?

Response: No, because the impact should also affect other persons within any business including employees and potentially even suppliers, not just those specifically classed as officers.

- should some other general derivative liability template be adopted?

Response: No.

- should there be a business judgment rule defence?

Response: Potentially yes, providing the extent to which Corporations have embedded Whistleblower protection, Whistleblower support facilities and educated their workforce on how to deliver transparency in custodial management if its assets should be a prime component or activity to be able demonstrate transparency and openness in management practices. The establishment of 1900 hot lines and such similar facilities should be a prerequisite for demonstrating transparency in management Practices.

However the business judgment rule should in this context not allowed to be be narrowly limited to only the financial consequences for the corporation. A more appropriate context would be Triple Bottom Line outcome focused.

Page 53 Section 10.4 Responsible Officer Template - Issues for consideration

Respondents are invited to comment on any aspect of the discussion in this Section on developing a responsible officer derivative liability template, including:

- Who should have what burden of proof in relation to reasonable steps?

Response: The Directors, Officers and employees of the Corporation, individually and potentially collectively, unless the Corporation can demonstrate the extent to which they have embedded Whistleblower protection, Whistleblower support facilities and educated their workforce on how to deliver transparency in custodial management of its assets should be a prime component or activity to be able demonstrate transparency and openness in management practices. The establishment of 1900 hot lines and such similar facilities should be a prerequisite for demonstrating transparency in management Practices.

Whistlebower protection legislative provisions should be embedded within Corporations Law and all Government businesses should be subject to the same provisions whether enacted Federally or mirrored in identical State legislation.

- Should some other responsible officer derivative liability template be adopted?

Response: No

- In what circumstances, if any, should a responsible officer template substitute for a general derivative liability template?

Response: It should not, they go hand in hand and are complimentary. However this is providing the extent to which Corporations have embedded Whistleblower protection, Whistleblower support facilities and educated their workforce on how to deliver transparency in custodial management of its assets should be a prime component or activity to be able demonstrate transparency and openness in management practices. The establishment of 1900 hot lines and such similar facilities should be a prerequisite for demonstrating transparency in management Practices, adequately supported by proper Whistleblower Protection legislation.

<u>Overall commentary</u>

It is clear that if one involves all of the stakeholders in any business, and especially all of its employees and service providers, in helping to keep unethical, corrupt and incompetent practices out of bounds, that open and transparent business environment will no longer support these corrupt and unethical activities. However, the protection of the people who will expose such practices has historically been almost completely lacking and there has been little legislative backing for supporting whistleblowing and enforcing transparency within business. Unless this is corrected, the litany of failures and breaches will inevitably continue.

I look forward to hearing from you should you require further information.

Sincerely

Alan du Mée
Principal
MSc., MBA, FAICD, FAIM, MIIE

AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS

ABN 11 008 484 197

Submission

to

Corporate and Markets Advisory Committee

on

Personal Liability for Corporate Fault Discussion Paper

12 August 2005

Introduction

The Australian Institute of Company Directors (AICD) supports legislative reform designed to achieve uniformity across federal, state and territory laws which impose personal liability on company officers for corporate fault.

Many benefits are likely to follow from achieving national uniformity in such laws, including:

- directors' obligations will be clearly defined and it will be possible to implement uniform strategies to ensure compliance;
- directors of companies engaging in multi-jurisdictional businesses will necessarily have the same duties and defences under corresponding legislation which will produce economic benefits;
- directors' and officers' insurance (D&O) premiums are likely to be reduced (by removing uncertainty about potential areas of liability);
- unnecessary drafting inconsistencies will be removed;
- corporate law will become national;
- a consistent body of case law will be developed; and
- Australia will be a more attractive place for foreign investment with a more certain regulatory environment.

Furthermore, amendment of these laws will be consistent with the Federal Government's desire to reform corporate laws in a way which achieves maximum economic benefit for the corporate community as well as removing unnecessary and complex red tape. In this regard, we also note the recent House of Representatives Standing Committee on Legal and Constitutional Affairs Inquiry into the Harmonisation of Legal Systems which has a similar objective.

CAMAC has limited its Discussion Paper to commonwealth, state and territory laws in the fields of environmental protection, occupational health and safety, hazardous goods and fair trading. CAMAC has indicated that it chose these areas because of their significance to commercial operations of many enterprises. Nevertheless, there are numerous other areas where laws of the commonwealth, states and territories have an impact on commercial transactions of companies carrying on business countrywide, including, especially, taxing statutes and laws relating to transport.

While strongly supporting a proposal for national reform, the AICD strongly supports reform across all legislative areas, not solely in the four areas which are the focus of the CAMAC Discussion Paper. Having said that, AICD is of the view that any model recommended for national uniform legislation, does need to include some flexibility and allow for variation in specific circumstances, where warranted.

The AICD believes that it is anathema to the proper and efficient management of a corporation to apply different criteria to determine whether directors or officers have committed an offence under different laws and in different jurisdictions. This lack of clarity

means that a single approach to compliance is unlikely to be adequate to relieve officers from liability under different regulatory regimes within the same state or territory or under similar regulatory regimes in different states and territories. Simply, we see no reason why the approach taken to imposing liability on corporate officers under workplace laws in Tasmania should be materially different to laws imposing liability on corporate officers who are responsible for polluting a stream in Queensland.

As noted by CAMAC, derivative liability is designed to focus the minds of directors and officers on ensuring corporate compliance with legislation. It is very hard to be focussed on achieving that outcome, when the provisions designed to bring about that focus are so diverse. The costs of complying with different state and territory based laws are already high. Convincing company officers to adopt differing compliance regimes to ensure observance of each such law, will ensure that those costs remain high while returning no discernible benefits.

Derivative liability should be sparingly used and must be justified in very specific and clearly defined circumstances. We are concerned about the growing trend to adopt this form of liability in legislation. Our strong support for the development of uniform derivative liability laws should be read and understood in that context.

Derivative liability

CAMAC has sought comment on the rationale for derivative liability for corporate officers. The AICD opposes derivative liability on the basis that it is based on an underlying assumption that directors are at fault merely because a corporate breach has occurred. The AICD believes this is an unjust assumption which must be challenged. Many of the laws imposing derivative liability on company officers (most especially state and territory laws) seem to contemplate the concept of a small or family-based company with tightly held ownership and control where liability can be traced directly back to the 'guiding hands' of those companies. However, not all companies are of that kind. The larger and more complex the business conducted by a company, the more unreasonable it is to suggest that directors or senior officers should automatically be regarded as being liable for every corporate breach of applicable legislation.

The AICD considers that a more relevant test in determining liability is whether the director or officer has been involved, whether through action or inaction, in the corporate breach. That sort of model would seem to be a much more reasonable and just way of attaching liability to company officers. Well drafted 'aiding and abetting' type provisions would be more than adequate to catch directors and officers who have acted in a manner to deserve punishment. For example, section 75B of the Trade Practices Act 1974 regards a person as being 'involved' in a contravention of that Act where the person has:

- aided, abetted, counselled or procured the contravention;
- induced, whether by threats or promises or otherwise, the contravention;
- been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention; or
- conspired with others to effect the contravention.

Those categories are very broad and would, in general, be appropriate to identify and bring within the purview of the legislation, any directors or officers who are culpable.

Direct liability

CAMAC notes that some legislation, such as industrial manslaughter laws, imposes direct, rather than derivative liability on company officers. Legislation which potentially imposes a gaol term on those found liable needs to be very carefully considered. While AICD accepts that it may be just to impose potential gaol terms on those found guilty of industrial manslaughter, those laws must only apply to individuals who have a duty or responsibility for that particular area and who have the ability to influence those outcomes. In a large organisation, where a workplace death occurs, it is not appropriate for directors or senior officers to be subject to imprisonment unless they have acted in a manner deserving of punishment. For example, where a corporation puts in place appropriate systems designed to ensure the workplace, health and safety of its employees, appropriate senior staff are engaged to oversee and monitor that process and those senior managers and all other appropriate staff are properly trained, directors and senior managers should not be exposed to gaol terms where a workplace fatality occurs.

In section 10 of the Discussion Paper, CAMAC refers to the responsible officer template. While such a template may be a viable proposition in situations of industrial manslaughter or other legislation which imposes direct, rather than derivative, liability on company officers, it must be approached cautiously.

By way of example of the concerns we have, let us consider a large company which appoints an occupational health and safety manager who: is responsible to ensure that all relevant laws and regulations are known and communicated to the responsible line managers; is responsible for systems being in place for training, monitoring and reporting both to management and the Board; and, is responsible for heading up audit teams as well as major incident and accident investigations. Such a person should not, in the view of the AICD bear any 'special responsibility' on behalf of the company for breaches (such as a workplace death) beyond that expected by his or her specific duties because he or she would have absolutely no authority and control over day-to-day operations management. In this example, liability (if any) resulting from a workplace death or serious injury should, *prima facie,* be a line responsibility, not the liability of the occupational health and safety manager. Furthermore, as a practical matter, it would be difficult to find a person to take on that responsibility given the prospect of his or her being subjected to a potential for a gaol term, if a workplace death occurred.

As a result, the AICD considers that this form of template may be difficult to apply in practice. It would not, in any sense, be appropriate for the person holding that office effectively to become a 'guarantor' of corporate performance, nor would it be appropriate for that person to become a ‘scapegoat’ where others might be responsible. This template might be worthy of further consideration if it were to include appropriate safeguards, such as requiring the person to have failed in the performance of his or her tasks in a significant and demonstrable way, for example by failing to notify line managers of relevant laws or regulations or misleading senior executives in relation to known unsatisfactory or unsafe practices. Meaningful defences may also be appropriate for example, where he or she has not

been properly trained but had sought that additional training or has notified superiors of systemic workplace problems.

Liability of officers of private enterprise organisations and government owned enterprises

The AICD believes that officers of both types of organisations should be dealt with in the same way.

Practical effects of differences in approach in legislation imposing liability on corporate officers

The practical effects of the differences are most marked for those companies carrying on business in more than one jurisdiction. It should not be assumed that this is confined to the larger companies.

The cost in having different compliance regimes and different consequences in terms of potential penalties is considerable, although not easily measured. In large companies, the problems are exacerbated where managers are transferred between jurisdictions giving rise to additional training costs and, potentially, his or her exposure to penalties through an inadvertent breach of unfamiliar legislation.

The differing approaches also cause problems with indemnities that may be provided by the company and the availability of indemnities under D&O insurance policies both for the officer and the company. Indemnity may be provided in one jurisdiction, but not another, for the same statutory breach.

CAMAC templates

As we stated earlier, AICD is supportive of a uniform national model for statutory provisions imposing derivative liability on company officers. Such a model should be sparingly used and should be justified in very specific and clearly defined circumstances. However, we do not support a regime of strict liability which seeks to place company officers in a situation where they are deemed guilty where a corporate breach has occurred without some level of personal culpability being proven against them. Company officers should be afforded the same presumption of innocence as any other member of the community.

While there has been a growing trend, in some states and territories, to impose liability in this way, the AICD opposes this approach most strenuously. It is the obligation of the prosecution to make out the offence, and if he or she can do so, for the officer to make out any relevant defence. For that reason, we support the ALRC template, coupled with suitable defences (which we discuss in more detail below) and strongly oppose the representative template.

We also have issues with the alternative template. In particular, we are concerned that laws of this kind are not common and there is no well developed body of law about how they should be interpreted. It is not immediately clear who will end up bearing the onus. The other difficulty we have with this template is that it has the capacity to elevate what is no more than

negligence to an offence. While negligence is one element of the offence detailed in the ALRC template, viewed in context, there are other criteria which must be made out before the prosecution will succeed. In the alternative template, negligence is the core offence. The alternative template also needs to be contrasted with the duty of care and diligence in section 180 of the Corporations Act which is only a civil penalty offence unless the lack of care is coupled with recklessness or intentional dishonesty and a failure to exercise powers in good faith or for a proper purpose. Given that the laws under review commonly impose criminal sanctions on officers for corporate breaches, the notion of company officers being subject to gaol terms for nothing more than negligence would be a considerable extension of existing laws imposing liability on officers.

A case in point is the proposed law imposing criminal sanctions for cartel conduct under the Trade Practices Act which, we understand, will make it clear that those involved must have engaged in the relevant conduct for a dishonest purpose before an offence can be said to exist.

Additionally, it is clear in the ALRC and alternative templates that in order to succeed, the prosecution must make out its case beyond reasonable doubt. Given the possibility of gaol terms, the lower civil standard of proof is inappropriate. We believe that the standard of proof required should be stipulated.

Defences

Possible defences to any charge seeking to impose penalties for derivative liability include:

- due diligence;
- no influence;
- no knowledge;
- reasonable steps;
- reasonable mistake;
- reasonable reliance on information provided by others;
- impractical to comply;
- no control; and
- no authority, permission or consent.

Whichever model is ultimately employed, defences are appropriate. However, the AICD does not favour a wide range of defences, but rather a small number of appropriate defences which will relieve officers from liability where directors have acted properly and exercised appropriate judgment given the information available to them and the responsibilities they are vested with.

The AICD prefers the due diligence defence (although not the **all** due diligence defence which is the defence in some state and territory legislation which we believe sets the bar too high). The due diligence defence may not be appropriate in all circumstances, but it is something many directors are familiar with given the availability of this defence under

Chapter 6D the Corporations Act to offences arising in relation to capital raising disclosure. Continuous disclosure requirements mean that listed and disclosing entities will in many cases have continuous disclosure reporting processes which they use to ensure that they meet their disclosure obligations and this should assist them to ensure the availability of a due diligence defence in other Acts as well.

Other appropriate defences include the reasonable reliance defence of the sort found in section 189 of the Corporations Act and a defence where the officer lacks knowledge, notwithstanding taking reasonable steps to be properly informed. We do not support a 'no influence' defence as we believe it sets the evidential bar too low.

Business Judgment Rule

In general, the AICD agrees with CAMAC's views on the applicability of a business judgment rule defence. However, we do not rule out altogether the possibility of it being appropriate to include a business judgment rule defence in certain legislation, for example, legislation which imposes direct rather than derivative liability on an officer.

Definition of 'officer'

While achieving uniformity of laws improving personal derivative liability on company officers is a worthwhile goal, unless we can also achieve uniformity in the way 'officer' is defined across relevant laws, considerable uncertainty will continue to exist as to the precise group of individuals who are covered by these laws. Considerable thought has recently been given to the description of 'officer' in the Corporations Act and there would be great value in having a consistent approach taken in laws imposing derivative liability, especially if that approach mirrored the definition of 'senior manager' in the Corporations Act.

Conclusion

The AICD strongly supports the notion of uniformity of laws imposing personal liability on company officers. However, in drafting those laws, relevant legislatures should not reverse the onus of proof. Australians who are not company directors or officers are entitled to a presumption of innocence. That presumption should be available to all company officers as well.

We have addressed in this submission the considerable burden, both in terms of cost and inconvenience, which company officers have to confront in their daily business when dealing with inconsistent laws which potentially impose personal liability on them.

Those laws lack uniformity both within and across jurisdictions. In many cases these differences are difficult to rationalise. A good example is the Road Transport (Compliance and Enforcement) legislation (C&E) due to come into force in New South Wales and Victoria on 1 September 2005. The penalties and defences vary between the two states and there seem to be no obvious policy reasons for these differences. The C&E is an initiative of the National Transport Commission whose charter promotes uniform or nationally consistent transport laws. In most cases, C&E being an example, it has chosen the nationally consistent approach

based on a model law concept which allows the jurisdictions to pick and choose how they adopt the laws. This is a clear example of the introduction of new inconsistent laws, which are being adopted under a banner of national uniform legislation. It demonstrates how rapidly the position is deteriorating.

In taking its approach to national uniformity the National Transport Commission has relied upon existing environmental, occupational health and safety, corporations and taxation laws and in some jurisdictions road transport laws as precedent for personal liability of directors. Substantive reform of this kind justified on arguable or misunderstood precedent is simply not satisfactory, especially in an area which is so important to the Australian economy.

We are concerned that through these types of provisions, especially those found in state and territory legislation, our corporate laws, which are among some of the most advanced in the world, are being inadvertently, and possibly irretrievably damaged. The Corporations Act sets out the statutory duties of directors, which largely, but not fully, codify their common law duties. Those Corporations Act duties are sometimes amended to reflect current community thinking and expectations and to remedy defects brought to light in case law. Nevertheless, those amendments have been well thought out and changes to them are usually the subject of public consultation and considerable debate before they are adopted.

We are concerned too that the states and territories are reforming the law in a manner inconsistent with longstanding principles and with the duties and liabilities of directors and officers set out in the Corporations Act and under the common law. In particular, the duty of care and diligence under section 180 in particular seems to have been forgotten or ignored by state legislators, as have the defences in sections 189 and 190.

Personal liability of company directors and officers is increasing at a steady rate. It is simply unacceptable that the laws which impose personal liability are being adopted in such a piecemeal way. AICD also believes that derivative liability concepts should be sparingly used and must be justified in very specific and clearly defined circumstances. Our strong support for the development of uniform derivative liability laws must be understood in that context.

The AICD supports the need for strong laws, but urges that legislators urgently consider sensible measures to make the laws uniform and fair so that company officers, no matter where they work, and no matter what field they work in, can act in the knowledge that they will be treated in exactly the same way as other company officers who work in other locations or fields.

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12 August 2005

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
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Dear Mr Kluver

PERSONAL LIABILITY FOR CORPORATE FAULT

The Chamber of Commerce and Industry Western Australia (CCI) is the peak business association in Western Australia. It is the second largest organisation of its kind in Australia, representing approximately 5,000 organisations across all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance. About 80 percent of CCI members are small to medium enterprises, and members are located across all geographical regions of WA.

1. Introduction

We refer to the Corporations and Markets Advisory Committee (CAMAC) discussion paper of May 2005 titled "Personal Liability for Corporate Fault" (CAMAC Paper).

The CAMAC Paper reviews different Commonwealth, State and Territory statutes that impose personal liability on directors for breaches by their corporations, and argues that a more standardised approach would lead to more effective and cost-efficient compliance with regulatory goals. The CAMAC Paper invites submissions on a number of proposals for a standard template that each Australian jurisdiction could adopt.

In sum, there is a substantial divergence between State and Territory legislation, which generally deems a director liable for an offence unless the director can show he/she was duly diligent, and Commonwealth legislation, where the onus is on the prosecution to establish a director has committed an offence.

The purpose of this letter is to make submissions in broad support of the template put forward by the Australian Law Reform Commission (ALRC) in the report of 2002 titled "Principled Regulation" (which largely resembles Commonwealth legislation). That template is found at section 9.2 of the CAMAC Paper.

2. Allocating the burden of proof and defences

The question of who should bear the onus of proof is important.

Like the Commonwealth legislation, all the State and Territory statutes require the prosecution to prove beyond a reasonable doubt that a defendant comes within a relevant category of individuals potentially liable.

However, the State and Territory statutes typically treat the remaining elements in a liability provision as defences, which the defendant must prove on the balance of probabilities. The CAMAC Report (at page 34) notes that:

"In effect, an individual is presumed to be guilty unless he or she establishes a defence. This contrasts with some, but not all, of the Commonwealth legislation discussed…"

2.1 State and Territory approach – placing an unfair burden on directors

CCI submits that the predominant pattern of derivative liability in State and Territory legislation is inherently unfair and unreasonable, and strikes at one of the cornerstone principles of democracy, the presumption of innocence.

The existing State and Territory legislation permits a government regulator to charge a director with an offence, leaving the director with the decision whether to defend the action, in a situation where the director bears the burden of establishing a defence on the balance of probabilities.

This standard of proof – the balance of probabilities – is reasonably high and, combined with the nature of the defences, places a large evidential burden on the director which is costly and time consuming. There is a real risk that directors may be prevented from defending an action due to the evidential burden.

CCI has received advice that leading evidence to establish defences, like the due diligence defence, has resulted in court hearings of up to four weeks.

Commercial costs, in relation to retaining lawyers and experts to establish a defence, may provide a disincentive for individuals to undertake corporate roles. Further, directors may decide not to defend an action due to commercial pressures, irrespective of whether they are actually guilty of an offence. Directors will be unlikely to access legal aid and the costs of defending may be prohibitive.

2.2 Commonwealth approach – a more just solution

Under Commonwealth legislation, such as the *Environment Protection and Biodiversity Conservation Act 1999 and Hazardous Waste (Regulation of Exports and Imports) Act 1989,* where a corporation commits an offence, an individual may also be liable where the prosecution proves beyond a reasonable doubt that the individual:

(a) is a director or other executive officer of the body corporate;

(b) was in a position to influence the conduct of the body corporate in relation to the contravention;

(c) knew that, or was reckless or negligent as to whether, the contravention would occur; and

(d) failed to take all reasonable steps to prevent the contravention.

These are all elements which the prosecution must prove beyond a reasonable doubt. CCI considers that the Commonwealth statutes provide a more reasonable

means of imposing derivative liability against individuals for corporate fault, and reduces the risk of injustice occurring.

3. Adopting a uniform template across all jurisdictions

CCI supports the adoption of a uniform template for offences of personal liability for corporate fault across all jurisdictions thereby enabling directors to understand in a much less complex way the types of defences available to them. That simplification is also likely to result in directors more clearly appreciating their legal responsibilities in performing corporate functions. Such a template should not, however, erode the current rights of directors.

The CAMAC Paper essentially puts forward two approaches towards prosecution of derivative liability actions against an individual:

(a) the ALRC template (at section 9.2 of the CAMAC Paper) which resembles an amalgam of several Commonwealth statutes; or

(b) what is referred to as the "State and Territory representative template" (at section 9.3 of the CAMAC Paper).

The fundamental difference between the two approaches is the allocation of the burden of proof and defences in any derivative liability action against an individual.

While there are alternative formulations of the ALRC template, the general thrust of the ALRC template is that the burden is placed on the prosecution to prove the elements of the offence beyond a reasonable doubt.

By contrast, under the State and Territory representative template (again there are alternative formulations), where a corporation contravenes a relevant law, any director or other person who is concerned, or takes part, in the management of the corporation is deemed to also be liable unless the person establishes a defence.

As noted above, CCI considers that the existing State and Territory legislation imposes an unfair and unreasonable evidential burden on individuals that ultimately may result in injustice.

Further, persons in a democratic society are supposed to be presumed innocent until proven guilty. The State and Territory legislation strikes at the heart of this principle. The adoption of the ALRC template would not lessen the obligation on directors to use reasonable steps to prevent contraventions. Directors will still want to ensure that they have evidence to rebut any allegation under a prosecution in accordance with the ALRC template. The element of the offence (failure to take reasonable steps) will be well known to directors because it will become notorious if it is applied across the range of statutes creating derivative liability.

For these reasons, CCI supports the adoption of a uniform template on similar terms to the ALRC template outlined in section 9.2 of the CAMAC Paper.

4. Conclusion

In summary:

(a) The predominant pattern of derivative liability in State and Territory legislation is inherently unfair and unreasonable.

(b) The existing State and Territory legislation permits a government regulator to charge a director with an offence, leaving the director with the decision whether to defend the action, bearing in mind that the director bears the burden of establishing a defence on the balance of probabilities.

(c) Under the State and Territory regimes, there is a real risk that directors will be dissuaded from defending actions due to the nature of the defences and the evidential burden involved. Directors may decide not to defend an action due to commercial pressures, irrespective of whether they are actually guilty of an offence.

(d) Under the Commonwealth regimes identified above, the prosecution must prove all elements of an offence beyond a reasonable doubt. This provides a more reasonable means of imposing derivative liability against individuals for corporate fault, and reduces the risk of injustice occurring.

(e) CCI recognises the benefit in adopting a uniform template for offences of personal liability for corporate fault across all jurisdictions, provided the uniform template is on terms similar to the Commonwealth legislation discussed or the ALRC template (at section 9.2 of the CAMAC Paper).

Please contact our Mr Bill Sashegyi, Director Industry Policy on Tel: (08) 9365 7567 or email sashegyi@cciwa.com if you have any questions in relation to the above.

Yours sincerely

J L Langoulant
Chief Executive

CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

12 August 2005

Mr John Kluver
Executive Director
CAMAC
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Dear Mr Kluver

Personal Liability for Corporate Fault
Discussion Paper

Chartered Secretaries Australia (CSA) welcomes the opportunity to comment on the discussion paper *Personal Liability for Corporate Fault*.

CSA is Australia's peak membership body for governance professionals, and considers itself fully qualified to respond to these matters. In Australia, CSA has over 8,500 members and affiliates working as company secretaries, governance professionals and other officers in corporations, who advise their boards on matters of governance.

Members of CSA have a thorough working knowledge of directors' and officers' duties and the *Corporations Act 2001*.

In respect of the discussion paper, CSA comments:

The distinction between direct and derivative liability

Implications of the current law: impact on corporations and individuals

CSA has reservations about the concept of derivative liability, especially where people have no power to influence the offence committed by the body corporate, but are held liable by reason of their formal position in the corporation, rather than for any actual acts or omissions. CSA prefers the concept of accessorial liability, as a form of direct liability for intentional and knowing participation in a corporate breach.

Notwithstanding this, CSA acknowledges that derivative liability is already recognised in various Commonwealth, state and territory statutes and that the social goal of a responsible corporate compliance culture is desirable.

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CSA would like to point to some of the practical implications of the application of derivative liability. Under most state occupational health and safety (OH&S) and environmental legislation, if an individual is injured at work or if an environmental incident occurs on (or emanates from) a company's premises, the company will almost certainly be guilty of an offence. Under most state legislation, once a company has committed an offence, the directors and officers will be deemed also to have committed an offence, unless they can prove that they were not in a position to influence the relevant conduct or that they exercised all due diligence to prevent the relevant conduct.

Consider the example of a company with thousands of people employed at multiple sites using heavy mobile equipment, or a labour hire company with thousands of employees working on thousands of client sites in a variety of occupations. Directors could potentially be liable to prosecution if an unfortunate safety or environmental incident were to take place, despite having no knowledge of, or ability to ameliorate, the circumstances giving rise to the incident, no matter how seriously the directors take their responsibilities and no matter how much time they spend focusing on safety and environmental issues.

For example, it is important to differentiate between foreseeable and/or preventable accidents, such as that which occurred at the Esso gas plant explosion at Longford in Victoria in 1998, and those accidents that cannot be prevented and where people are injured without any person being responsible for the injury, such as when a hydraulic line ruptures, despite the fact that it is well-maintained.

CSA also believes that any consistent principle of derivative liability imposed on directors and officers, or extended to a wider category of persons, ought not extend the current forms of derivative liability to be found in various Commonwealth, state and territory statutes.

CSA strongly recommends that any further reform of the *Corporations Act* in the future or introduction of other legislation that has a bearing on corporations, directors and officers should not add to the existing complexity. That is, CSA recommends that new statutes should not impose further derivative liability on directors and officers. If further amendments to the *Corporations Act* are proposed in the future, consideration should be given to whether the derivative liability provisions in other legislation are still appropriate

Is it necessary to go beyond accessorial liability and impose individual derivative liability?

CSA recognises that to the extent that derivative liability creates potential liabilities on the part of directors and officers, it provides significant incentives for directors and officers to put in place effective risk-management arrangements to ensure that the corporation complies with its obligations. It has been suggested that ‘accessorial liability alone may not create sufficient incentive, given that the general principles of this type of liability require a person to have actual knowledge, or be wilfully blind, about certain corporate conduct’ (page 19 of the CAMAC discussion paper).

Individual fairness

Limiting derivative liability to directors and officers

One argument is that derivative liability should be limited to directors and officers with the power to influence corporate conduct, that is, the persons attracting personal liability for a corporate breach should be those who have both the authority to make decisions about the organisation as a whole and the power to enforce them. In practice, there are few individuals in a corporation with the power to make these decisions.

For example, an OH&S Manager may have a broad scope of responsibility for OH&S, and may make recommendations concerning OH&S issues to the executive committee of a corporation, but may not have the power to make critical decisions concerning OH&S and enforce them. In this example, if the executive committee did not approve recommendations made by the OH&S Manager, the OH&S Manager should not be exposed to derivative liability for any breach of statutory safety requirements which resulted.

Another example concerns risk managers and compliance managers in financial services corporations. They are likely to report to more senior managers and, ultimately, to a member of the executive committee, which has the power to make and enforce decisions concerning these areas of responsibility. The risk and compliance managers should not be held liable for any breach of legislation as a result of actions or inactions by the executive committee, when they have not had the power to make and enforce the relevant decisions.

Expanding derivative liability to a wider category of persons

An alternative argument is that derivative liability should be extended to a wider category of persons.

Directors and officers could potentially be held liable by reason of their formal position in the corporation, rather than for any actual involvement in acts or omissions, and despite having made every effort to ensure OH&S or environmental compliance frameworks have been developed and effectively implemented and observed. CSA notes that, in Australia, there is no similar provision as exists in the United States in relation to a 'responsible corporate officer' doctrine (analogous to derivative liability) which permits a defendant to raise a defence that he or she was 'powerless' to prevent or correct the violation.

There is, therefore, an argument for personal liability for any breach of OH&S or environmental legislation attaching to the person whose acts or omissions caused the breach, rather than to directors and officers by virtue of their position in the corporation. Limiting the scope of derivative liability to directors and executive officers may thwart safety efforts in corporations, as those responsible for particular worksites or groups of employees do not necessarily take 'ownership' of the safety obligations. Indeed, this reflects the position under most state OH&S and environmental legislation.

CSA's position

CSA does not support persons being subjected to derivative liability merely because of their position in a corporation, where the breach was caused by conduct outside of their control and they made reasonable efforts to ensure that appropriate compliance systems and processes are in place. At the senior executive level, individuals generally monitor the performance of others; they cannot be involved in the day-to-day implementation of processes and systems.

While a uniform approach to derivative liability across Australia would be highly desirable, any extension to the liabilities that already exist would add complexity to an already complex area and would be highly undesirable.

CSA strongly recommends that any common form of derivative liability should apply equally to government business enterprises (GBEs) as to corporations. A consistent principle should carry through, regardless of the sector in which the entity operates.

CSA also notes that, if additional liabilities are introduced beyond those which apply to directors and officers, inequity may be introduced. Directors' and officers' liability insurance (D&O) policies provide insurance coverage for directors and officers but, at present, may not provide coverage for other employees. There are many limitations on the extent of coverage that insurance companies will provide beyond directors and officers, with the result that other employees may not have the benefit of insurance coverage. Individuals should be entitled to the benefit of insurance coverage against the risk of personal liabilities, yet imposing derivative liability on individuals other than directors and officers may place some individuals at risk without the benefit of insurance.

Have respondents encountered in practice any problems with disparate Commonwealth, state and territory statutes that impose individual liability and provide for various defences?

To date, while it could be said that CSA members have not encountered any problems in practice with disparate Commonwealth, state and territory statutes that impose individual liability and provide for various defences, CSA members note that the existing variety of standards and tests contained in legislation imposing derivative liability makes compliance much more difficult to manage than it would be under a uniform approach. Currently there is a great deal of legislation in Australia, requiring corporations to respond to differing standards and tests, and this involves an allocation of resources and the attendant costs of such allocation.

CSA welcomes the efforts of the Corporations and Markets Advisory Committee (CAMAC) to seek a uniform approach to derivative liability in Australia and in developing and applying a legislative template for imposing derivative liability. .CSA strongly supports one consistent principle and one common form of derivative liability. Having a common form would promote compliance and reduce compliance costs by removing the need for corporations to respond to differing standards and tests. However, it seems to CSA that a uniform approach, without the imposition of additional liabilities, could only be achieved with the support of the states.

Should the ALRC template be adopted, either as proposed by the Commission or with any modifications?

If a uniform approach were to be implemented, with the support of the states, CSA recommends the use of the Australian Law Reform Commission (ALRC) template, rather than the state templates also put forward as potential models.

CSA's preference for the ALRC template is based on the fact that:

- it requires proof that an individual was in a position to influence the outcome
- it puts the burden of proof on the prosecution, not the defence, notwithstanding that it recognises that the defence must show that all reasonable steps were taken to prevent a breach of the statute
- derivative liability is attached to 'an individual, by whatever name called', rather than only to directors and senior managers. However,CSA supports including a specific reference to directors
- use of the phrase 'the individual knew that…the contravening conduct *would* occur ' is consistent with ensuring that the burden of proof rests with the prosecution.

CSA does not object, having regard to the problem raised, to the defendant having an evidential onus to provide prima facie evidence of having taken one or more reasonable steps (for the reasons stated in para 9.6 of the Discussion Paper on page 47), but from that point, the onus should be on the prosecution to negate that evidence beyond reasonable doubt. Such a regime would have the effect of requiring the prosecution to prove (in each case beyond reasonable doubt):

- recklessness or negligence as to the likelihood of the company's contravening conduct occurring, and
- that the director/officer failed to take reasonable steps to prevent the conduct.

Should the state or territory representative template be adopted?

CSA does not support the state or territory representative template as one to be adopted.

Should the alternative state template be adopted?

CSA does not support the alternative state template as one to be adopted.

Should some other general derivative liability template be adopted?

CSA does not support some other general derivative liability template as one to be adopted.

Should there be a business judgment rule defence?

If derivative liability is extended through the organisation on the basis of the ALRC template, there is no need for a business judgment defence. The 'reasonable steps' criterion in the ALRC template is a sufficient defence. The business judgment rule focuses on directors' duties within a corporation, whereas the legislation reviewed in the CAMAC paper deals with a corporation's external regulatory compliance obligations. Furthermore, the business judgment rule applies to civil liability only, not criminal prosecutions.

Who should have what burden of proof in relation to reasonable steps?

See our comments above for who should have the burden of proof in relation to reasonable doubt. Our recommendations relate to the fact that, while still placing a significant burden on directors and officers to do the right thing, a framework as recommended by CSA would provide more certainty for those individuals subject to derivative liability than the tenuous link between 'crime' and punishment that exists currently.

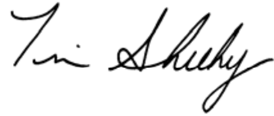
Should some other responsible officer derivative liability template be adopted?

CSA does not support this at this time, but notes that the US 'responsible corporate officer' doctrine permits a defendant to raise a defence that he or she was 'powerless' to prevent or correct the violation.

Further information

In preparing this submission, CSA has drawn on the expertise of the members of its two internal national policy committees. We would welcome the opportunity to meet with you to discuss any of our views in greater detail. Please call me if you would like to set up a meeting. I can also arrange a meeting with our members.

Yours faithfully



Tim Sheehy
CHIEF EXECUTIVE

Submission to the Corporations and Markets Advisory Committee

Personal Liability for Corporate Fault

Discussion Paper

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Introduction

This submission addresses the release of the CAMAC Personal Liability for Corporate Fault Discussion Paper (May 2005). The University of Technology, Sydney's (UTS) has a corporate law group within the faculty of law as well as the independent Centre for Corporate Governance, a UTS key research centre, who have attempted to provide informed debate on these critical issues. Some of the suggestions that have been provided in this submission are of a policy nature and question the need for change without empirical data and support, through to technical suggestions as to the drafting of particular provisions.

If any of the responses require further explanations, please contact Professor Michael Adams at the UTS Faculty of Law at Michael.Adams@uts.edu.au

Staff involved in producing this response

The UTS Law Faculty has a variety of staff from many different areas of the law In respect of this submission, the substantive legal submissions have been prepared by Professor Michael Adams, with help legal academic staff such as Dr

Colin Hawes, a lecturer at UTS, Angus Young, a part-time lecturer and PhD student and Ms Marina Nehme, a part time lecturer and masters student at UTS, each members of the corporate law group. Additional administrative research assistance was provided by Ms Morgen Kerry of the Faculty of Law, UTS.

ADAMS; Michael is the Perpetual Trustees Australia Professor of Financial Services Law and also Professor of Corporate Law in the Faculty of Law at UTS. He is the Assistant Director of the UTS Centre for Corporate Governance and has been teaching and researching corporate law for over twenty years. This research has been supported by Morgen Kerry, research assistant to Professor Michael Adams at the UTS Centre for Corporate Governance.

HAWES; Colin Dr is Lecturer of Law at the University of Technology, Sydney, teaching and researching in the area of corporate law, Chinese & Asian corporate/commercial law and international banking and finance law. He previously practiced law and taught at universities in British Columbia and Alberta Provinces, Canada

NEHME; Marina is a part time Lecturer in Corporate Law at the University of Technology, Sydney and researcher in corporate law issues.

YOUNG; Angus is a part time Lecturer in Management, Research Associate at ICAN Research Centre, Faculty of Business at the University of Technology, Sydney, Tutor in Business Law at Insearch, and a researcher in corporate regulatory issues.

Explanatory Notes

Two brief notes. First, references throughout the body of this submission to 'the group' are references to the corporate law group within the UTS Law Faculty. Second, for the sake of clarity and coherency in this submission, the group has considered it apposite to reproduce parts of the draft discussion paper where necessary. A second submission will be made by the same group in respect of the *Corporate Duties Beyond Board Level* Discussion Paper.

General Observations:

The discussion paper, *Personal liability for corporate fault*, May 2005 looks at circumstances in which a director or manager of the corporation may be personally liable for contravening conduct simply as a consequence of the position they hold, or the function they perform, within that corporation when a corporation contravenes a statutory requirement. The discussion paper, through proposing certain templates suggests alternative methods of assessing the compliance of directors/officers.

To date, CAMAC has found that the approach taken both within and between the Commonwealth, State and Territory jurisdiction for imposing individual derivative liability is inconsistent. Even in the circumstances where legislation implies the same method or concepts, different terminology is used to determine the procedure. These discrepancies may detract from the current methods of corporate governance as often it may be difficult for individuals to understand their legal responsibilities in such a diverse regulatory environment.

But is accessorial liability sufficient? Do we really need a derivative liability to be imposed on directors? CAMAC notes that one argument for going beyond accessorial liability to derivative liability is to ensure that people in key positions within a corporation inform themselves and assist in the prevention of any misconduct by the corporation.

This is a valid and poignant view. More commonly ASIC is requiring officers to give personal guarantees against company breaches the law. One explicit example of this can be identified in the majority of enforceable undertakings whereby ASIC requires the directors of the company to monitor the undertaking and it adds a clause that notes that in case the company breaches the undertaking, the directors will be held liable.

However, derivative liability will have the effect of imposing more liability on directors. Do we need to add more liability on directors? Directors are already liable for breaches of duty of care, duty to act in good faith and for proper purpose, duty to avoid conflict of interest and the duty to ensure that the company does not trade when it is insolvent. In addition, the director will be

liable for accessorial liability and cannot claim that they were not involved in the company as a defence. The director will be held liable anyway if he/she breaches the abovementioned duties.

Do we need to have a derivative liability in the *Corporations Act*? The group has come to the conclusion that the discussion paper issues, while valid, are already covered adequately by the provisions of s 79 of the Corporations Act.

Consideration Issue 2.6

Comment upon any aspect of the discussion in this section on the distinction between direct and derivative liability, including any aspect of the commonalities and differences between the application of direct and derivative liability to private sector corporations and government business enterprises.

If legislative changes are brought in, in the area of derivative liability for directors, this will require regulation- generally an area left to ASIC in the areas of regulating and overseeing corporate governance compliance. It is a worthy area to examine whether where public organisations are State based Government Business Enterprises, there will be issues with a Commonwealth Organisation such as ASIC regulating a State based organisation. The group does not address this issue with a ready answer, but leaves it as an issue for contemplation by the readers of this submission.

Consideration Issue 3.4

Comment on any aspect of the discussion in this section on the rationale for derivative liability, including in what circumstances, if any, it is necessary as a matter of public policy to go beyond accessorial liability and impose individual derivative liability.

- Currently, corporate liability without personal directorial liability for corporate fault is an insufficient deterrent for corporate offences. This is particularly of concern with larger corporations, for whom, it is often less expensive to pay monetary penalties for breaches of occupational safety, environmental and trade practices regulations than pay to make changes

to established business practices which would bring them into line with corporate governance accepted practices.

- The practice of making directors/ officers personally liable for breaches would ensure that internal corporate compliance programs are put in place rather than simply avoided by corporations willing to pay for offences. Directors/officers are much more likely to ensure compliance when penalties are imposed directly upon the individual.

But are there cheaper/ less drastic alternatives?

- A sliding scale of penalties for corporations- depending upon the size/ assets of the corporation so that the costs of the breach will almost certainly outweigh the costs of the compliance.
- Clarification of and greater enforcement of the accessory provisions in s 79 of the *Corporations Act*, ensuring that they apply to environmental law and other relevant offences. Some rewording of s 79 along the lines proposed by the ALRC template (in 9.2 below) may achieve this objective more effectively than simply introducing a whole new provision.

Culture:

Ultimately this issue is a question of culture. Who is responsible for corporate culture? In large organisations, it may be difficult to determine which individuals are responsible for certain activities or areas/sub cultures within the organisation. A question to consider then, is would individual liability for directors and officers ultimately change the culture and the corporations' adherence to statutory requirements of the organisation?

Generally, it is the board of directors and the officers who are directly responsible for the establishment and conduct of procedure in the corporation. If these officers/directors were directly responsible for the outcomes of the company- would this change the culture and sub cultures i.e. the procedures and culture of protection or adherence to the law that the company has?

This is a fundamental question to consider in relation to this topic- would a culture of change and adherence evolve from these changes, or would it simply

mean that more officers/directors are prosecuted or disciplined? The *Commonwealth Criminal Code* requires a culture of compliance which could help enforce this concept within the corporate world.

Too often today, directors liabilities or any penalties that have been imposed upon the officers/ directors of a company are simply built into the costs of the corporation- thus, other parties, such as the shareholders have been paying for the irresponsible behaviour of directors and officers of the corporation. An illustration of this is the recent James Hardie investigation.

The question of corporate culture and a culture of compliance is well documented in the academic literature. Over the last two decades Australia has experienced massive shifts in business regulatory approaches. Policies have switched from a focus wholly on deregulation to selective re-regulation. Clarke *et al.* (2003)[1] argue these regulatory changes were, in part, carried by the economic reforms of the 1980s, which resulted in some "entrepreneurs" and “high flyers” profiting from speculative and unsustainable business ventures that ended, ultimately, in several high profile corporate collapses. Notwithstanding these factors, current trends indicate that the growth of business regulation will persist, as the nexus between norms of market pressure and norms of social accountability continue to spur further debate.

Julia Black (1997)[2] remarks that regulations are a framework of rules prescribed by authorities to coerce a target group of constituents towards certain desirable outcomes. Rules are generalised control mechanisms which provide a blunt instrument: they are abstract categories with which to group together particular instances or occurrences that are seen, somehow, to embody the definitional category forming the operative basis of the rule. Consequently the design of rules is based upon generalised calculations, both retrospective and prospective, which are vulnerable both to over and under-inclusiveness of phenomena that falls within their putative and actual ambit.

[1] Clarke, F., Dean G. and Oliver, K. (2003) Corporate Collapse; Accounting, Regulatory and Ethical Failure, Cambridge University Press, Melbourne

[2] Black, J. (1997) *Rules and Regulators*, Clarendon Press, Oxford

Critics such as Sally Simpson (2002)[3] point out that 'control and command' type regulation have certain shortcomings because empirical evidence suggests that strict regulation does not improve compliance. Instead, it increases the amount of litigation – especially where defendants have deep pockets – as is the case with corporate organisations.

Baldwin *et al.* (1998)[4] note regulating corporations is not a clear-cut task. First, there is no shortage of laws regulating corporations: there is any number of frameworks that attempt to restrict and apprehend undesirable behaviour by corporate organizations, as well as by their key decision-makers. Choosing which instrument to use is not always easy. Another added complexity is that many activities that may subsequently be represented as illegal are often viewed by both regulator and regulate, at a given time, as normal behaviour or business – at least until it is established that some detriment to other parties has been caused. These complexities are not due to the shortcomings of the law but to the delicate nature of business judgements and the many competing interests that struggle to define the arenas in which they are engaged.

Given the nature and intricacies involved in regulating corporations, socio-legal theorists argue that enforced self-regulation would a more efficient and effect alternative, rather than the traditional 'command and control' strategy. Ayres and Braithwaite (1992)[5] characterize 'enforced self-regulation' as a negotiated instrument between the state and firms or industry groups. Firms and industry groups are required to propose their own regulatory standards so as to avoid harsher or direct state controls. If individual firms breach these 'private' or 'negotiated' regulatory standards, the state will then resort to legal action. The advantages from this approach are: (1) lower cost and less monitoring by the state; (2) more flexible and adaptive rules contingent on changing circumstances

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[3] Simpson, S. (2002) *Corporate Crime, Law, and Social Control*, Cambridge University Press, New York

[4] Baldwin, R., Scott, C. and Hood, C. (ed) (1998) *A Reader on Regulation*, Oxford University Press, New York

[5] Ayres, I. and Braithwaite, J. (1992) *Responsive Regulation; Transcending the Deregulation Debate*, Oxford University Press, New York

operationalised under the review of peer members in industry groups or the directors of a firm, and (3), since industry groups or individual firms share specific expertise and insights, effective monitoring will be better than if done by the state.

Managers' roles thus evolve beyond managing the affairs of a firm to including 'quasi-regulatory' obligations. These have to be institutionalised within the firm and thus a new breed of professionals, known as compliance officers, managers, and consultants, emerge in many business organizations, in new semi-professional roles that clearly go beyond the traditional bounds of general counsels and legal advisers. The effectiveness of their performance in this role will be measured by the design and implementation of the compliance programs for which they are responsible.

Many compliance systems are drafted along the lines of the 'Compliance Program: AS 3806-1988' developed by Standards Australia.[6] Regulators such as the Australian Securities and Investment Commission, Australian Competition and Consumer Commission, Australian Taxation Office, and many state agencies, have adopted this framework as a measure to be used for assessing how well firms comply with various corporate regulations.

Even though compliance type regulatory strategy is a top down monitoring structure, nurturing a compliance culture is expected to foster a better enforcement ethos amongst executives and employees. Fiona Haines (1997)[7] argues that compliance programs do not necessarily create a governmental culture at anything other than a superficial level, since it may be easier and cheaper to comply with the 'terms' stipulated in a selective manner, or use a 'blinkered' approach, rather than reform culture at every level of the organization. For instance, corporations might not rigorously enforce and police regulatory obligations where they concentrate most of their resources on creating profits for their shareholders: regulatory compliance may be somewhat lower in the list of priorities and not effectively scrutinized or subject to controls.

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[6] Standard Australia International (1998) *Australian Standard; Compliance programs*, AS 3806-1998

[7] Haines, F. (1997) *Corporate Regulation; Beyond 'Punish or Persuade'*, Clarendon Press, Oxford

The literature on this issue is largely confined to socio-legal perspectives. There appears to be a lack of research understanding and analysis from an organisation studies approach (see Clegg et al 2002)[8]. For example, the Australian Law Reform Commission depict compliance culture as a failure of corporate culture to endorse and encourage regulatory compliance, but stop short of explaining how compliance culture could be nurtured beyond mere processes and procedures.[9]

The definition and scope of corporate culture is hotly contested in the organisational literature. Edgar Schein (1997)[10] defines culture as the deep, basic assumptions and beliefs that are shared by organizational members. Culture is not displayed on the surface but is rather hidden and often unconscious. It represents the taken for granted way an organization perceives its environment and itself.

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[8] Clegg, S. R. Pitsis, T., Rura-Polley T., and Marosszeky, M. (2002) 'Governmentality Matters: Designing an Alliance Culture of Inter-organizational Collaboration for Managing Projects', *Organization Studies*, 23:3, 317-337.

[9] Australian Law Reform Commission , *Principled Regulation Report: Federal Civil & Administrative Penalties in Australia*, Report 95 (2002), pp 295-7

[10] Schein, E. (2002) 'Organizational Culture', pp. 196-205 in S. R. Clegg (Ed.), *Central Currents in Organization Studies II: Contemporary Trends, Volume 7*, London: Sage; originally published in *American Psychologist* (1990) 45: 109-119.

To get a better understanding of the different components of culture in organisations, Schein differentiates between three levels of culture.

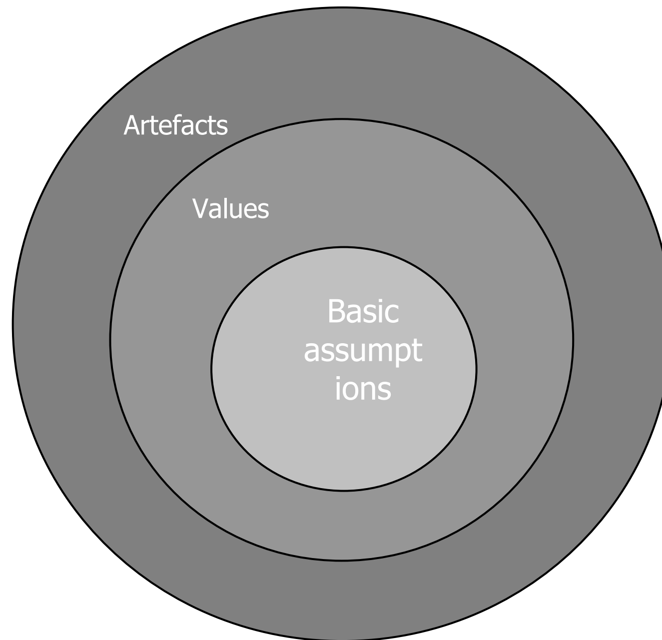


Figure 1 Schein's Three Levels of Culture; or, the Dartboard of Culture

The outer level of the figure represents the level of artefacts: this includes visible organisational features such as the physical structure of buildings, their architecture, uniforms, interior design and logos for instance. This level is easily observable, but does not reveal everything about an organisation's culture. Nonetheless, where the new semi-professions are physically located in relation to the corridors of power will be significant. The mid-level refers to values. They represent a non-visible facet of culture, as they express the norms and beliefs that employees express when they discuss organizational issues.

Mission statements or commitment to equal employment opportunities are part of this level. The deep culture is located at the inner level – where the

basic assumptions are hidden beneath artefacts and expressed values. This is the deepest and most important level, the bullseye in the dartboard of culture.

It includes the basic assumptions shaping the worldviews, beliefs and norms of organisational members, which guide their behaviour without being explicitly expressed. It is the most influential level, since it works surreptitiously and shapes decision-making processes almost invisibly. It is hard to observe, and even harder to change. Nonetheless it is the level that carries most potential for transformation. Hence, nurturing and promotion a culture of compliance requires more than a formal structure and process orientated system to be put in place.

Consideration Issue 7.2

Comment on any aspect of the discussion in this paper on the means by which statutes impose individual derivative liability including:

Have respondents encountered in practice any problems with disparate Commonwealth, State and Territory statutes that impose individual liability and provide for various defences?

If so, what have been the practical effects of these differences in approach, for instance, the impact on compliance programs?

These new proposals and methods of enforcing compliance of directors/officers underplay the effectiveness of s 79 of the *Corporations Act*. Section 79 has, to date, been very stable and has proven effective in pursuing directors and officers from wrongdoings in relation to corporations. The question to be considered here then, is, why change a provision that currently operates relatively effectively?

A further question that should be considered by CAMAC is whether the provisions should be changed before a demonstrated failure has occurred. Do the new provisions make the law clearer, or indeed more murky or confusing to enable both understanding and compliance? Would the current provisions provide a clearer path to understanding for officers and directors than the suggested provisions? What is clear in Australia today is that much time and money has been invested over the last decade to educate corporations and

directors and officers about their compliance responsibilities. To install new provisions would require further educatory programs, more disruption during the 'change over' period and indeed new confusions and stresses for those running corporations. Whether changes are necessary and the best course of action at the present time, is financially and based on corporate efficiencies a necessary and integral question to contemplate.

Is there any evidence to demonstrate that changes will protect shareholders any more effectively than in the existing law?

Consideration Issue 8.4

Comment upon any aspect of the discussion in this section on developing a derivative liability template including:

Are the criteria for assessing the alternate templates appropriate?

Should there be additional or different criteria?

The group proposes that a general template be included in the *Corporations Act* . The underlying purpose of the model is to make adherence to laws uniform between States and different forms of business enterprise. If a different model were to be introduced into each jurisdiction, the action of doing so will defeat the initial purpose of introducing the model.

If a model is proposed and chosen, this must be implemented into the *Corporations Act*, having the effect of making the model a uniformity across all jurisdictions. Without uniform implementation, the use of a model will be of limited use in order to encourage compliance as, states will continue to use their own methods to regulate.

Consideration Issue 9.8

Comment upon any aspect of the discussion in this section on developing a general derivative liability template, including:

Should the ALRC template be adopted, either as proposed by the Commission or with any of the following modifications, namely:

- *modify the categories of individuals liable by adding a specific reference to directors*
- *require the prosecution to prove that the individual knew that, or was reckless or negligent as to whether, the contravening conduct might (rather than 'would') occur*
- *impose an evidential onus on a defendant to provide admissible prima facie evidence of having taken one or more reasonable steps, which the prosecution would then have to negate beyond reasonable doubt*

Should the State and Territory representative template be adopted either:

- *as set out, or*
- *modified to impose only an evidential rather than a legal burden on the defence in relation to the defences?*

Should the alternative State template be adopted?

Should some other general derivative liability template be adopted

Should there be a business judgment rule defence?

If a new legislative template is introduced – whatever final form it takes – it should definitely be included in the *Corporations Act*, so that it applies in a uniform manner throughout Australia. If the template is merely "promoted as a model for each jurisdiction," and not included in the *Corporations Act*, then the

whole purpose of the reform will be nullified. The states will simply continue to adopt their own inconsistent frameworks.

Thus, with respect to the proposed templates, the Faculty proposes that the definition of those who will be liable should be consistent with the recommendations of extending the duty of care in the CAMAC discussion paper *'Corporate Duties Below Board Level'* (May 2005), i.e. those liable should include "directors, officers, or any other person who takes part, or is concerned, in the management of the corporation".

While we believe that the ALRC template is more practicable than the other proposed templates, the ALRC template would require some modifications. These would include:

(a) defining those who will face liability consistently with any revisions to s.180(1) of the *Corporations Act* (as noted above);

(b) making the test for knowledge, recklessness or negligence with respect to the breaching activity consistent with part 2.2 of the *Criminal Code*, in other words, more detailed and defined more carefully. In fact, there needs to be more consideration overall of the differing burdens of proof for civil and criminal liability;

(c) using "might occur" rather than "would occur"; and

(d) imposing an evidential burden on the defendant with respect to taking reasonable steps to prevent the contravening conduct (as it would be very difficult to prove that someone has not taken any steps)

The representative template goes too far in creating an absolute liability that infringes on the presumption of innocence. Since the typical offences being prosecuted will be at least quasi-criminal, one should not tilt the balance too far in favour of ASIC and against individual rights.

The alternative template creates a test that is extremely difficult for the prosecution to satisfy, for example, proving "knowledge" of the officer. It is also unclear what it means to "have regard to" the enumerated factors: are they

defences or not? Again, the quasi-criminal nature of a prosecution by ASIC makes it essential that the rights of defendants are set out very clearly in the statute.

Burdens of Proof:

The burden of proof used in these templates are a very important consideration. The ALRA template implements the element of '*mens rea*' into all offences of directors and officers. This in turn, places the evidentiary burden on the prosecution to prove that the director/ officer had the necessary mind set to commit the crime and additionally, protects the concept of the presumption of innocence. These factors are important for a variety of reasons:

- upholds the basic underlying principle of the Australian legal system of innocence until guilt is proven
- Avoids the introduction of 'strict liability' offences being implemented into the *Corporations Act*.

Consideration Issue 10.4

Comment upon any aspect of the discussion in this section on developing a responsible officer derivative liability template, including:

- *who should have what burden of proof in relation to reasonable steps ?*

- *should some other responsible officer derivative liability template be adopted?*

The responsible officer derivative liability template would lead to a highly undesirable situation where only one officer becomes liable for the wrongful behaviour of many corporate actors.

The responsible officer may also lack the power or authority to put in place compliance measures. If he or she raises a successful defence that all his/her attempts to put measures in place were rebuffed by the Board, does that mean

the Board cannot be held liable for obstruction? If other members of the Board can be held liable, then why have a responsible officer at all? If other members cannot be held liable, then wrongful behaviour could easily go unpunished. Finally, what are the "designated purposes" for which the responsible officer will be held liable? The template leaves this open

The template also leaves undefined the concept of what the "designated purposes" are for which a responsible officer will be held liable.

This directly relates back to the whole purpose of the reform proposal: is it just to unify the existing disparate state legislation, or is it meant to extend personal liability to directors/officers for *all* corporate fault? The scope of the legislation needs to be addressed more clearly before a clear idea of its potential benefits can be formed.

The Canadian Position

In Canada, there is no general personal liability provision for corporate breaches of statute. In his monograph *Canadian Criminal Law* (Carswell 1995), Don Stuart (at p.590) refers to automatic personal liability imposed on corporate officers as "bypassing fundamental principles of justice to scapegoat company executives. … The normal fault required for accessory liability is an intent to aid the commission of an offence. This should also be the standard for persons working in corporations. Apart from arguments of law enforcement expediency, it is difficult to justify special accessory rules for company executives and directors. In the case of directors, there would often be a vast difference between the culpability of a hands-on inside director and that of an outside director. A corporate executive should be punished on the basis of his or her own act and fault. Working for a company should not forfeit rights to be protected against unjust punishment."

However, Stuart also notes (with disapproval) that some individual Canadian federal and provincial statutes do in fact impose personal liability on officers and directors for offences by the corporation. One example is the Ontario Environmental Protection Act, R.S.O. 1990, c. E-19, s.194, which reads in part as follows [emphasis added]:

194. (1) **Every director or officer of a corporation has a duty to take all reasonable care to prevent the corporation from,**

(a) discharging or causing or permitting the discharge of a contaminant, in contravention of,

(i) this Act or the regulations, or

(ii) a certificate of approval, provisional certificate of approval, certificate of property use, licence or permit under this Act;

(b) failing to notify the Ministry of a discharge of a contaminant, in contravention of,

(i) this Act or the regulations, or

(ii) a certificate of approval, provisional certificate of approval, certificate of property use, licence or permit under this Act; …..

….

Offence

(2) **Every person who has a duty under subsection (1) and who fails to carry out that duty is guilty of an offence**. R.S.O. 1990, c. E.19, s. 194 (2).

The Canadian approach suggests that imposing a general personal liability on officers/directors for corporate fault would be too draconian, especially if it included criminal and quasi-criminal offences, due to the lack of proof of individual fault. However, restricting personal liability to a handful of offences in the area of environment, occupational safety and so on begs the question as to why there are double standards for different kinds of breaches. The group believes that these issues need to be discussed by CAMAC in more detail.

The American Position:

CAMAC has noted that the USA has developed a Responsible Corporate Officer doctrine (RCO). The discussion paper however, failed to note the criticism that surrounds this doctrine in the USA.

The RCO was first introduced in the USA in the Public Welfare Statutes in the 1940's in the case of *United States v Dotterweich* (1948) 320 US 277. In that case, Dorweich, the President and General Manager of a small pharmaceutical packaging company, had been convicted, along with his company, for misdemeanour violations of the *Federal Food, Drug and Cosmetic Act of 1938*. Dotterweich was held personally liable for violations of the Act even though there was no showing that he knew of or participated in the illegal activity. His mere position in the company made him liable.

Today the RCO in the USA is also applied in environment laws. This doctrine is being criticized by both academia and the legal profession. It was possible to apply the RCO in the Public and Welfare Statutes because the Acts are ones of strict liability. Accordingly there is no need to prove mens rea- just holding a board position is sufficient to attract liability. The principle when applied to the environment laws is more complex because the liability is not one of strict liability. As a result, there is an ongoing debate about the efficiency and the application of the RCO in the USA. Should a person be liable because of the position they hold or because they knew that the contravention was taking place. So do we require a present element of mens rea or not? Most of the cases in the USA that deal with RCO in relation to environment laws require that the prosecution proves that the person knew of the contravention. Accordingly the burden of proof is on the prosecution.

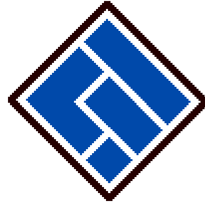
Conclusion:

CAMAC should be commended for commencing an important discussion on this topic of corporate fault liability and the supplementary discussion on liability below board level. However, as our submission indicates, there is a lot more to these issues than which is raised in the Discussion Paper. The existing law is not "failing" in a demonstratable way and these potential changes could cause greater uncertainty in this complex area. The work that is being conducted on corporate governance and corporate social responsibility also goes to the heart of the civil and criminal liabilities of corporations. CAMAC needs to take into careful consideration these many threads and not produce a "knee-jerk" reaction to some current corporate failures. The Corporate Law Group at the faculty of Law and the UTS Centre for Corporate Governance, both support the refinement and development of the concept of a culture of compliance, as found in the Commonwealth *Criminal Code* and as has been developed by the Australian Competition and Consumer Commission.

UTS Corporate Law Group, Faculty of Law.

10th August, 2005

Please email any comments/questions to Michael.Adams@uts.edu.au



AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

SUBMISSION TO

CORPORATIONS AND MARKETS ADVISORY COMMITTEE

PERSONAL LIABILITY FOR CORPORATE FAULT

Introduction

ASIC accepts that some of the variations in the drafting of derivative liability provisions can and should be eliminated. However, ASIC considers that some of these variations are a necessary result of the variations in the circumstances and seriousness of the behaviour they proscribe.

Therefore, ASIC suggests that a single model template of general derivative liability should not be recommended, but rather a range of templates should be put forward to accommodate the significant variation in the contexts in which such provisions are used.

An important consideration is whether any variation in the drafting of such provisions results in a difference to the practical approaches that are required in compliance. Technical variations in the drafting of provisions, while of significance in the context of a prosecution, might not necessarily require significant differences in the approach to compliance. If, in spite of differences in the wording of either the principal offence provision or any defence provisions, a prosecution of a derivative liability provision would generally be successfully defended by an officer of a company which has robust compliance systems and a culture of compliance, then technical variations in the legislation are of little practical concern. In the case of minor offences of a regulatory or administrative nature, it may not be appropriate to include an elaborate qualification or defence. .

Because ASIC does not currently administer any provisions that are full examples of the "responsible officer" model of derivative liability, we will comment only briefly on the proposed templates for such provisions.

General derivative liability templates put forward in the Discussion Paper

ASIC considers that it is not feasible to develop a single template for use in all cases where general derivative liability is to be imposed. Instead, ASIC considers that a range of templates would be more appropriate.

There is a wide range of circumstances where derivative liability is currently imposed in Australian legislation. This is clear even from the fairly limited number of examples of derivative criminal liability in the legislation that ASIC administers.

Derivative offences can be of a purely regulatory nature, such as the offence of failing to lodge a particular document, or they might be more substantive. They may impose a significant penalty or a more modest one. They may occur in situations where there are sound policy reasons for requiring all officers or directors to ensure that certain things do or do not occur or they may occur in situations where it is appropriate for responsibility to rest with a smaller number of executives who have control or influence in the area or with one person, such as the company secretary. Each of these variables may dictate a different approach in the drafting of relevant provisions.

In ASIC's view, instead of adopting a single template, it would be better to devise a range of templates to accommodate these situations. These templates would form drafting conventions for provisions across a wide range of legislation. ASIC sees no reason why the templates should be included in the *Corporations Act 2001* (Corporations Act).

Becausemost derivative offences arise from specific obligations on the part of companies and officers, it is unlikely that there would be many instances where it would be appropriate to have a defence based on the business judgment rule.

The Australian Law Reform Commission Template

A template of this nature might be appropriate where derivative liability is imposed for serious misconduct on behalf of the corporation and the penalty imposed on the liable person is substantial.

However, the template requires the prosecution to establish that a person *"was in a position to influence the conduct of a body corporate".* This would appear to be the case even with the proposed alternative formulation by CAMAC which suggests that there be a specific reference to *"directors"* in addition to the test of a person who is *"concerned, or takes part in the management of the corporation".* ASIC is concerned that placing this requirement on the prosecution might provide a mechanism for directors to escape responsibility inappropriately.

In ASIC's view, it should not be available to directors to attempt to argue, in circumstances where their formal role requires them to exert influence in a matter, that because of the corporate structure or because of particular informal or formal arrangements, they did not have the necessary influence. For example, there are some situations in which the law imposes a clear obligation on directors to prevent certain types of misconduct. The insolvent trading provisions in the Corporations Act are an example of this although they do not create derivative liability because there is no primary liability on the company. In cases of this nature, it would be inconsistent with the underlying policy of requiring all directors to take active responsibility for the matter, if the prosecution was required to prove that the director was in a position to influence the conduct of the body corporate in relation to the contravening conduct or if the director were able to escape responsibility by arguing that they did not in fact have such influence.

Additionally, this template is clearly not appropriate for circumstances where derivative liability is imposed for breaches of regulatory offences and the penalty is not substantial. An example of this type of offence is s 188 of the Corporations Act which has a penalty of 5 penalty units (ie $550). The burden that this template places upon the prosecution to establish difficult and complex matters is not appropriate for these types of offences which often currently impose strict liability. The application of Chapter 2 of the Criminal Code to the template in Commonwealth statutes would require proof of intention in relation to the failure to take all reasonable steps and the template itself requires proof of knowledge or recklessness as to whether the contravening conduct would occur. Intentional failure is generally a difficult matter for the prosecution to establish.

In the case of such regulatory offences, it would also be more appropriate for the issue of whether reasonable steps were taken to be dealt with by way of a defence.

Further, in the case of many minor offences concerned with administrative matters, such as s 188 of the Corporations Act, it will often be more appropriate to place liability on one person, such as a director or secretary rather than dividing responsibility among a range of persons according to the functional tests set out in the template. These offence provisions would stand in contrast to more serious offences where such functional tests are particularly appropriate

ASIC agrees with CAMAC's suggestion that the formulation of the mental element be changed so that it is sufficient for the prosecution to prove that the individual knew or was reckless as to whether the contravention *might* occur.

ASIC also agrees that it might be appropriate to place an evidential burden on the defendant to establish what reasonable steps were taken.

State and Territory Representative Template

It is assumed that liability under this template is intended to be strict. If this is the case, it will need to be expressly stated in Commonwealth statutes in order to prevent the inclusion of fault elements under Chapter 2 of the Criminal Code. If this is done, a template of this nature will be generally appropriate in many situations; but might be less appropriate in circumstances where the potential penalties imposed upon the individual are high.

As noted above, it will not always be appropriate for the question of whether the person was, as a matter of fact, in a position to influence the relevant conduct to be a factor in liability. This will still be the case in some circumstances where, as here, this is a defence rather than an element of the offence. It is also unclear whether there is much practical difference between "exercising all due diligence to prevent the relevant conduct" and "taking all reasonable steps to prevent the relevant conduct" and whether it is necessary to include both defences.

Again, in some circumstances, it may be appropriate for liability to be simply placed on a person who occupies a certain position such as "director" or "secretary".

ASIC considers that there should be a legal burden upon the defendant to establish the applicability of the defences as such matters would be peculiarly within the defendant's knowledge.

Alternative State Template

Again, it is not clear how the template is intended to interact with Chapter 2 of the Criminal Code. Unless there is some express provision to the contrary when this template appears in Commonwealth legislation, the prosecution would probably have to establish that the officer's failure to take reasonable care was intentional.

If this were the case, then, this template would arguably not be suitable for circumstances where the offence was a 'regulatory' one and the penalty were relatively small.

While it is said that there is no legal burden on either the prosecution or the defendant with respect to the factors for determining guilt, in reality, the onus will be on the prosecution to establish a failure to take reasonable care by reference to these factors. In order to secure a conviction, the prosecution would presumably have to establish that a consideration of these factors led to the overwhelming conclusion that the individual should be convicted. ASIC considers that this is a fairly unusual form of drafting for a provision imposing criminal liability and might create some uncertainty until its construction has been settled by the courts.

Responsible Officer derivative liability template put forward in the Discussion Paper

The Discussion Paper indicates that the template is intended to impose a legal burden on the defendant to establish a defence of taking all reasonable steps. In fact, it is not clear

if the template achieves that aim. The part of the template that establishes liability comprises two sentences.

> *A responsible officer must take reasonable steps to ensure compliance by the corporation with its obligations under the Act [in relation to those designated purposes]. A responsible officer is liable for non-compliance unless that person proves that he or she took all reasonable steps.*

These sentences really perform the same function and one of them would probably suffice. The second sentence does impose a legal burden on the defendant to establish that reasonable steps were taken but the first sentence appears to establish an offence of failure to take reasonable steps. It is likely that a court would find the use of both sentences confusing.

15 August 2005

Our Ref: JM:LW

Direct Line: 9926 0256

17 August 2005

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Mr Kluver

Re: Personal Liability for Corporate Fault

I refer to the Corporations and Markets Advisory Committee (CAMAC) Discussion Paper, dated 5 May 2005, entitled "Personal Liability for Corporate Fault".

The Discussion Paper has been reviewed by the Law Society's Business Law Committee (Committee) and the Law Society welcomes the opportunity of making a submission on this important issue.

Set out below are certain issues raised by the Committee. The matter has not been considered by the Council of the Society and the views expressed are those of the Committee alone.

The Committee believes that the CAMAC Discussion Paper represents an excellent beginning to implementing serious reform on this issue. The Committee sees the introduction of rational and coherent legislation as fundamental to achieving fair outcomes for all stakeholders.

This submission makes comments regarding individual derivative liability for corporate misconduct. No attempt is made to deal with individual accessorial liability or with personal liability under the *Corporations Act*.

The Committee believes that individual accessorial liability (ie criminal liability that arises from an intentional and knowing participation in a breach of the law) is better dealt with under the existing legislative regimes.

The Committee understands that liability issues under the *Corporations Act* are the subject of a separate CAMAC paper.

Overview

The Committee believes that most directors and managers are committed to protecting employees, consumers and the environment from potential harm from business activities. While personal liability may act as an impetus for complying with relevant legislation, there is a danger that misguided zeal on the part of some regulators may result in reluctance for responsible individuals to become involved in proactive management of risk – particularly where the individual concerned has assets which may be at risk where a pecuniary penalty is involved.

The Committee shares the obvious concern of Senator the Hon Ian Campbell that "potential liability would result in a disincentive for persons to accept or continue to hold directorships or engage in entrepreneurial but responsible risk-taking."

While the Committee is not aware of any empirical data which would support a claim that derivative liability for individuals has made board and managerial service less attractive, Committee members have noticed an increasing (and perhaps unwarranted) concern with possible criminal prosecutions among their clients.

The Committee suggests that comment should be sought from the Australian Institute of Company Directors or other representative body on this aspect of the Discussion Paper.

Same Actions – Different Tests

Section 6 of the Discussion Paper identifies potential targets for individual derivative liability in different jurisdictions. The tables in sections 6.4.1 and 6.4.2 of the Discussion Paper highlight the lack of consistency between various states in the imposition of such liability and the defences available to prosecution.

Take for example the case of a possible breach of occupational health and safety legislation in New South Wales and Western Australia. In New South Wales the potential target for individual prosecution is defined in s.26 of the *Occupational Health and Safety Ac*t 2000:

> "…each director of the corporation, and each person concerned in the management of the corporation, is taken to have contravened the same provision unless the director or person satisfies the court that:
>
> (a) he or she was not in a position to influence the conduct of the corporation in relation to its contravention of the provision, or
>
> (b) he or she, being in such a position, used all due diligence to prevent the contravention by the corporation."

In Western Australia s.55(1) of the *Occupational Safety and Health Act* 1984 specifies

> "Where a body corporate is guilty of an offence under this Act and it is proved that the offence occurred with the consent or connivance of, or was attributable to any neglect on the part of, any director, manager, secretary or other officer of the body, or any person who was purporting to act in any such capacity he or she, as well as the body corporate, is guilty of that offence."

No specific defences appear to be enumerated under the Western Australian *Act.*

This comparison demonstrates a lack of parity between relevant legislation – in this case deemed positional/managerial liability in New South Wales compared to fault-based positional liability in Western Australia. The lack of specific defences in Western Australia is of concern.

The Problem of Different Tests

Differing legislation is a fact of life in a federation. However, given the ever increasing scale of cross-jurisdictional business (interstate and international), there is a need for consistent and rational rules governing individual derivative liability for corporate actions.

This is even more the case where the derivative liability appears related to the reckless or negligent acts or omissions of individuals.

The question of whether a person is negligent (or reckless) is, in the absence of statutory modification, a question to be determined according to the common law. In *Kable v Director of Public Prosecution* (1996) 189 CLR 51 McHugh J stated at 112:

> "Unlike the United States of America where there is a common law for each State, Australia has a unified common law which applies in each State but is not itself the creature of any State."

In *Lipohar v The Queen* (1999) 200 CLR 485 the Court was asked to deal with a question relating to a conspiracy to defraud in relation to premises in Melbourne – a common law offence in South Australia where the prosecution was launched. A question was raised as to whether an indictable offence had occurred under South Australian law. In dealing with the question of whether the offences were specific to a particular law area, Gaudron, Gummow and Hayne JJ noted:

> "Different intermediate appellate courts within that [judicial] hierarchy may give inconsistent rulings upon questions of common law." (at 507)

Later the Justices noted:

> "…inevitably there will be times where intermediate appellate courts do not speak with one voice on particular issues." (at 507)

The High Court has made plain that there is but one common law in Australia. But directors and managers of corporations cannot rely on the High Court setting right erroneous views of state courts on the proper application of the common law – especially where the court is faced with a criminal charge based on applications of the common law.

Differences in state legislation regarding individual derivative liability create uncertainty and unease for business and individuals. Rather than leaving the High Court to determine whether or not an offence based on "negligence" or "recklessness" or a defence based on "due diligence" or "reasonable steps" is made out, the Society suggests that the Standing Committee of Attorneys-General (SCAG) be asked to form a working group to report on and progress proposals to codify the basis for prosecutions of individuals for corporate fault and the defences that might be available to such charges.

Individual Liability – some general comments

The Commitee acknowledges that the expectations of the broader community are such that a *Tesco* based test in determining individual derivative liability is not appropriate. However, some form of coherent and easily applied cross-jurisdiction test is necessary.

Derivative liability should only be possible where the position and power of the relevant individual allows that person to have a significant impact on the normal operations of a company. "Positional" liability should not be the test – a person may be described by a particular job title but that is not always an accurate reflection of the role and responsibilities within an organisation.

Where criminal liability may be imposed (particularly when penal sanction is possible), the Committee believes that the prosecuting authority must bear the onus of proving all elements of the offence beyond reasonable doubt. There should be no "deeming" provisions which render the individual automatically liable in the case of a corporate contravention.

Any prosecuting authority must be bound by the prosecution guidelines relevant in the particular jurisdiction (eg the *Standards of Professional Responsibility and Statement of the Essential Duties and Rights of Prosecutors* promulgated by the International Association of Prosecutors which has been adopted by the New South Wales Director of Public Prosecutions).

Derivative Liability Template

The Committee believes the Australian Law Reform Commission (ALRC) template with certain modifications merits further close examination.

Using the ARLC template as its starting point, the Committee believes an effective system for individual liability could be provided as follows:

> "Where a corporation contravenes relevant legislation, the prosecution must prove the following physical and fault elements in any derivative liability action against an individual:
>
> - The individual was concerned, or took part, in the management of the corporation at the time of the contravening conduct;
> - The individual was in a position to determine the conduct of the body corporate in relation to the contravening conduct; and
> - The individual knew that, or was reckless or negligent as to whether, the contravening conduct would occur."

The relevant standard of proof for the elements described above will depend on the nature of the claim made against the individual. A criminal charge should require proof beyond reasonable doubt. A civil claim should require proof on the balance of probabilities although the Committee would advocate a *Briginshaw* approach to determining whether the standard has been met.

In the event that the prosecution succeeds in proving the elements of the charge as formulated above, the individual should have available the following defences:

"Where any contravening conduct committed by a body corporate is attributable to an individual, that person will not be liable if the person proves that he or she:

- Exercised all due diligence to prevent the contravening conduct; or
- Took all reasonable steps to prevent the contravening conduct."

The onus of proving the elements which might amount to a defence obviously lies with the individual upon a civil standard.

Responsible Officer Derivative Liability Template

Section 10 of the Discussion Paper proposes a form of template which would "impose a specific statutory duty on one or more individuals within a corporation to act, or supervise the conduct of others, to ensure that the corporation complies with its statutory responsibilities."

The Committee strongly opposes the introduction of any such template.

The Committee believes that "targeting" an individual in this fashion is unfair. It will create unnecessary pressure on one person and perhaps lead other managers who have the ability to influence corporate behaviour having a false sense of security. It is difficult to imagine any person agreeing to become the responsible officer when faced with potential liability in circumstances where he or she may have no effective control (as opposed to responsibility) for workplace behaviour.

Take, for example, a deemed offence under New South Wales occupational health and safety legislation. The nomination of a responsible officer and an incident which breaches the *Act* will automatically lead to a regulator focussing attention on the responsible officer – possibly ignoring the root cause of the incident. Unless and until the responsible officer could prove the affirmative defences, he or she may be subject to criminal liability even though the incident may have been the result of pure misadventure.

Further Submission

The Committee is keen to contribute to further discussion on these issues and looks forward to working with CAMAC and/or SCAG in developing a sensible and coherent response to the issues raised in the Discussion Paper.

If any further information is required in relation to this submission please contact Laraine Walker, Executive Member of the Business Law Committee by telephone on (02) 9926 0256 or email to lxw@lawsocnsw.asn.au .

Yours sincerely,

John McIntyre
President

Australian Shareholders' Association Ltd
ABN 40 000 625 669

12 August 2005

Mr John Kluver
Executive Director
Corporate and Markets Advisory Committee
GPO Box 3967
Sydney NSW 2001

By email: john.kluver@camac.gov.au

Dear Mr Kluver

ASA submission: Personal Liability for Corporate Fault

We attach our submission on the Corporations and Markets Advisory Committee Discussion Paper, Personal Liability for Corporate Fault. In summary the ASA supports a personal liability for corporate fault regime which enhances the ease with which directors fully appreciate their legal responsibilities in performing their corporate function and penalties faced for any breach. The ASA strongly supports development of a standardised approach across each Australian jurisdiction.

Shareholders are owners of the company and any residual value. Therefore removal of inefficiencies and prevention of breaches, including any consequent imposition of fines, enhances long term shareholder value.

Yours sincerely

Stuart Wilson
Chief Executive Officer

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Australian Shareholders' Association Ltd

AUSTRALIAN SHAREHOLDERS' ASSOCIATION

Personal Liability for Corporate Fault
Corporations and Markets Advisory Committee Discussion Paper

ASA position

The Australian Shareholders' Association policy statement *Shareholders expect* sets out shareholders' expectation of companies, directors and management as in the following excerpt:

ASA Policy Statement
Shareholders expect

2. Purpose of companies, and related management issues
2.1 Compliance with laws, regulations and guidelines
Shareholders expect companies to comply with all laws relating to companies (in particular, the Corporations Act and Regulations), general laws and regulations, specific laws and regulations affecting the operations of particular industries, accounting standards, and the ASX Listing Rules. Shareholders also expect companies to comply with the spirit of the principles of good governance established by the ASX Corporate Governance Council.

2.2 Behaviour of company managers and directors
Shareholders expect the directors and executives of companies to act responsibly and ethically.

2.3 Financial performance is a primary goal
Subject to the foregoing level of compliance and behaviour, shareholders expect companies to use the resources entrusted to them to generate value for shareholders by maximising cash flows and profits over a time horizon appropriate to the primary activities of each company. This economic function should be their primary purpose.

2.4 Directors
Directors are elected by shareholders to oversee the management of companies in the interest of the company itself and its stakeholders. Shareholders, as the ultimate owners of the company and its primary stakeholders, expect directors to be accountable to them for the performance of this role.

ASA Comment

In relation to the issues raised in this discussion paper the ASA supports a regime which:

- enhances the ease with which directors and officers fully appreciate their legal responsibilities in performing their corporate function and the penalties faced for any breach.
- facilitates corporations setting policies and practices in place to ensure corporate compliance that are efficient and cost effective;
- does not add a disincentive for appropriately qualified and capable individuals from taking corporate roles.

Uniformity across state boundaries will enhance corporate efforts to prevent breaches. Further standardisation will also enhance the ability of shareholders to assess the efforts of directors and officers with regard to compliance.

In summary the ASA supports a liability regime that encourages individuals connected with corporations to endeavour to ensure they comply with regulatory standards and other requirements. A regime that penalises directors and officers for events outside their control is seen as a disincentive for competent directors to put themselves at risk.

Ideally a board and its members will be confident (through appropriate diligence) that systems are in place to ensure obligations are met and breaches avoided. Clear guidance should be available to the directors as to what is considered to represent appropriate diligence. Avoiding liability through inactivity or unwillingness to 'rock the boat' should not be available.

The ASX Corporate Governance Principles cover risk at Principle 7 *Recognise and mange risk.* The principle follows: Establish a sound system of risk oversight and management and internal control. The system should be designed to:

- identify, assess, monitor and manage risk
- inform investors of material changes to the company's risk profile.

A sound system of risk oversight and management and internal control which identifies, assesses, monitors and manages risk should provide an adequate defence in the area of derivative liability.

The ASA is concerned that a harsh derivative liability regime may act as a disincentive for competent directors to join companies that are currently operating in a risky fashion – precluding remediation efforts. Criminal sanctions for breaches outside a directors' control with the director bearing the onus of proving lack of guilt is likely to prevent new directors joining a risky company board, and contributing to improvement.

Reversal of the onus of proof makes the law more complex for the investor who needs some appreciation of the law in order to make and manage investment decisions. Adequate defences need to be simple and clear set director, shareholder and community expectations.

We take issue with the comment on page 16 of the discussion paper regarding the limitations of monetary penalty: "corporations may, in effect, be able to pass on the cost of any penalties imposed on them to others, such as through reduced dividends to shareholders …." Shareholders are the owners of the corporation. Any surplus funds retained by the corporation are generally owned by the shareholders whether or not they are paid out in dividends. Shareholders would prefer their companies have an appropriate system of risk management in place which avoids breaches and consequent penalties (both natural and imposed).

VACC Comments

in response to the release of the

Corporations and Markets Advisory Committee
Personal Liability for Corporate Fault

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12 August 2005

Introduction

The Victorian Automobile Chamber of Commerce is an employer organisation which represents more than 5000 Victorian and Tasmanian members operating in the retail motor industry. The retail motor industry consists mostly of small businesses with less than ten employees. VACC membership is divided into fifteen divisions that cover a diverse range of sectors within the retail motor industry including; towing services, automobile repairs and panel beating, specialist repairers, motor cycles, commercial vehicles, tyres, parts recycling, new car dealerships, used car dealers, service stations, component manufacturing, and farm machinery dealers.

The retail motor industry is a significant part of the small business community in Australia, accounting for at least 5.9% of the small business sector, and provider of at least 8.7% of employment. Essentially, the majority of employing businesses are those that join the Association.

In Victoria, VACC members make up the majority of employing businesses within the automotive industry across the state. In Victoria, the industry employs 50,000 people located in around 9,800 sites comprising 7,619 ABN registered businesses (2001). The industry's total retail sales in the State amounted to $7.5 billion and generated $11 billion in total income in 1999.

In Victoria, 63.53% of VACC membership are incorporated with 36.47% being either sole proprietors and partnership operations. In Tasmania, 50.75% of VACC's membership is incorporated with 49.25% of members operating as sole proprietors and in partnership arrangements. VACC members incorporate for a number of reasons but invariably a majority of the members incorporate to seek the protection that a corporate entity provides. It must be noted that any potential or perceived disincentive of incorporation will invariably impact on VACC members choices.

VACC as the representative body of employers engaged in the retail motor industry has an interest in the Review of directors' duties. This written submission is by no means a complete response to the Discussion Paper prepared by the Corporations and Markets Advisory Committee (CAMAC) on Personal Liability for Corporate Fault released on 5 May 2005.

The CAMAC Discussion Paper (the Paper) reviews the circumstances in which directors and corporate managers may be criminally liable for corporate misconduct merely by reason of their formal position or function in a company and without the need to establish their own personal misconduct. The Paper invites comment on the need to go beyond corporate and accessorial liability to impose derivative liability on individuals on the basis of the position they hold in the company.

It must be stated from the outset that VACC considers that any proposed changes should create civil duties, rather than criminal offences. Penalties should be monetary, judicially determined and based on the seriousness of offences and the circumstances of the breach. Enforcement requires a mix between education and persuasion on the one hand and, in serious or repeated cases, prosecution and penalties on the other.

ISSUES FOR CONSIDERATION:
Reference 2.6
Distinction between direct and derivative liability.

VACC considers the potential for officers of corporations to be subjected to direct liability to be a significant disincentive to them taking on management roles and leads to a total focus on compliance issues and processes.

The Paper cites a number of examples in existing legislation of the approaches currently taken both within and between the Commonwealth, State and Territory jurisdictions for imposing individual derivative liability. Broadly, the derivative liability provisions reviewed used one of four approaches to determine whether an individual may be held criminally liable as a result of a contravention by a corporation, namely, whether the individual:

- held formal positions within the corporation (positional liability);
- was concerned with, or involved in the management of, the corporation (managerial liability);
- had operational or organisational responsibility for the contravening conduct (responsible officer liability); or

- promoted, authorised or acquiesced in a contravention by the corporation (participatory liability).

These examples clearly illustrate the lack of uniformity found within current legislation and VACC supports the development of a legislative template which would promote compliance, consistency, reduce compliance costs and assist corporate decision makers to understand what is fully expected of them.

As with implementation of any legislative changes, VACC would envisage a need for comprehensive educational and training programs, in order to promote the establishment of a pro-active culture.

Rationale for Derivative Liability
Reference 3.4

VACC considers that monetary fines, if significantly substantial, do act as a strong incentive for corporations to ensure that they comply with their regulatory obligations. The fines do not only act as a deterrent for the corporation which has committed the breach but, as a result of the publicity attracted, can act as a deterrent for other corporations/businesses. Additionally, directors are held accountable by their shareholders for breaches that occur, therefore potentially subjecting their own livelihood to harm.

VACC considers that Corporate liability is sufficient in the vast majority of circumstances, with the exception of those circumstances where individuals have acted in a reckless or culpable manner. Individuals should not be held liable if they took reasonable care (i.e. to do what a reasonable person would do in the circumstances) to ensure that the breach did not occur. VACC considers that an individual liability template should provide a general incentive for officers of organisations to take appropriate steps to ensure compliance.

VACC endorses the importance that at least some individuals in key positions within a corporation should or ought to inform themselves to ensure the prevention or to help forestall any misconduct by their corporation. However, VACC recognises that a balance must be achieved between the individual rights of directors and other

individuals as compared with the public interest of ensuring corporations are duly accountable for corporate misconduct. Hence, any increase in the prospective liability of corporate directors and managers must be carefully assessed especially when it relates to criminal sanctions and penalties.

VACC considers that the constant raising of the bar and imposition of further personal liability will not only deter applicants to positions of authority within an organisation, but also poses the potential of discouraging incorporation of bodies within Australia due to a perception, that the possibility of criminal action being levelled at an individual, is perceived to be greater than the financial rewards of the position.

Implications of the Current Law
Reference 7.2

The Commonwealth, State and Territory environmental, occupational health and safety, hazardous goods and fair trading statutes contain a range of particular fault elements that may attach to a corporation or to various individuals of a body corporate. This in turn requires various defences to be established by that particular corporation, or individual, in order to negate the differing fault elements.

A comparison between Tasmanian and Victorian Occupation Health and Safety legislation shows there is significant differences between the OHS Acts, in that Victoria's Act contains Officer liability provisions, which require Officers to 'take reasonable care', whereas Tasmania's Act requires Employers to appoint a Responsible Officer.

Whilst it would not be unreasonable to expect that the different approaches would lead to some practical effects, the reality is, that there have been so few prosecutions against officers in Victoria or responsible officers in Tasmania to provide any real evidence of these effects.

Developing a Derivative Liability Template
Reference 8.4

VACC does not oppose tougher penalties being applied to persons who hold a complete disregard for any corporate breach.

However, VACC acknowledges that directors and/or managers are not always aware of every aspect of the day to day operations of their corporations. Hence, the VACC supports the stance that there is a need when developing a template to ensure directors and/or other managers should be accorded with fairness.

VACC suggests that to ensure directors and/or other managers are accorded with fairness, defences provided in any proposed template need to contain a number of elements to be proven. Due to the gravity of criminal liability it is argued that this stance must be maintained to establish that an individual holds the requisite mens rea for such an offence.

VACC considers that there should be no absolute or strict liabilities, deemed guilt or reverse onus of proof in any civil or criminal proceedings, nor any other basis on which employers, directors, management personnel or employees are treated less favourably than the defendants in prosecutions under any other equivalent law. Persons charged with offences should be accorded natural justice and, in criminal cases the standard presumptions such as beyond reasonable doubt should apply.

Alternative General Derivative Liability Template
Reference 9.8

In order to address the inconsistency in individual derivative liability, the Discussion Paper is of the view that there should be one standard legislative template for imposing such a liability. Of the three template examples provided, VACC supports, albeit to a limited extent, the approach proposed by the Australian Law Reform Commission, whereby if a corporation has contravened a statutory requirement, in order to subject an individual associated with that corporation to personal liability under a derivative liability provision, the prosecution would need to establish beyond a reasonable doubt that the individual:

- is concerned or takes part in the management of the corporation;

- was in a position to influence the corporation's conduct in relation to the relevant conduct;

- knew, or was reckless or negligent as to whether the contravening conduct would occur; and

- failed to take reasonable steps to prevent that conduct.

Coupled with these provisions, VACC recommends that the word “might” should not be substituted for the word “would”. To remove the word “would” may lead to prosecutions where an individual does not hold the necessary element of ‘mens rea’ that is required for most criminal prosecutions.

Responsible Officer Derivative Liability Template
Reference 10.4

The Discussion Paper proposes that an individual derivative liability template should be based upon the concept of “responsible officer” liability. This would ensure that where it is appropriate to identify one or more persons as being responsible for certain conduct, the particular legislation will provide that:

- a corporation must appoint an individual within the corporation to be a responsible officer for that conduct or, alternatively, each director will be deemed to be a responsible officer; and

- a responsible officer is liable for the corporation's non-compliance with that conduct unless they can prove all reasonable steps were taken to ensure compliance.

VACC supports the concept of making persons accountable for breaches where that person or persons have or had the ability to prevent or mitigate a breach of legislation. However, VACC cannot support the concept of the establishment of a nominated ‘Responsible Officer’ with liability attaching only to that position, and not necessarily to any fault attributable to that individual. Further, with respect to holding individuals liable for criminal offences that are committed by someone else, including

a corporate body, the presumption of innocence takes on particular importance no matter which system of attributing liability is used.

VACC acknowledges that the appointment of a “Responsible Officer” may be an over simplistic view to merely correlate the culpability of certain individuals with the culpability of the corporation. However, it is asserted that such a stance undermines the complex nature of the corporate decision-making process and the diffusion of responsibility within corporations. Such a proposal could lead to reluctance by persons to assume senior management positions within an organisation, for fear of incurring liability for an event for which they could have had no control over.

As indicated supra, VACC is not in a position to support the instigation of reverse onus provisions. Not withstanding, the burden of proof upon the prosecution should not be diluted and should always remain as beyond reasonable doubt. Hence, the template that ought to be adopted, is one where the evidential burden rests solely with the prosecution to prove as charged.

nsw
young LAWYERS
A Fresh Perspective

19 August 2005

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Mr Kluver,

RE: CAMAC Discussion Paper: Personal liability for corporate fault

The NSW Business Law Committee ("Committee") comprises young lawyers either under the age of 36 or in their first 5 years of practice and law students, all of whom have a keen interest in Business Law.

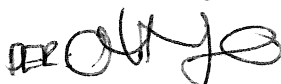
The Committee congratulates the Corporations and Markets Advisory Committee ('CAMAC') on its Discussion Paper addressing the complex issue of personal liability for corporate fault and would like to thank CAMAC for the opportunity to make this submission.

The Committee is delighted to make a submission in relation to CAMAC's Discussion Paper, and notes that the Committee confines its comments to those issues for consideration raised in Parts 3 'Rationale for derivative liability' and 9 'Alternative general derivative liability templates'.

The Committee submits the notion of derivative liability is open to challenge and would prefer to see greater efforts made to address the more complex problem of corporate liability for corporate fault. In the alternative, however, the Committee acknowledges the widespread and disparate approach to derivative liability taken across Australia and welcomes the adoption of a federal template for general liability aimed at clarifying the law relating to personal liability for corporate fault. The Committee takes the view that such a template would promote certainty and consistency in the regulation of business, increase access to the law and, ultimately, reduce costs to business.

The Business Law Committee of NSW Young Lawyers thanks CAMAC for considering this submission, which was compiled with the assistance of Committee members Duncan Brakell, Robyne Cottee and Jeremy Green. Duncan, Robyne, Jeremy or I would be very willing to discuss this submission should CAMAC see fit.

Yours sincerely,



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The Business Law Committee of NSW Young Lawyers ('the Committee') makes the following submission in relation to the Discussion Paper:

3.0 Rationale for derivative liability

The discussion paper posits, 'is it necessary to go beyond direct corporate liability to derivative personal liability'? That is, the key issue is whether, by virtue of the relationship between a corporation and its senior personnel, liability ought to be apportioned personally to those individuals for the criminal behaviour of the corporation.

In the Committee's view, the notion of derivative liability is open to strong challenge. Having adequately punished the corporation for its criminal behaviour, in the absence of a causal nexus between the individual and the behaviour of the corporation, is it necessary also to punish the individuals purely because of their relationship with the corporation? After all, assuming the interests of justice have been served by appropriately punishing the corporation, what is it that is sought as an outcome?

An introduction to the principle

At common law, the criminal liability of a corporation is ordinarily determined by reference to its officers or senior managers (however defined). This relationship was explained in the leading English case of *Tesco Supermarkets Ltd v Nattrass*,[1] where Lord Reid was at pains to emphasise that a corporation cannot possess knowledge or intention of its own, rather the directing mind and will of the corporation is to be found in the minds of its most senior personnel.

By contrast, 'derivative liability' is a creature of statute. It adheres not to the reasoned and principled approach of the common law; indeed, in many ways, it seeks to reverse the common law principles of criminality and burden of proof. Unlike accessorial liability, derivative liability does not attach itself to an individual because of that person's involvement in another's commission of an offence. Rather, derivative liability presumes or deems an individual to be guilty of an offence committed by another because of the relationship between the two. One might suggest 'presumptive' or 'deemed' liability is more accurate and appropriate nomenclature for derivative liability.

In the context of corporate criminality, derivative liability involves individuals (generally, directors or senior managers (however defined)) being presumptively liable for the criminal actions of the corporations with which they are associated. That is, typically, where the corporation is found guilty of a criminal act, *ipso facto*, the directors are guilty unless the directors can make out a defence. Thus, such an approach disregards one of the first general principles of criminal law – the requirement for the prosecuting authority to prove both *mens rea* and *actus reus*.

In this way, as only statute law can, derivative liability reverses both the presumption of innocence and the burden of proof in corporate criminal matters. Derivative liability sits uncomfortably with Article 14(2) of the *International Covenant on Civil and Political Rights,* to which Australia is a party and which demands that 'everyone charged with a criminal offence shall have the right to be presumed innocent until proved guilty according to law'. When viewed at this fundamental level, it is unsurprising Professor Fisse has described this statutory development of derivative liability as 'sweeping and radically unprincipled'.[2] The Committee shares Professor Fisse's views.

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[1] [1972] AC 153.
[2] Brent Fisse, 'Recent Developments in Corporate Criminal Law and Corporate Liability to Monetary Penalties', (1990) 13 University of New South Wales Law Journal 1, 5.

Example of statutory derivative liability

As the Discussion Paper outlines, derivative liability is evident in various forms in many Australian statutes. Section 26 of the *Occupational Health and Safety Act 2000* (NSW) provides a typical example:

> (1) If a corporation contravenes, whether by act or omission, any provision of this Act or the regulations, each director of the corporation, and each person concerned in the management of the corporation, is taken to have contravened the same provision unless the director or person satisfies the court that:
>
> (a) he or she was not in a position to influence the conduct of the corporation in relation to its contravention of the provision, or
>
> (b) he or she, being in such a position, used all due diligence to prevent the contravention by the corporation.

The above provision displays all the hallmarks of derivative liability. Having established that the corporation has contravened the law, the prosecution need do no more to establish the guilt of a director in relation to the same offence. Thus, the law *presumes* the director guilty. The onus is on the director to prove one of the two defences in paragraphs (a) or (b).

Personal liability for corporate fault

The Committee does not contest the argument that a director's duty of care and diligence is a fundamental, irreducible requirement of participation in the management of the company.[3] Where a director is negligent in the performance of its duties, there can be no doubt that direct liability for this negligence should arise. Further, if the corporation is found to have contravened the law, whether civilly or criminally, and this contravention was, in whole or in part, brought about by a director neglecting the duties it owes to the corporation, personal liability for that neglect of duty should be apportioned to the director.

Similarly, it is an inescapable and undeniable truism that corporations must be punished for their criminal behaviour. The more difficult question, to which derivative liability provides a blunt answer, is how appropriately to punish corporations. The Committee submits it is this question that first must be answered before advancing to the secondary issue of imposing that liability on others.

If the purpose of punishing a corporation is to rehabilitate and to deter, then it is necessary to have an understanding of the way in which corporations are likely to react to punishment, be it through monetary fines, corporate sanctions, or enforceable undertakings, to establish new internal practices. Likewise, one must be sure that derivatively imposing liability on individuals for the malfeasance of a corporation will have the desired effect on the particular individual, individuals more widely and the corporation as a whole. Will automatically punishing a director for the criminal behaviour of the corporation on whose board the director serves deter or prevent the corporation from repeat offending? Or are individuals within an organisation expendable, such that the organisation will do away with those punished individuals and continue on its way, unhindered? Even a rudimentary understanding of organisational behaviour would suggest that many corporate misdemeanours come down not to the direct responsibility of one director or manager, but to processes or culture within the organisation.[4]

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[3] *Deputy Commissioner of Taxation v Clarke* [2003] NSWCA 91; (2003) 57 NSWLR 113; Demetra Arsalidou, 'To be Active of Inactive: Is this a "New" Question for Company Directors?' (2003) 17 *Deakin Law Review* 1, 1 <http://www.austlii.edu.au> at 3 August 2005.

[4] Furthermore, it also needs to be recognised that a corporation may develop an internal sociology of its own, which impacts upon the behaviour of individual personnel: Jonathan Clough, 'Sentencing the Corporate Offender: The Neglected Dimension of

As Professor Fisse and Dr Braithwaite have explained:

> Another factor which tends to limit the deterrent efficacy of individual criminal liability for corporate crime is the expendability of individuals within organisations. It is a truism that bureaucracies have greater staying power than their human functionaries; as Kenneth Boulding put it, the corporation 'marches on its elephantine way almost indifferent to its succession of riders'. The risk thus arises of rogue corporations exploiting their capacity to toss off a succession of individual riders and, if necessary, indemnify them in some way. The continuing relevance of the risk of personnel expendability is evident from the reported reaction of Sir Jeffrey Stirling, Chairman of Peninsular and Oriental Steam Navigation Company, to the Zeebrugge ferry disaster: 'Responsibility lies squarely with those on board who had professional responsibility to ensure that the ship sailed safely.' This assignment of responsibility contrasts starkly with the finding of an official inquiry that the management of the ferry company, Thomson Thoresen (a subsidiary of P & O) had been at fault in failing to ensure adequate standard operating procedures on board the ferry: 'All concerned in the management, from the members of the Board of Directors down to the junior superintendents, were guilty of fault in that all must be regarded as sharing responsibility for the failure of management. From top to bottom the body corporate was infected with the disease of sloppiness.' In such a case, corporate liability provides a multi-spectrum antidote which proceedings against employees would not necessarily achieve.[5]

One of the limitations of the attribution doctrine is that it oversimplifies the structures of larger corporations and fails to take adequate account of their complex and interconnected processes, where corporate decisions and operations are often the result of the conduct of a number of individuals at different levels of management.[6] Therefore, accountability for corporate wrongdoing must reflect modern corporate governance frameworks and decision-making, which is often the product of corporate policies and procedures rather than individual decisions.[7]

Importantly, the doctrine of derivative liability fails to reflect the separate concepts of individual and corporate blameworthiness.[8] That is, the fact that a corporation may be blameworthy does not necessarily mean that the individual director is blameworthy in respect of the same offence. The Committee supports the approach adopted in the *Criminal Code Act 1995* (Cth), which conceptualises the corporation as a discrete and unique entity which can have a 'moral personhood' independent of its individual members, and which can be criminally culpable in its own right.

A key example is death in the workplace. There is no question that death in the workplace is a significant issue in New South Wales, where a total of 2,209 work-related deaths occurred between 1987 and 2000. In cases such as these, the prosecution of culpable individuals within an organisation can be a very effective way of punishing and deterring corporate crime. From the perspective of these individuals, the prospect of a criminal conviction, especially one that leads to imprisonment, such as under subsections 32A(5) and (6) of the *Occupational Health and Safety Act 2000* (NSW), may have a greater deterrent effect than a

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Corporate Criminal Liability (2002) <http://www.lawbookco.com.au/academic/Corporate_Misconduct_ezine/pdf> at 27 July 2005.

[5] Brent Fisse and John Braithwaite, 'The Allocation of Responsibility for Corporate Crime: Individualism, Collectivism and Accountability' (1988) 11 *Sydney Law Review* 468, 496–97 (footnotes omitted).

[6] J Gobert, 'Corporate Criminality: Four Models of Fault' (1994) 14 *Legal Studies* 393, 400.

[7] The Committee appreciates that the study of organisational behaviour is not an exact science and it would be impractical, if not impossible, to identify precisely which model of accountability should be applied to particular conduct engaged in by a particular corporation.

[8] Karen Wheelwright, 'Corporate Liability for Workplace Deaths and Injuries – Reflecting on Victoria's Laws in the Light of the Esso Longford Explosion' (2002) 16 *Deakin Law Review* 1, 11 <http://www.austlii.edu.au> at 8 August 2005.

sanction imposed on the company.[9] However, in the context of derivative liability (as opposed to direct personal liability) the Committee takes the view the public interest for accountability must be balanced against the rights of individuals not to be exposed to criminal penalties, where they could not reasonably have influenced or prevented such conduct from occuring.

The Committee submits it is necessary for governments to consider how best to punish corporations, rather than simply rely on statutory removal of fundamental common law rights of individuals. It is the Committee's view that derivative liability provides a simple, blunt, inadequate and ineffective response that satisfies the need for public accountability but ignores and fails to answer the more complex question of appropriate corporate sanctions. Further, as the Discussion Paper highlights, directors and corporate officers may be 'unduly exposed to personal liability, including criminal sanctions', and that 'undue reliance on derivative liability may make board service less attractive'.

The Committee supports a regime of personal liability for personal fault. If the corporation contravenes the law, the corporation should be punished. If the corporation contravenes the law and a director or other senior manager is involved (in the manner defined in s 79 of the *Corporations Act 2001* (Cth)), personal liability for that involvement should attach to the director or senior manager. Similarly, if the corporation contravenes the law and this involves a director in a personal breach of the law or a duty owed to the corporation, action against the director ought to be taken. However, the Committee cannot support a regime that apportions to individuals criminal liability for the actions of corporations, solely by virtue of the individual's position within the corporation.

The Committee encourages CAMAC to consider in its further proposals alternatives to derivative liability for corporate fault. For example, the importance of promoting a robust culture of compliance and the development of risk management programs within and at the expense of the corporation. If we are, as a business community, to further examine individual fault attribution as an alternative to corporate liability, there must be scope to consider mechanisms for tailoring pecuniary penalties relative to the offence committed or profit gained therefrom or the size of the offending corporation.[10]

9.0 Alternative general derivative liability templates

Broad support for a general legislative template for derivative liability

The importance of certainty and consistency in the regulation of business in Australia cannot be underestimated. It is important both for business and for achieving the government's policy objectives. The Committee firmly believes business, as a whole, will comply with and embrace a legislative and regulatory framework that can be readily understood. In recent years, both the federal and state governments have evinced an appreciation of the need for consistency in corporate regulation in ensuring the continued operation of a federal system of corporate law and regulation. Similarly, the federal government's recent reforms of financial services and markets regulation were based, in part if not in whole, on the need for uniformity.

The Discussion Paper highlights the disparate approach to derivative liability taken across Australia. It is the Committee's view that it is undesirable, both from a business and regulatory perspective, for a person operating across jurisdictions in Australia to have to turn to multiple statutes in order to answer what that person regards as a relatively simple, yet important, question — when will I be liable? What is more, under the current legislative

[9] A Cowan, 'Scarlet Letters for Corporations? Punishment by Publicity Under the New Sentencing Guidelines' (1992) 65 *Southern California Law Review* 2387, 2393.
[10] The Committee understands that this is representative of the approach in place under Canadian law, but acknowledges that consideration of penalty regimes is out of scope in this Discussion Paper.

approach to derivative liability, the answer that person would receive would be a most unsatisfactory 'it depends…'.

While differences in legislative approach are an inherent corollary of Australia's constitutional structure, in the Committee's view, where the opportunity exists to eliminate inconsistency and uncertainty in business law, it should be taken.

The Committee supports any legislative initiative that would serve to remove unnecessary complexity in the law (in a manner that does not reduce its effectiveness or ability to achieve the policy underpinning it) and, in so doing, improve access to the law and reduce costs for business. It is the Committee's view that a general legislative template for derivative liability, adopted at a federal, rather than state, level is an appropriate and desirable method for promoting consistency, certainty, understanding and compliance with the law and reducing costs to business.

Adoption of the Australian Law Reform Commission (ALRC) template

The Committee considers the ALRC template to be the most attractive of the options presented in the Discussion Paper and would support the development of a modified version of such a legislative template for inclusion within the *Corporations Act 2001* (Cth) (the Corporations Act).

Modification of the ALRC template

Individuals to whom derivative liability attaches

The Committee considers the ALRC template could be improved by modifying the category of individuals to whom derivative liability would attach either by adding an express reference to 'directors' or defining the category solely as applying to 'officers' (as defined in section 9 of the Corporations Act).

'Might' or 'would'

In respect of the third limb of the ALRC template, which requires the prosecution to prove the individual knew, or was reckless or negligent as to whether, the contravening conduct *would* occur, the Committee takes the view that a more reasonable test would be whether the individual knew, etc., the contravening conduct *might* occur. Use of the word *would* may be read as implying absolute certainty of foresight; although the Committee acknowledges that the courts have not always interpreted *would* in this way (see, for example, the explanation of the words *may*, *might*, and *would* in *F v National Crime Authority* (1998) 154 ALR 471). However, if *would* is to be adopted and interpreted as requiring absolute certainty, in many cases, this would present an insurmountable obstacle of proof for the prosecution and the simplest of arguments in defence (namely, that the defendant lacked absolute certainty, even if a high degree of probability existed).

A similar, but inverse, argument could be made in respect of the word *might*. Namely, that, in the presence of all other elements, derivative liability would attach if the defendant knew that there was even the vaguest of suggestions of the occurrence of the contravening conduct. The Committee acknowledges such an interpretation is undesirable.

The Committee submits the choice of word used in this context is important and warrants careful examination. The preferable outcome, from the Committee's point of view, is for derivative liability to attach in circumstances where the prosecution is able to prove the individual knew, or was reckless or negligent as to whether, the contravening conduct was more likely than not to occur. That is, the question should be one of probability, not possibility or absolute certainty.

Reasonable steps – adjusting the onus

The Committee supports removing the need for the prosecution to prove the defendant failed to take all reasonable steps to prevent the contravening conduct. The Committee agrees such a requirement may set the bar unnecessarily high for the prosecution by, arguably, requiring the prosecution to negate beyond reasonable doubt every possible reasonable step the defendant could have taken in the circumstances.

The Committee would prefer the question of whether reasonable steps were taken to prevent the contravening conduct to be addressed evidentially by the defendant. That is, the defendant should be required to provide admissible prima facie evidence of having taken one or more reasonable steps, which the prosecution would then have to negate beyond reasonable doubt. Such a defence should be an absolute defence.

An additional benefit of such an approach would be, effectively, to impose a positive obligation on individuals to ensure reasonable steps are taken. This obligation is more likely to lead to a reduction of the contravening conduct, which is the aim of the legislation.

A 'Business Judgment Rule' Defence

The Committee does not support the adoption of a Business Judgment Rule defence for criminal matters. The Committee takes the view such a defence would permit individuals to avoid criminal liability on the grounds that it was in the economic interests of the corporation to disregard a statutory obligation. Such an outcome is entirely unacceptable.

CAMAC - Personal Liability for Corporate Fault – Discussion Paper

SUBMISSION BY THE ACCOUNTING BODIES

The discussion paper ('DP') considers the circumstances in which directors or other responsible corporate officers may be personally liable for corporate misconduct because of the positions or functions they have within the organisation.

The DP seeks to review legislation under which this derivative liability is imposed (Commonwealth, State and Territory legislation other than the Corporations Act ('CA')) and proposes model provisions that may balance the legislation's public interest goals with the rights of individuals who may be affected. The key issue that it addresses is the disincentive issue. It asks; "what are the circumstances in which an individual may incur penalties (as a result of criminal liability) in consequence of corporate fault"?

Concerns have been raised about legislation that imposes derivative liability on company officers by reason of their formal position in the corporation, rather than their actual acts or omissions. The paper asks if derivative liability is to apply, to whom should it apply? The USA Responsible Corporate Officer ('RCO') defence that an RCO is 'powerless' to prevent or correct the violation is examined.

2.6 The discussion in section 2 on direct and derivative liability is adequately set out in the summary.

Due to differing State, Territory and Commonwealth regulatory laws there are marked differences not only between the liabilities flowing from private sector responsibilities to government business enterprises ('GBEs'), but also between the various pieces of legislation.

The Advisory Committee paper rightly draws attention to the lack of uniformity across Commonwealth, State and Territory derivative liability provisions. The Accounting Bodies agree that there is a need for a uniform process to ensure regulatory efficiency and fairness to individuals occurs consistently across all jurisdictions. The Advisory Committee's paper suggests development and application of a legislative template for imposing derivative liability. Whilst this may have wide application it would only be useful if it was applied consistently by the Commonwealth, States and Territories to all relevant legislation. This may present real practical difficulties; e.g. the sheer task involved, the inability to resolve differences, etc.

The DP suggests application of such a legislative template may promote compliance and reduce compliance costs. It is not clear from the proposals how this would result nor what process would enable the development and application of such a template.

3.4 The DP seeks comment on the circumstances in which it may be necessary, as a matter of public policy, to go beyond accessorial liability and impose individual derivative liability. The discussion paper does not take into account the derivative liability provisions of the CA. The Accounting Bodies, however, suggest that under the CA there are remedies for director's non-compliance with their statutory

responsibilities. Under Part 2F 1A of the CA (providing leave has been granted by the court), a person may apply to the court to bring a derivative action. Whilst the court needs to be satisfied that all normal company procedures have failed to achieve the justice sought, the provisions are ones of last resort and provide the action for derivative liability. The ability to bring a derivative action is not confined to shareholders[1].

It is the Accounting Bodies' firmly held view that there are adequate provisions in the current legislation to enable a derivative liability action in the CA. Those provisions, combined with the more direct accessorial liability, provide the appropriate coverage for incorporated bodies.

GBEs, on the other hand, do not fall within the ambit of the CA and, therefore, the legislation under which each is established may benefit from across-the-board legislation along the lines of CA Part 2F 1A having application.

Section 6 deals with the general principles dealing with potential derivative liability. The legislation is consistent in attributing personal liability to directors and those concerned in management of the corporation. The apparent lack of concession for dissenting directors is of concern to the Accounting Bodies, particularly where there is strict liability, i.e. no defences of reasonable or diligent exercise of powers is taken into account.

State and Territory legislation clearly exposes liability to classes of persons not necessarily involved in management (or, arguably, senior management) of a company[2]. The Accounting Bodies are concerned that with the heavy burden of derivative liability, there should also be a strict and consistent requirement under the various pieces of legislation for proper, ongoing training as to an individual's obligations under the relevant legislation.

The Accounting Bodies are also concerned at the statement at paragraph 6.4.2 of the discussion paper, that '… an individual is presumed to be guilty unless he or she establishes a defence'. Appendix 7 sets out defences to persons subject to derivative liability under State and Territory legislation. It states that the defences impose a legal burden on a defendant to prove the defence on the balance of probabilities. Although Cowley[3] notes 'From our research, … there has recently been a trend, which is more a matter of public policy than anything else, for our legislators to provide that, when a company breaches an Act of Parliament, the directors should automatically and *ipso facto* be liable as well, mostly with the opportunity to make out a defence, but with the onus being on the director to do so. This reverses the situation which had previously been applied where generally a director would only be liable if he or she had aided and abetted or been involved in or authorised or failed to exercise due diligence to prevent the commission of an offence. In each of those cases, the legislation required those prosecuting the offence to make their case out against the director.' The Accounting Bodies believe that the general legal requirement to prove the 'guilt' of a party nevertheless precedes the requirement of an individual to <u>then</u> (only after the offence is proven) establish a defence.

[1] Swansson v Pratt (2002) 20 ACLC 1, 594 @ 1,600 per Palmer J
[2] See table in 6.4.1
[3] 'Developments affecting the personal liability of Directors', 24 Oct 2003, Bruce Cowley @ p4

7.2 The paper asks ‘have respondents encountered in practice any problems with disparate Commonwealth, state and territory statutes that impose individual liability and provide for various defences, and, is so, what have been the practical effects in approach on, for instance, the impact on compliance programmes?

8.4 As previously discussed, the Accounting Bodies support the concept of a legislative template that harmonises the approaches taken to individual liability and defences in the various jurisdictions. The overall criteria of practicality and fairness, suitability and enforceability appear appropriate, but the Accounting Bodies have concerns that templates developed on these lines will be able to apply to all incorporated bodies as well as GBEs.

Rather than the establishment of defences under the template as a ‘responsive’ mechanism, the Accounting Bodies suggest that the suitability requirement deal with the suitability of the proving of the offence and impose, proactively, the requirement for all entities to develop compliance systems.

Along with the development of a legislative template, it may also be worth considering whether a single regulatory body should have responsibility for the processes under the template, given the diversity of the Commonwealth, State and Territory legislation.

9.8 It is proposed that one of three possible alternative templates be adopted. Within the ALRC template the discussion paper suggests alternatives that could apply. The Accounting Bodies do not support any of the alternatives proposed in the ALRC template because: (i) the first two are unnecessary in that they are covered by the common law, and (ii) the third would potentially have the effect of overriding the common law. The Accounting Bodies strongly support the common law proposition that the offences must be proved beyond reasonable doubt.

10.4 The representative template is reasonable in that it provides a broad range of defences for an individual involved in management of a corporation, if a corporation is proved to have contravened relevant legislation. What cannot be determined is whether this ‘representative template’ would be appropriate for all Commonwealth, State and Territory legislation for all incorporated entities and GBEs.

The alternative state template is opposed by the Accounting Bodies because it; (i) seems to impose strict liability on an individual and a presumption of guilt; and (ii) it provides minimal defences.

The ‘business judgement rule’ is defined in section 180(3) CA to mean ‘any decision to take or not take action in respect of a matter relevant to the business operations of a corporation’. Whilst it does not, by definition, operate under other laws, the Accounting Bodies do not agree that it relates only to the economic interests of a corporation. By their very nature, business operations encompass economic consideration as well as all statutory obligations and external matters that touch on the business of the corporation, for example, environmental, health and safety, etc.

The Accounting Bodies support inclusion of a 'business judgement' type defence in the template. This is to ensure that a director or other person concerned in management properly discharges his or her obligations under the various pieces of relevant legislation, rather than to provide a 'safe habour' where that person neglects to make a business judgement or makes a judgement that is not in good faith or for a proper purpose. Inclusion of this type of defence would also need to be extended to specifically relate to criminal as well as civil liability.

In principle, the Accounting Bodies support the devolution of immediate responsibility to a 'responsible officer'. In practice the plethora of relevant legislation[4] and the obligations thereunder, would need to be properly and continually identified and vigilant compliance procedures established and monitored. Directors and managers within incorporated bodies and GBEs are appointed to those senior positions because they are considered to have the expertise and experience (and are remunerated accordingly) to have accountability for compliance, among other things.

It would be of concern if a 'responsible officer' was appointed who was not in management ranks because that person would be unable to influence processes. The nature of such an appointment would need to be clear and the person would have to have adequate power and authority to be able to impose compliance and bear responsibility for breaches. Again, the Accounting Bodies would only support such a template on the basis that prosecution of any alleged offence required proof beyond reasonable doubt.

The Accounting Bodies consider it would be preferable to include any 'responsible officer' template within a general derivative liability template. In any event, the standard needs to align with the Commonwealth Criminal Code's requirements of negligence or recklessness to satisfy a criminal offence.

[4] Nearly 300 pieces of legislation across 11 jurisdictions – Bruce Cowley, 24 October 2003 in 'Developments affecting the personal liability of directors'.

Submission to Companies and Markets Advisory Committee

Dr David Morrison[1]
Dr Colin Anderson[2]

1. The discussion paper raises an important broad issue that is fundamental to the nature of the corporation. The issue is to what extent directors may be held liable for the wrongdoings of a corporation that they manage. We will discuss this first, then deal with the templates offered and make some concluding remarks as to the Business Judgment Rule.
2. We acknowledge that this Discussion Paper calls for one aspect of director liability, namely that of derivative liability for company committed wrongs. However, it is our view that such laws need to fit within an overall framework of director liability, and preferably one that sits within the *Corporations Act*. Whilst this might seem hopeful given the federal nature of the legal framework within Australia, we think that there are already substantial constraints upon company directors where they or their advisors are forced to have reference to many acts of parliament, State and Commonwealth, in order to determine their various obligations. Therefore whilst we do not necessarily support the liability imposed under these other acts of Parliament, we think that the director liability for company wrongs ought to be contained within the *Corporations Act* rather than contained in a variety of other acts of Parliament.
3. Furthermore, we note the inconsistency that currently exists between the statutes that impose the various obligations upon companies and their directors as outlined in the Discussion Paper at Chapter 6 and express our preference for the ALRC template as outlined at paragraph 9.2.
4. By way of preliminary comment, it is our view that statutes imposing liability on citizens need to be clear as to meaning and that those statutes in fact are enforced. If the legislature takes the view that it is appropriate for a liability to be imposed, then it seems imperative that a person whose behaviour is caught by the relevant provisions by committing a wrong doing is able to be effectively prosecuted. Such legislative amendments would be greatly improved, in our view, if they prevent such a person escaping punishment merely because there was an incorporated entity interposed themselves and the conduct.
5. There is a great difficulty however with striking an appropriate balance between these objectives and the encouragement of appropriate entrepreneurial risk-taking activity. As the Discussion Paper rightly recognises, there may well be an increased disincentive for persons to accept or continue to hold directorships in the face increasing obligations and increasing potential liability. The nature of some business activity is such,

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[2] Department of Law, University of Southern Queensland, Toowoomba.

that no one individual or small group of individuals should bear the entire risk of such potential liability.

6. It is also the case that directors are unlikely to be able to diversify the risks that they carry in the same way as shareholders or creditors might diversify. Accordingly making directors liable for more situations may cause other untoward impacts. First is the possibility that there might be an inappropriate rise in the remuneration demanded by directors and another is that directors may fail to have companies enter into projects that are in fact beneficial.
7. How much risk directors and other senior officers should bear is at the heart of the dilemma. It must be recognised that directors and other senior officers as a group of individuals are likely to be relatively inefficient bearers of risk associated with commercial activities.
8. It also seems likely to be the case that where onerous obligations are imposed, whilst one impact might be a reluctance on the part of directors to hold positions, another might be that risk-taking activity is then borne by government in any event, for example by way of providing incentives or exemptions from liability. The absence of hard data and indeed models that might map director incentives and government behaviour make it impossible to know just how much regulation the market can bear and just how much it costs for private exemptions to be made. The difficulty with exemptions of any kind is that they defeat the purpose of the regulation in the first place.
9. It is our view that the ALRC template provides the best balance between the need to impose appropriate liability and the desire to allow sufficient incentive for commercial activities to be undertaken in the corporate form.
10. In relation to the other templates, we are of the view that the State and Territory Representative Template as discussed in Part 9.3 clearly shifts the balance of proof to the director or other person concerned. This of itself imposes an inappropriate burden on an accused being required to prove their innocence thus going against the innocent until proven guilty principle, fundamental to the Australian legal system. The alternative State template discussed in Part 9.4 appears to be somewhat vague on the issue of who has the burden to prove whether the director or other person concerned took reasonable care.
11. In relation to the ALRC template it takes into account the physical and fault elements that ought to be the basis of any conviction. It importantly recognises the need for the individual to be in a position to influence conduct. This is an important consideration because imposing a liability in these situations is akin to a criminal responsibility and fundamental concerns of justice require that a person not be convicted where they could not alter the activity to ensure it does not breach the legislation.
12. It is also our view that the notion of a responsible officer needs to be carefully considered since making a person responsible for an outcome may be a means for others to avoid their responsibility. It is however our view that the idea is not completely without merit because it is up to someone ultimately, to have responsibility for the actions of the company. It may be difficult to accept that the determination of who is responsible is a matter left solely for the company

to decide. Even if a responsible officer is appointed, will this preclude others within the company from being held liable?

13. We also feel that there are associated issues with respect who within the company should be held liable. The notion of directors' duties now seems to apply to directors so appointed, or so acting, and also to a more limited extent, senior officers in certain respects. It is our view that the level of responsibility that these measures extend to is part of a wider concern about directors' liability for the totality of the company's operation.
14. We believe that the ALRC model ought to apply to any person in a position of responsibility in the company, whether or not that person is a director or an officer as within the terms of the *Corporations Act*. Because we are considering criminal or quasi-criminal actions and responsibilities for those actions, they ought not to be limited in application to persons holding a particular position.
15. As regards the business judgment rule, we agree with the Discussion Paper at paragraph 9.7 that it is inappropriate to apply the rule in such circumstances. If the ALRC template was to be adopted this negates, in our view, the need for a business judgment rule with respect to this type of liability.

Thank you for giving us the opportunity to present our views.

David Morrison and Colin Anderson

14 September 2005

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
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Dear Mr Kluver,

Submission in relation to "Personal Liability for corporate fault - Discussion Paper - May 2005" ('Paper')

INTRODUCTION

Promina Group is a leading group of trans-Tasman insurance and financial services companies. Promina Group Limited, the ultimate holding company, is listed on the ASX and the New Zealand stock exchanges.

In accordance with the invitation for public consultation, we set out below our comments on the proposals.

COMMENTS

1. Accessorial Liability

The Paper posits a threshold question of how to apportion responsibility for the misconduct of a corporation, between the corporation and the individuals who make up or control that corporation.

Our primary submission is that accessorial liability for individuals should apply and should satisfy the public policy reasons for attributing liability to individuals in a corporation as well as the corporation itself.

Accessorial liability as defined in the Paper, is applicable to an individual who intentionally and knowingly participates in the wrongdoing. Sometimes accessorial liability is imposed through statute. However, general common law principles also apply.

We are of the view that the concept of accessorial liability is well-established and flexible and that this substantially reduces, if not negates the need for any derivative liability model.

2. Derivative Liability Model

On the assumption that accessorial liability is not deemed to be only model for making individuals liable under the various Commonwealth, State and Territory legislation, we make the following comments on the derivative liability model on the basis that our primary submission is not accepted.

In our view, the Australian Law Reform Commission ('ALRC') template is the best basis for a derivative liability template of the four templates in the Paper. The ALRC template provides that:

> Where a corporation contravenes relevant legislation, the prosecution must prove the following physical and fault elements in any derivative liability action against an individual:
>
> 1. The individual, by whatever name called and whether or not the individual is an officer of the corporation, is concerned, or takes part, in the management of the corporation; [An alternative formulation would be to add a specific reference to directors]
>
> 2. The individual was in a position to influence the conduct of the body corporate in relation to the contravening conduct;
>
> 3. The individual knew that, or was reckless or negligent as to whether the contravening conduct would occur; [An alternative formulation would be to substitute the word 'might' for 'would'] and
>
> 4. The individual failed to take all reasonable steps to prevent the contravening conduct. [An alternative formulation would be to impose an evidential onus on the defendant in this regard.]

We support the ALRC template on the following basis:

- It puts the legal burden on the prosecution to prove beyond reasonable doubt each of the physical and fault elements. This criminal burden of proof is in contrast, for example to the State and Territory derivative liability template, which places the onus on the defendant.

- The fault elements require an individual to be in a position actually to influence the contravening conduct. This is consistent with the idea that if a person is responsible for conduct, they should also be in a position to be able to control or influence that conduct.

We would recommend the following changes to the ALRC template:

- In element 1, the definition of individual currently includes any person who is concerned in or takes part in the management of the organisation. Our view is that the responsibility of an individual for liability for corporate fault should only apply to an officer of that organisation as defined in section 9 of the Corporations Act 2001.

- In element 2 we do not accept the alternative formulation that an individual is responsible contravening conduct which 'might' occur. In the absence of any test, the word 'might' is too vague.

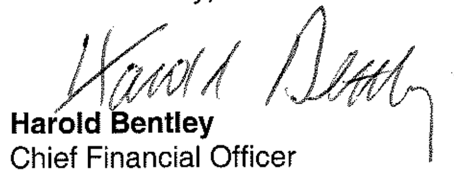
- The template should also include defences for the individual concerned.

3. Other comments

As a group of companies which operates in all states and territories of Australia, the Promina Group is subject to a plethora of legislation. Subject to our primary submission, Promina would support a template which harmonises the tests across all jurisdictions for derivative liability on directors and other corporate officers.

Thank you for considering our submission. Please do not hesitate to contact me if you have any questions about our comments above.

Yours sincerely,



Harold Bentley
Chief Financial Officer

Business
Council of
Australia

Submission to the Corporations and Markets Advisory Committee

on the Discussion Paper

Personal Liability for Corporate Fault

September 2005

Introduction

The Business Council of Australia (**BCA**) appreciates the opportunity to make this submission to the Corporations and Markets Advisory Committee (**CAMAC**) on its Discussion Paper, *Personal Liability for Corporate Fault*, May 2005.

The BCA is an association of chief executives of leading Australian corporations with a combined national work force of almost one million people. It was established in 1983 to provide a forum for Australian business leadership to contribute directly to public policy debates in order to build a better and more prosperous Australian society.

This submission covers two basic areas. First, the submission urges CAMAC to examine the appropriateness of the proliferation of derivative liability in State and Commonwealth legislation. This should be a threshold issue that is examined before consideration is given to the harmonisation of current laws. Secondly, in those limited circumstances where derivative liability is appropriate, the BCA supports harmonisation of those laws.

Derivative Liability

The CAMAC Discussion Paper notes that legislation

> "*may impose liability on individuals arising from a corporate breach either for their own conduct, including as accessories, in connection with that breach (direct liability) or by virtue of their relationship with the corporation, for instance, the position they hold or the function they perform in that corporation (derivative liability)*"[1].

The focus of the BCA's submission is on derivative liability.

The BCA believes that derivative liability should only be imposed in the most exceptional circumstances. The essence of derivative liability is the reversal of the fundamental legal principle that an individual is innocent of an offence unless proven guilty. Under derivative liability, an individual can be deemed to be guilty of an offence by virtue of their position within an organisation. It is then incumbent on the individual to prove a defence (usually set out in the legislation). The CAMAC Discussion Paper provides an example in relation to the Victorian Government's previously proposed *Crimes (Workplace Deaths and Serious Injuries) Bill 2001*[2].

The BCA is concerned that there is a growing tendency for Governments, particularly those at the State and Territory level, to introduce derivative liability. Such provisions typically hold "*each Director of the corporation, and each person concerned in the management of the corporation*" liable for contraventions by the corporation[3]. It is of particular concern to the BCA that individuals can be found to be criminally liable through derivative liability. This can create a situation where a private individual inflicting serious harm or death through their own direct

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1 Corporate and Markets Advisory Committee, *Personal Liability for Corporate Fault*, Discussion Paper, May 2005, p 9.

2 Ibid, p 10.

3 See *Occupational Health and Safety Act 2000* (NSW) s 26; *Environment Protection Act 1970* (Vic) s 66B; *Dangerous Goods (Transport) Act 1998* (WA) s 40(5) for examples of this or similar terminology.

actions has greater legal rights than an individual who is a Director or senior executive of a national corporation where an employee is seriously harmed or killed. In the former case, the private individual is taken to be innocent until proven guilty beyond reasonable doubt. In the latter case, derivative liability means the Director or senior executive is deemed to be guilty unless they can prove themselves innocent through successfully mounting a defence.

Rationale for Derivative Liability

The Discussion Paper suggests five rationales for imposing liability on individuals, not just corporations, where a convention of the law has occurred, namely:

- *limitation on monetary penalties*, particular where corporations can absorb or pass on the costs of financial penalties;
- *personal fault*, where individuals with a corporation have particular duties or responsibilities;
- *social sanctions*, where the community expects individuals to be held to account for their actions;
- *specific incentive*, where the imposition of individual liability is seen as an incentive for the individuals to ensure future compliance with legislation; and
- *general incentive*, where the risk of imposition of individual liability is seen as an incentive for individuals to ensure compliance by the corporation with legislation.

The BCA appreciates the merits of these rationales and does not support a view that, as a matter of principle, individuals within a corporation should be shielded from liability for their actions. The BCA believes strongly, however, that each of these rationales can be fully satisfied through accessorial (direct) liability. The BCA argues that there should be a direct relationship between the actions or omissions of an individual and their liability for the consequences of those actions or omissions. The BCA also argues that the nature of the penalty for an individual should be in proportion to the degree of their direct involvement or responsibility for the offence.

None of the rationales above justify imposing derivative liability over direct liability. In other words, each of these rationales could be satisfied through properly constructed direct liability provisions, such as the example, of s 79 of the *Corporations Act 2001*, given in the Discussion Paper[4].

The Discussion Paper goes on to pose the question[5]:

> "*Does the fact that individuals connected with corporations may be subject to accessorial liability, either under particular legislation or by application of general criminal law principles, negate or substantially reduce the need for derivative liability?*"

4 pp 16 – 17.
5 p 17.

In the view of the BCA, the answer is emphatically yes.

The Discussion Paper sets out a further possible argument from going beyond accessorial liability, namely that accessorial liability may be an insufficient incentive for individuals within a corporation to take their responsibilities seriously. The Paper suggests, for example, that non-performing Directors could escape accessorial liability by claiming that, while they had acted negligently or recklessly, they were not aware of the circumstances leading to the corporate offence, and were therefore not liable[6]. It seems difficult to the BCA to construct a scenario where, if the Directors were close to the actions or omissions that led to the offence, their 'negligence' or 'recklessness' would not amount to 'willful blindness' and therefore fall within the scope of accessorial liability[7]. If the Directors were not sufficiently close to the action or omission, it seems very likely that another individual, such as a company executive or manager, is more likely to be responsible for the action or omission and is likely to fall within the scope of accessorial liability.

Given that the rationales set out above for derivative liability can be equally satisfied through direct liability, the BCA questions the true rationale for Governments introducing derivative liability. The fundamental difference between derivative liability and direct liability is critical to this question, namely that derivative liability reverses the onus of proof.

The BCA suggests that there are, in fact, two fundamental reasons why Governments introduce derivative liability, regardless of the rationales advanced by Government:

- *Prosecutorial Expediency* – by reversing the onus of proof, derivative liability also reverses the burden of conducting a case; that is, the burden falls on the Directors and employees of the corporation rather than on the prosecuting authorities; and

- *Political Expediency* – derivative liability allows Governments to be seen to be taking a 'tough' stand against offences in certain areas, particularly where these offences carry strong emotional triggers for the community (hence the predominance of derivative liability in areas such as occupational health and safety, hazardous goods, consumer protection and environmental laws).

The BCA argues strongly that neither of these reasons is sufficient to overturn the fundamental principle that an individual is innocent of an offence unless proven guilty, particularly in relational to criminal offences.

Summary

The Business Council of Australia believes that, as a first step, the Corporate and Markets Advisory Committee should challenge the proliferation of derivative liability clauses and recommend Governments replace such clauses with appropriate direct liability provisions.

6 Ibid.
7 See *Giorgianni v R* (1985) 156 CLR 473 at 487-488, as cited in the Discussion Paper at p 17.

Harmonisation

The BCA supports the need to harmonise laws across Australia's multiple jurisdictions.

One of the greatest frustrations for business is dealing with multiple layers of regulation. Most businesses have to deal with regulations imposed by Local, State and Commonwealth Governments. There is typically little coordination between these levels of Government, resulting in unnecessary compliance costs for business. There are also many areas where responsibility for regulation is shared between a number of different jurisdictions. This often results in different laws in different jurisdictions, despite each jurisdiction having the same policy objectives. The increase in compliance costs, particularly for national firms, can be considerable, even though there is no additional benefit from having a multitude of different regulations (see Box below). A classic example of this problem occurs in occupational health and safety regulation, where each State has a different regime to achieve the same outcome.

These concerns are relevant to the consideration by CAMAC of the need to harmonise laws governing personal liability for corporate fault.

The BCA has recently released a comprehensive study of regulation in Australia, *Business Regulation Action Plan for Future Prosperity*[8]. As part of that Action Plan, the BCA recommended that Australian Governments adopt the principle that, where an area of regulation is a shared responsibility between jurisdictions, there should be a move towards a single, consistent national regime. This is particularly the case where responsibility is shared between the Commonwealth and the States or between the different States.

This does not mean that the Commonwealth should necessarily take over responsibility for all regulation. There is a range of alternative models for ensuring shared responsibility, but a single regulatory regime. The States in particular have a responsibility to harmonise their regulatory regimes in areas that are clearly State responsibilities.

Australia has already achieved harmonisation with corporations law and with competition law. While the BCA's strong preference is for the removal of derivative liability provisions, it does supports efforts to harmonise laws governing personal liability for corporate fault.

8 Business Council of Australia, *Business Regulation Action Plan for Future Prosperity*, May 2005, available from www.bca.com.au.

The Productivity Commission has highlighted some estimates of the direct costs of multiple workers' compensation and OH&S Frameworks around Australia. While these costs do not relate directly to laws governing personal liability for corporate fault, they illustrate that the costs of multiple laws are real:

- **Optus** estimates that, if it received a single national self-insurance licence, it would expect savings of up to $2 million per annum of its $6 million annual workers' compensation costs. It estimated that the cost of complying with multiple workers' compensation and OH&S arrangements adds about 5 to 10 per cent to the cost of workers' compensation premiums.
- **CSR** estimates the cost of maintaining and renewing five self-insurance licences at over $700,000 per annum, compared to $200,000 for a single licence.
- **Insurance Australia Group** estimates that the existence of multiple schemes added $10.1 million to the cost of setting up a single national IT platform. In total, it estimates that having to comply with multiple jurisdictions adds about $1.7 million to IT costs annually. Further, it estimates that a national scheme could offer overall operating cost savings to the group of $1.2 million per annum and reduce actuarial costs by $400,000 per annum.
- **BHP Billiton** estimated that it costs in the vicinity of $50,000 to purchase a system to manage and supply information for each State and Territory OH&S regime.
- **Skilled Engineering** estimates that the annual cost saving from operating under a single set of national OH&S and workers' compensation rules would be in excess of $2.5 million, or some 15 per cent of the company's annual costs of OH&S and workers' compensation.
- A survey by the **Building Products Innovation Council** and the **Housing Industry Association** of building product manufacturing companies, has estimated the cost impact of complying with different State and Territory building laws to be between 1 and 5 per cent of company turnover. Even at a conservative 2 per cent cost impact, this equates to some $600 million annually on building product manufactures alone.

Source: Productivity Commission, *National Workers' Compensation and Occupational Health and Safety Frameworks*, March 2004; Productivity Commission, *Reform of Building Regulation*, November 2004.

Templates

The CAMAC Discussion Papers proposes a number of possible templates for derivative liability provisions. On the basis that the BCA's principal concern with derivative liability is the inappropriateness of reversing the onus of proof for individuals, the BCA prefers the template put forward by the Australian Law Reform Commission. The 'State and Territory representative' template does not address the fundamental concerns with derivative liability raised above. The 'alternative State' template is a considerable improvement on the 'representative' template, however, the BCA's preference is for there to be a positive onus on the prosecution to prove its case.

Summary

The BCA supports the basic principle that, where an area of regulation is a shared responsibility between jurisdictions, there should be a move towards a single, consistent national regime. The BCA therefore supports moves to harmonise provisions for personal liability for corporate fault. Of the templates suggested in the Discussion Paper, the BCA strongly prefers the Australian Law Reform Commission template.

Conclusion

The CAMAC Discussion Paper deals with serious issues for executives and Directors. The BCA is concerned that Governments have been too willingly to disregard fundamental legal principles and impose derivative liability on corporate employees, largely for reasons of political and prosecutorial expediency. As a threshold question, therefore, the BCA believes that CAMAC should question the appropriateness of the spread of derivative liability, particularly as the rationales advanced for derivative liability can be equally satisfied through direct liability.

To the extent that derivative liability or other provisions for personal liability for corporate fault remain, the BCA supports the harmonisation of these provisions. The template which provides the best opportunity to achieve harmonisation in a manner that addresses business's concerns with derivative liability is that proposed by the Australian Law Reform Commission.

The contact officer at the BCA on this issue is:

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27 September 2005

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Sir

PERSONAL LIABILITY FOR CORPORATE FAULT - SUBMISSIONS

The Commercial Law Association of Australia Limited (CLA) has a proud tradition within law and business spanning over 40 years. The Association provides an opportunity for lawyers and those involved within finance and commerce to network, and lobby government on issues of mutual concern. The Association also aims to improve the flow of information, promote high professional ethical standards, and increase the dissemination of information on corporate law issues.

We refer to the Corporations and Markets Advisory Committee's Discussion Paper entitled *Personal Liability for Corporate Fault* dated May 2005.

With particular reference to section 3.4 of the Discussion Paper, the CLA does not support a proposal to implement a standard derivative liability template for personal liability for directors across the legislation of all Australian jurisdictions. Various Commonwealth, State and Territory statutes currently impose different forms of liability on those considered responsible for serious breaches of legislative provisions where the perceived risk of potential harm to society is great. In the CLA's view, a statutorily applied standard template, applicable across all Australian jurisdictions, irrespective of context, indiscriminately imposes too heavy a burden upon those conscientious directors who seek to comply with the already onerous duties imposed upon them.

Our reasons for this view are discussed below. We support principal reliance on accessorial liability over derivative liability; we do not see any benefit in a responsible officer template as explained below.

Accessorial liability

As decided by the High Court in *Giorgianai v R* (1985) 156 CLR 473 at 487-488, extracted at page 17 of the Discussion Paper, and accessorial liability provisions in the *Corporations Act 2001* and criminal legislation, accessorial

liability necessitates involvement and an actual level of awareness of the individual in the contravention. Knowledge of the essential facts that constitute the offence, or wilful blindness (not negligence or recklessness), must be proven beyond reasonable doubt to gain a conviction.

The CLA regards this test and the current state of the law on accessorial liability to be appropriate.

Derivative liability and derivative liability templates

The CLA considers that no corporate culturally ameliorative benefit is to be gained by widespread "templated" derivative liability, of whatever template, over the above test and the current law on accessorial liability. The current examples of where derivative liability is personally placed on directors should continue to be regarded as "exceptions to the rule", rather than the basis for a new standard rule of derivative liability. Any such exceptions should be very carefully considered, and specifically directed to the public policy that is sought to be achieved in placing personal liability on particular persons. To this end, we support the observations extracted on page 3 of the Discussion Paper from the Corporate Law Provision Reform Program Paper No. 3, *Investors' Duties and Corporate Governance* (1997).

Responsible officer derivative liability

We consider that it should be open to company Boards to determine to whom within their company is delegated, if at all, responsibility for particular matters. No amount of delegation or statutory allocation of responsibility to a particular person should derogate from the company's responsibility to attend to a matter, and for the directors' ultimate responsibility, as the appropriate motivating organ of the company, for the matter, with the attendant potential liability for breach of their more generally expressed directors' duties and for accessorial liability.

A difficulty in statutorily placing responsible officer liability on a particular person within a company is that those individuals made so responsible are unlikely in the extreme to be able to cause to occur, and to cause expenditure to be incurred, on all matters that must be dealt with to satisfy his or her statutory responsibilities. He or she may have available an argument to the effect: "I didn't have the company's money, resources and authority to do what I was required by the statute to do." No such argument is available when the company itself has this obligation.

Placing particular responsible officer responsibility on a subordinate to the Board inevitably also leads to practical internal conflicts in who has the last say in the matter within the company.

In closing, the CLA does not consider it helpful, particularly for compliance purposes, for there to be a growing number of statutes, or a common template, for individual responsibility in the private sector, apart from accessorial liability. Nor does the CLA consider such increased personal liability to be justified in the private sector where, in the public sector, Westminster traditions of Ministerial responsibility seem to hold lessening sway, whereas those traditions ought to be upheld.

We trust that these submissions are of assistance in your deliberations.

Should you wish us to expand upon any of them, please do not hesitate to contact the writer in the first instance.

Yours faithfully

Daren Armstrong
Secretary – Legislative Review Task Force

Law Council
OF AUSTRALIA

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Sir

Personal Liability for Corporate Fault - Submissions

Please find below the submissions of the Corporations Committee of the Business Law Section of the Law Council of Australia ("the Committee") in response to the Discussion Paper issued by CAMAC in May 2005. Whilst these comments have been endorsed by the Business Law Section, owing to time constraints, the comments have not been considered by the Council of the Law Council of Australia.

Introduction

The Committee strongly believes that the policy issues raised by the Discussion Paper are important to the Australian regulatory landscape. The Committee notes with concern developments over recent years seeking to impose liability on directors and officers, particularly in the context of environmental and workplace safety legislation, that might impose criminal liability on a director in circumstances where the director has exercised the standards of care and diligence that would meet contemporary community expectations of what is required of a director.

For this reason the Committee strongly supports the work of CAMAC in developing the issues set out in the Discussion Paper and in providing a forum for these policy issues to be ventilated and encourages Commonwealth and State governments to adopt a template (as recommended below) for imposition of derivative liability. At the same time however, the Committee encourages all legislators to impose derivative liability only in rare cases, and in narrowly defined circumstances.

The plethora of non-uniform provisions in a myriad of State, Territory and Commonwealth laws which impose duties and responsibilities on company officers has led to complexity and confusion, which does not promote compliance or easy enforcement. Many of the duties and liabilities are similar but not the same, and this imposes unnecessary cost on companies which do seek to abide by the law.

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There would be great benefits if the principles governing responsibility and liability of corporate officers could be dealt with in a simple and uniform manner, and hence in principle the Committee can see the benefits of dealing with what is essentially a corporate law issue exclusively in the Corporations Act. However, the Committee recognises that the Commonwealth, States and Territories have the legislative power to impose liability on corporate officers in relation to a wide range of subject matters where there may be a diversity of policy drivers or special circumstances which require specific laws to address them. That said, the Committee urges that all legislators strive to adopt a consistent approach wherever possible.

Derivative Liability

The Committee considers that accessorial liability is normally the correct basis for imposition of liability on corporate officers for corporate default. However, the Committee accepts that there may be cases where accessorial responsibility may not be enough to achieve a higher order policy objective, and a greater incentive may be required to ensure that company officers cannot escape responsibility by turning a blind eye to corporate misbehaviour. There may also be extreme cases where the policy drivers require officers to be liable on quasi-strict or absolute liability basis (but such cases should be rare).

It is of concern to the Committee that there is an increasing trend in State laws (and to a lesser extent in Commonwealth laws) towards imposing personal liability on company officers for corporate breaches automatically without regard to the behaviour of the officer concerned, with the onus of proof being placed on the officer to establish that a defence to the charge is available.

The Committee believes that all governments should exercise some considerable thought before imposing derivative liability on company officers, in particular whether it is necessary in that particular law and whether it achieves any particular policy objective. As the Business Council of Australia said in its discussion paper entitled *Business Regulation Action Plan for Future Prosperity*, new legislation should 'not be introduced when the existing requirements are not being enforced'. The use of derivative liability provisions in such cases is, in effect, an abrogation of the government's proper enforcement role and involves a transfer of costs from the government (or the community at large) to corporate officers. This should only occur where there is a sound policy foundation, rather than just on the basis of budgetary expediency.

In this context, the Committee argues that derivative liability provisions should not be included automatically in all new Bills, but serious consideration should be given to whether such a provision is really necessary to ensure corporate compliance, or whether rigorous enforcement of the legislation on its own should be adequate. Once that test has been satisfied, and only then, should personal liability be imposed. In those cases where derivative liability is considered necessary, then the Committee strongly urges the use of a uniform provision of the kind contemplated by the Discussion Paper.

Templates for reform

In the Discussion Paper, CAMAC presents and seeks comment on three templates designed for use in legislation where the legislators see fit to impose derivative liability on company directors and other officers.

The Committee supports very strongly a model based on the ALRC template. The Committee prefers that model because it respects one of the fundamental principles of our legal and political system, namely the right of any citizen to be regarded as innocent until proven guilty. The representative template reverses the onus of proof and deems an officer to be guilty unless he or she proves the availability of a defence. The problem with this approach can be readily seen in the case of those laws which impose prison terms on company officers who are liable.

Furthermore, any laws imposing liability on company officers should also require those prosecuting the offence to make out the charge to the criminal standard of proof. Again, this is especially significant where there are potential prison terms for offenders.

There have been significant developments in the duties of care skill and diligence imposed on directors in Australia over the last decade. The Committee believes that those developments properly reflect community expectations in terms of the responsibility of directors in the context of modern corporations, particularly listed corporations where there is a significant distinction between the roles performed by directors and management. As such the Committee believes these principles are a good starting point for determining the minimum policy position applicable to a regime of derivative criminal liability imposed on directors and officers for corporate conduct.

Case law such as *Daniels v Andersen* (1995) 16 ACSR 607 and *Re HIH Insurance Ltd v Adler* (2002) 41 ACSR 72 make it clear that the director's proper role is that of guiding and monitoring management of the company with the following features:

- the director must be familiar with the fundamentals of the business in which the corporation is engaged;
- a director is under a continuing obligation to keep informed of those activities;
- directorial management requires a general monitoring of the corporate affairs and policies by way of attendance at board meetings;
- a director must maintain familiarity with the financial status of the corporation by regular review of financial statements.

Against this background, in the absence of suspicion or being put on notice of a deficiency, a director is entitled to delegate management tasks and to rely on management in discharging director responsibilities.

The Corporations Committee considers that the ALRC template best reflects a policy approach consistent with these principles.

There is one qualification the Committee would place on its support for a uniform template. If the representative template were chosen as the uniform template (and, for the reasons given above, the Committee would oppose that), the Committee considers that in cases of more serious charges against company officers, it would be quite inappropriate for the onus of proof to be reversed, and the onus of establishing guilt should be placed very clearly on the prosecution.

Responsible officer template

Whilst this template has some attraction, because the person whose job it is to ensure compliance is the person who is exposed to liability, there may be many reasons why persons who are made responsible officers may not be able to do their jobs, including not being properly trained or otherwise to have appropriate skills for the job, being starved of funds, not having recommendations acted upon or not having direct line responsibility for the breach concerned.

The Committee has some doubt about whether such a template could be made to work fairly in practice and whether or not it might be used by other directors or employees, who may have greater culpability, to avoid liability altogether – by appointing the so-called "Vice-President for Going to Jail".

Direct liability

Laws which impose direct personal liability on company officers, such as industrial manslaughter laws, especially those which impose prison terms need very careful consideration. The Committee does not support any law which make directors or other officers personally liable where an event, such as a workplace injury or death occurs, unless they have a duty to take action to prevent the occurrence and materially failed in that duty. While mere negligence of the civil kind may well result in civil consequences for the officer concerned, in the Committee's view, it should not be sufficient for a criminal charge against a company officer. The Committee considers that the higher standard of criminal negligence should be required before a director should be found liable in such situations. For the reasons outlined above the Committee considers that this template risks imposing a higher standard of conduct than that reflected in contemporary community expectations of directors.

Definition of Officer

In order to achieve any level of uniformity, it is essential also that the term 'officer' is uniformly defined. It is noteworthy that in the three templates three different approaches are taken. The ALRC template applies to an 'individual, by whatever name called and whether or not the individual is an officer of the corporation' who, 'is concerned, or takes part, in the management of the corporation'. The representative template simply applies to a 'director or other person who is concerned, or takes part, in the management of the corporation'. The alternative template applies only to 'an officer of the body corporate'.

This issue has been canvassed fairly widely in the context of Corporations Act duties and responsibilities in recent times and it seems to the Committee that there is a strong argument for imposing personal liability on the same group of corporate officers as the duties in sections 180 and 181 of the Corporations Act, (i.e. directors and other officers) as that expression is now defined.

Defences

Regardless of the template selected, the Corporations Committee believes that some defences are necessary as well. While some protections are already built into the

ALRC template, the Committee considers that it is still appropriate, at the least, to provide a due diligence defence (which most company directors would already be familiar with in other places) as well as a defence based on reasonable reliance on information provided by others (such as is found in section 189 of the Corporations Act).

These comments are consistent with the observations as to contemporary expectations concerning care and diligence of directors and officers outlined above.

Other observations

There are a number of other issues on which the Corporations Committee would like to comment. These include the following:

- The Committee would prefer uniformity of laws imposing personal liability on company officers to be global, not just limited to the four legislative areas reviewed by CAMAC. All laws imposing personal liability on officers should contain standard provisions across jurisdictions. This minimises the cost to companies and their officers which operate in more than once jurisdiction of understanding their liabilities – because they do not have to consider a variety of different but similar formulations of a duty and defences to liability – and increases the ease and hence likelihood of compliance.

- The Committee would support a business judgment rule defence in applicable situations. The Committee agrees with CAMAC's view that such a defence should not be available where a clear statutory obligation is imposed and that obligation is breached. However, such a defence (in a modified form) may be appropriate in some situations, but the directors (or other officers) have adopted the particular practice in question, exercising their judgment, believing on reasonable grounds, that practice is appropriate (and in this would be similar if not co-extensive with a "due diligence" or "reasonable reliance" defence). The defence seems more suited to laws imposing direct liability than laws imposing derivative liability.

- The Committee considers that governments should apply all laws imposing derivative liability on officers not only on private enterprise bodies, but also on officers of public sector bodies that are engaged in business activities, to the extent that they engage in such activities - and this view applies not only to the letter of the law, but also to its effective enforcement. There are no good policy reasons for maintaining any distinction. The Committee believes that considerable legislative amendments are likely to be necessary to make all existing derivative liability provisions apply to public sector personnel. If governments are unable or unwilling to apply derivative liability to their own personnel, then they should not expect higher standards from the private sector.

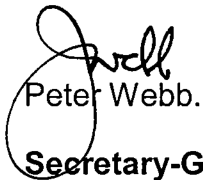
Conclusion

As said at the outset, the Corporations Committee favours the adoption by the Commonwealth and all States and Territories of a template for imposing derivative liability laws on corporate officers. Any such model must be fair and consistent with the underlying principles of justice in Australia, in particular, the onus of proof should reside with those prosecuting the offence and they should need to make out their case to the criminal standard of proof.

If such an outcome can be achieved, the costs and regulatory burden placed on companies carrying on business in Australia will be considerable reduced and we will see some real corporate law economic reform.

If you would like to discuss this submission, please contact the Chairman of the Corporations Committee, John Keeves on (08) 8239 7119.

Yours faithfully



Peter Webb.

Secretary-General

30 September 2005.

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26 October 2005

Mr John Kluver
Executive Director
Corporations & Markets Advisory Committee
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SYDNEY NSW 2000
Email: john.kluver@camac.gov.au

Dear Mr Kluver

This submission is made on behalf of the Insurance Council of Australia in response to the Corporations and Markets Advisory Committee's (CAMAC) discussion paper on *Personal Liability for Corporate Fault.*

The Insurance Council of Australia (ICA) is the representative body of the general insurance industry in Australia. ICA membership represents more than 90 percent of total premium income written by private sector general insurers. ICA appreciates the opportunity to provide a response on these issues and welcomes continued consultation on these issues as they are under review.

While individual ICA members have made separate submissions, this letter touches on specific issues common to ICA members, primarily those involving regulatory consistency and the need for a considered approach.

Personal Liability for Corporate Fault

ICA supports regulatory reform that provides consistency across jurisdictions and reins in compliance costs. It is also essential that legal responsibilities of directors and managers be certain. This ensures that proper corporate governance structures can be put into place that assist this group in understanding and upholding their responsibilities. Standardising these templates would be a welcome step in removing the overlap and inconsistency across regulatory regimes.

However, ICA is concerned with any proposal to extend derivative liability to a director or manager personally, simply because they hold a position or perform a particular function, instead of responsibility being held on the basis of their own actions or omissions.

ICA does not support a "one size fits all" approach to liability, nor does it believe that a derivative liability model is the appropriate model for determining directors' or officers' liability. Instead, it is ICA's view that an accessorial liability model is preferable as it is already broadly enforced and offers sufficient liability for wrongdoing.

To the extent that the derivative liability model is retained, ICA believes that that model must not place the onus of proof on the defendant nor remove the principal protection of being innocent until proven guilty beyond a reasonable doubt.

ICA is also concerned about the impact derivative liability may have on the industry, as it is likely to have the unintended consequence of further narrowing the pool of willing directors, and also to significantly deter innovation. ICA does not believe that there is sufficient evidence to indicate a need to extend derivative liability in areas where accessorial liability is currently in place. Accessorial liability is already well established in the law and allows for sufficient flexibility in the system.

Regulatory Environment

There is already growing evidence that the complexity of the regulatory environment has created a compliance mentality within corporations. Business decisions are being taken with compliance as a major factor. This need to further focus on compliance as the dominating concern, even at the middle management level, will continue to make companies more risk averse, stifle innovation and creativity.

ICA encourages CAMAC to have their reforms reflect the spirit of the Prime Minister's Taskforce to examine the reduction of red tape, and strongly believes that any changes should be implemented in a manner that keeps regulatory cost for companies to a minimum.

We would welcome an opportunity to discuss these matters further once you have had a chance to consider our comments.

Yours sincerely

Alan Mason
Executive Director

AUSTRALIAN BANKERS' ASSOCIATION INC.

David Bell
Chief Executive Officer

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11 November 2005

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
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john.kluver@camac.gov.au

Dear Mr Kluver,

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments to the Corporations and Markets Advisory Committee (CAMAC) discussion paper *Personal liability for corporate fault*.

1. General observations

The discussion paper considers the circumstances in which a director or officer may be personally accountable for a contravention of a statutory requirement by a company, simply because of the position they perform within the company.

Monetary fines and other penalties on companies can serve as substantial incentives for those with control of a company to ensure that the company complies with its legal and regulatory obligations. However, should individuals within a company, in addition to the company itself, be held personally accountable for all the actions of the company by reason only of their position (i.e. on a derivative basis)?

Reasons identified (in paragraph 3.2 of the discussion paper) for imposing personal liability for corporate misconduct include limitations on the effectiveness of monetary penalties imposed on companies; creating specific and general incentives for individuals to take responsibility for corporate compliance; apportioning personal fault to individuals within a company who have an ability to influence or prevent an act or omission; and expressing social disapproval where the community expects individuals to be held accountable for their actions.

The ABA believes that individuals who knowingly participate in a breach of the law should be held accountable for their actions. However, generally there should be a direct connection between the actions or omissions of the individual and the contravention. In this instance, penalties should be proportionate to the degree of direct involvement in, or responsibility for, the offence, rather than simply based on the severity of the offence.

The ABA considers that there are two essential law reform issues raised by the discussion paper:

- Allocation of the burden of proof in derivative liability proceedings against directors and officers, particularly with regard to whether directors and officers should bear the burden of proving available defences; and
- Cost of compliance for directors and officers wanting to ensure that defences are available to them under laws that impose derivative liability, particularly where directors and officers face inconsistent liability regimes across various statutes.

It is important that legal responsibilities of directors and other officers be certain. Equally, it is important for there to be a balance between the public interest in responsible business practices and accountability within companies on the one hand, and on the other, the right of directors and other officers to be protected from liability where they take reasonable steps to prevent the relevant contravention, or where they lack the relevant degree of control or influence within the company.

The increasing trend and extensive use of derivative liability in Federal, State and Territory statutes is concerning, because it can lead to the imposition of penalties on individuals irrespective of their actual degree of blameworthiness or fault in the circumstances. Therefore consideration should be given to the use of derivative liability only in exceptional, clearly defined and limited circumstances.

With this principle in mind, the ABA supports legislative reform for a nationally uniform scheme of personal derivative liability for corporate fault. It is important for unnecessary complexity to be removed so that companies, directors and officers have clarity regarding their particular duties and responsibilities. This is particularly important for companies that operate across jurisdictions and consequently are subject to different liability regimes, not only within a particular State or Territory, but between States and Territories as well.

2. Specific comments

2.1 Direct, derivative and accessorial liability

Legislation can impose direct liability (liability arising from an individuals' conduct), or derivative liability (liability arising from the position an individual holds within a company that has contravened its obligations) on a director or other officer within a company.

Under various Federal, State and Territory statutes, such as environmental protection, occupational health and safety, hazardous goods, fair trading, directors and other officers can be held personally accountable for corporate conduct where there is a breach of a duty to ensure compliance with laws.

Direct liability applies to a director or officer that has personally been involved in a corporate misconduct. Accessorial liability is applicable to a person who intentionally or knowingly participates in a corporate breach or necessitates involvement and awareness of the individual involved in the corporate misconduct. As a form of direct liability, accessorial liability imposes liability on directors and other officers for their complicit involvement in misconduct of the company. Accessorial liability focuses on the actual level of awareness and involvement, not simply whether the individual is a director or other senior officer. In addition, the prosecution must prove beyond reasonable doubt that the individual was an intentional participant in the misconduct.

Derivative liability imposes guilt on a director or officer where the company is found to have committed an offence. Derivative liability is generally determined by reference to the individuals' position within the company; involvement in the management of the company; or operational responsibility for the conduct that contravened the law.

In Australia, there are different standards of civil and criminal derivative liability, inconsistent defences available to directors and other officers and different compliance burdens. Directors or other officers can be found liable irrespective of whether they were involved in the contravention, or even knew of the circumstances by which the contravention occurred – in some situations, derivative liability can effectively reverse the onus of proof for criminal liability.

While in most cases there are statutory defences available, such as reasonable steps or due diligence, this is not always the case. For example, section 183(1) of the Consumer Credit Code provides that officers of the company that is taken to have contravened a provision of the Code are deemed personally accountable for the contravention. Similarly, the *Occupational Health and Safety Act 2000* (NSW) (OH&S Act) may impose liability on a director or other officer for a breach of an OH&S duty. Directors or people "concerned in the management of the company" may be found liable for an incident, and presumed to be guilty of an offence, even in circumstances where they are not in any real or practical sense culpable, such as a bank robbery.

Case law demonstrates that derivative liability under the OH&S Act (NSW) is not limited to senior management of a company, but can also capture any person who provides advice or makes decisions. The uncertainty associated with these provisions for deemed personal liability acts as a serious disincentive for people to take on positions of responsibility in companies in NSW. Recent case law demonstrates that individuals caught by the deemed personal liability legislation

can include technical specialists who are not directors or in any real or practical sense a part of the senior management of the company[1].

The ABA recognises the role of derivative liability in providing an incentive for directors and other officers to ensure the company complies with its legislative responsibilities. Some argue that accessorial liability is insufficient to give directors and other officers sufficient incentive to inform themselves of the company's activities and assist in prevention of any misconduct by the company. However, there must be a balance between the public interest in ensuring corporate compliance and the rights of individual directors and officers who take reasonable steps to ensure compliance of the company.

The ABA has a number of fundamental concerns with the concept of derivative liability:

- Personal derivative liability acts as a potential disincentive for qualified and competent individuals to take up directorships and other senior positions in companies.
- Inconsistency in treatment of personal derivative liability creates unnecessary compliance costs and may compromise good corporate governance by making it more difficult for directors and other officers to understand their legal responsibilities.
- Statutes that attribute personal derivative liability for offences where there is no personal act or omission or where there is no real capacity to influence the company's behaviour.
- Offences attributed to directors and other officers for the acts of third parties, in particular unlawful acts.

The ABA believes directors and other officers should generally not be deemed liable for corporate misconduct unless they intentionally or knowingly participate in the breach, or act negligently or recklessly.

It is important to differentiate between foreseeable incidents and those incidents that could not be prevented, particularly where the incident is the result of the acts of a third party. Under the OH&S Act (NSW) a person may be subject to criminal prosecution for the injury or death of a person, where injury or death has been caused by a third party within the workplace. For example, if in the course of an armed robbery, a bank robber kills an innocent bystander in the branch and is subsequently prosecuted for the crime, the bank branch manager, who has done nothing more than their job to the best of their ability, could also be subject to criminal prosecution.

The ABA believes that in some situations, derivative liability can attach responsibility to a person where there is no reasonable causal nexus between the wrong and the actions of that person.

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[1] For example, *Stephen Finlay McMartin v Newcastle Wallsend Coal Company Pty Limited & Ors* [2004] NSWIRComm 202.

Therefore the ABA considers that:

- Personal liability should only capture individuals that may reasonably be deemed to be personally accountable for the misconduct of the company; and
- Personal liability must be accompanied by the availability of fair and reasonable defences for directors and other officers.

Generally, the ABA considers that direct liability would adequately deliver the outcomes that derivative liability is supposed to deliver. Therefore, the ABA believes that the Government should assess the existing statutes and generally replace derivative liability with direct liability clauses or alternatively ensure that offences and defences for reasonable conduct are available. Derivative liability should only apply in exceptional, clearly defined and limited circumstances.

2.2 Complications with the current law

Currently the various statutes impose different concepts of derivative liability. Derivative liability should not be imposed on or extend to persons to which the liability already applies. It is important that existing complexity is not exacerbated by future legislative changes. Unnecessary resources and administrative costs increase the cost of compliance with disparate regimes.

2.2.1 Should personal criminal liability be imposed on directors or officers for all types of corporate fault?

The discussion paper does not consider whether there are some types of offences for which derivative liability is not appropriate. In practice, should directors or officers be criminally liable for an offence conducted by a dishonest employee?

As already stated, the ABA strongly believes that derivative liability should be limited to circumstances where the director or officer knew, or was reckless or negligent as to the contravening conduct. An extension of personal liability beyond directors and officers to other managers or employees could have a substantial impact on the efficiency and effectiveness of business and compliance programs. If there is uncertainty regarding the liability of companies and individuals within the company, it is likely that companies would have difficulty in implementing adequate risk management procedures and insurance for potential liabilities. For example, currently directors' and officers' (D&O) insurance provides coverage for directors and other officers, but does not generally extend to other managers and employees. However, some companies have already extended coverage to all employees, largely due to the current uncertainty with derivative liability. Lack of uniformity, complexity and uncertainty generates unnecessary compliance costs.

The ABA believes that:

- The law should not automatically impose fault on directors and other officers simply because of a contravention by the company, and liability must be based on whether the director or officer knew of, or was reckless or negligent as to the contravention;

- There should be a consistent principle of personal liability that does not impose additional complexity in the obligations of, or liabilities on, directors or other officers that legislators should adopt to harmonise approaches taken to personal liability; and
- Companies, directors and other officers should have certainty regarding their duties and responsibilities.

2.3 Alternative derivative liability templates

2.3.1 The "Australian Law Reform Commission" template

Personal derivative liability is only imposed if the prosecutor proves four elements beyond reasonable doubt about the individual, that the person:

- is concerned or takes part in the management of the company
- was in a position to influence the contravening conduct of the company
- knew, or was reckless or negligent as to whether the contravening conduct would occur, and
- failed to take all reasonable steps to prevent the contravening conduct.

This approach would place the burden of proof on the prosecutor, including the burden of proving that the director or other officer did not take reasonable steps to prevent the company's conduct. The prosecutor would have to prove beyond a reasonable doubt that the director or officer was reckless or negligent as to the contravention by the company and that the director or officer failed to take reasonable steps to prevent the contravening conduct.

The ABA does not support strict liability where directors or officers are deemed liable without some personal culpability. The ABA is particularly concerned with the treatment of dissenting directors or officers under strict liability provisions. Directors and officers should be afforded the same presumption of innocence as is given to other members of the community within the criminal system. The onus should rest on the prosecutor to establish all the elements of the offence, that include proof that the director or officer was complicit, negligent or reckless and most importantly, that this conduct caused the offence to occur.

The ABA supports appropriate defences attributed to offences for derivative liability, including due diligence, reasonable steps, no knowledge, no control/influence, reasonable reliance on information provided by others and reasonable mistake.

Therefore, the ABA believes that where a uniform approach is adopted by the Federal Government, with support of the States and Territories, and with consideration to the appropriate defences, that the ALRC template should be implemented with the added causation element to be provided. However, it is important to retain a degree of flexibility to allow for variation in specific circumstances, where appropriate.

A uniform approach can promote compliance, reduce compliance costs and remove the need for directors and officers to respond to differing legislative tests.

2.3.2 The "State and Territory representative" template

Personal derivative liability is imposed on directors and others concerned in or taking part in the management of the company unless the person proves, on the balance of probabilities, that:

- the person was unable to influence the contravening conduct, or if so the person exercised all due diligence to prevent the conduct, or
- the person took all reasonable steps to prevent the conduct.

This approach would impose criminal liability on directors once the prosecutor has proved a contravention by the company, unless the director or other officers can prove that one of the defences applies. The ABA believes that the representative template imposes a significant burden on directors and officers to prove that a defence applies. In practice, how do directors and officers prove that they took "all due diligence" or "all reasonable steps" when a company has breached the law, notwithstanding the efforts of the directors or officers?

The representative model is already quite common in existing legislation, but with numerous variations. The ABA does not support the automatic imposition of "no fault" criminal liability on a director or other officer merely because of their position. This template is not only inequitable but is a serious disincentive for people to become directors and other officers. The onerous obligations placed on directors and officers are having significant implications for business, particularly in attracting and retaining highly skilled directors, senior managers and specialised advisers.

2.3.3 The "Alternative State" template

Personal derivative liability arises only where the offence committed by the company is attributable to a director or other officer failing to take reasonable care. The Court must consider:

- what the officer knew
- the ability of the officer to make decisions that affected the company's conduct
- whether the contravention is also attributable to an act or omission of another person
- any other relevant matter.

This approach would require the prosecutor to prove beyond reasonable doubt that the director or other officer failed to take reasonable care, and that the company's fault was attributable to that failure. The prosecutor has to establish some connection between the company's fault and the acts or omissions of the director or officer before personal derivative liability can be imposed.

The alternative template would address some of the concerns with the representative template as personal liability would only arise where directors or officers failed to take reasonable care, and the company's fault was attributable to that particular failure. However, the ABA is concerned with this template as the director or officer effectively maintains the burden of proof to counter the evidence of the prosecutor.

3. Conclusion

The ABA believes that there are a number of factors that are relevant with regards to implementing a uniform approach to derivative liability. Factors to consider include:

- Can directors and officers be aware of each aspect of the day-to-day management and functioning of the company, and therefore reasonably held liable for all contraventions by the company?
- Are the defences realistic for the offences to ensure confidence in the integrity and procedural fairness of the law?
- Is the burden of proof realistic for prosecutors and defendants?
- Would reform impose unreasonable compliance costs, in particular on corporate governance practices?
- Does the liability imposed as a result of a contravention act as a disincentive for persons to accept or maintain directorships or other stewardships?
- Would reform make directors' and officers' (D&O) insurance policies more difficult to obtain and/or more expensive?

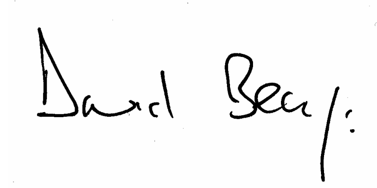
The ABA supports legislative reform to develop a uniform approach to personal liability for corporate fault in exceptional, clearly defined and limited circumstances. Arguably, a uniform approach will translate into greater certainty and legal predictability, which will assist directors and officers to implement effective risk management strategies and compliance programs as well as conduct themselves with understanding of their duties and responsibilities.

The ABA supports the Australian Law Reform Commission model template with the added causation element.

It is important that directors and officers do not become overly concerned with compliance to the detriment of the efficient management and functioning of the company. It is also important that criminal personal liability does not result merely from a position held, but rather from personal actions or omissions.

The ABA would be happy to discuss any of the issues raised in this letter with you further. Please contact me or the ABA's Director, Corporate & Consumer Policy, Diane Tate on (02) 8298 0410: dtate@bankers.asn.au.

Yours sincerely



David Bell

Law Institute Victoria

1 November 2005

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Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Mr Kluver,

RE: PERSONAL LIABILITY FOR CORPORATE FAULT

The Law Institute of Victoria (LIV) refers to the Discussion paper issued by CAMAC in May 2005 ('CAMAC discussion paper') and the Law Council of Australia's submission in response to the CAMAC discussion paper ('LCA's submission') which is attached.

The LIV has had the opportunity to consider the LCA's submission and endorses the LCA's submission.

Yours sincerely,

V.E. Strong.

Victoria Strong
President

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Sir

Personal Liability for Corporate Fault - Submissions

Please find below the submissions of the Corporations Committee of the Business Law Section of the Law Council of Australia ("the Committee") in response to the Discussion Paper issued by CAMAC in May 2005. Whilst these comments have been endorsed by the Business Law Section, owing to time constraints, the comments have not been considered by the Council of the Law Council of Australia.

Introduction

The Committee strongly believes that the policy issues raised by the Discussion Paper are important to the Australian regulatory landscape. The Committee notes with concern developments over recent years seeking to impose liability on directors and officers, particularly in the context of environmental and workplace safety legislation, that might impose criminal liability on a director in circumstances where the director has exercised the standards of care and diligence that would meet contemporary community expectations of what is required of a director.

For this reason the Committee strongly supports the work of CAMAC in developing the issues set out in the Discussion Paper and in providing a forum for these policy issues to be ventilated and encourages Commonwealth and State governments to adopt a template (as recommended below) for imposition of derivative liability. At the same time however, the Committee encourages all legislators to impose derivative liability only in rare cases, and in narrowly defined circumstances.

The plethora of non-uniform provisions in a myriad of State, Territory and Commonwealth laws which impose duties and responsibilities on company officers has led to complexity and confusion, which does not promote compliance or easy enforcement. Many of the duties and liabilities are similar but not the same, and this imposes unnecessary cost on companies which do seek to abide by the law.

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There would be great benefits if the principles governing responsibility and liability of corporate officers could be dealt with in a simple and uniform manner, and hence in principle the Committee can see the benefits of dealing with what is essentially a corporate law issue exclusively in the Corporations Act. However, the Committee recognises that the Commonwealth, States and Territories have the legislative power to impose liability on corporate officers in relation to a wide range of subject matters where there may be a diversity of policy drivers or special circumstances which require specific laws to address them. That said, the Committee urges that all legislators strive to adopt a consistent approach wherever possible.

Derivative Liability

The Committee considers that accessorial liability is normally the correct basis for imposition of liability on corporate officers for corporate default. However, the Committee accepts that there may be cases where accessorial responsibility may not be enough to achieve a higher order policy objective, and a greater incentive may be required to ensure that company officers cannot escape responsibility by turning a blind eye to corporate misbehaviour. There may also be extreme cases where the policy drivers require officers to be liable on quasi-strict or absolute liability basis (but such cases should be rare).

It is of concern to the Committee that there is an increasing trend in State laws (and to a lesser extent in Commonwealth laws) towards imposing personal liability on company officers for corporate breaches automatically without regard to the behaviour of the officer concerned, with the onus of proof being placed on the officer to establish that a defence to the charge is available.

The Committee believes that all governments should exercise some considerable thought before imposing derivative liability on company officers, in particular whether it is necessary in that particular law and whether it achieves any particular policy objective. As the Business Council of Australia said in its discussion paper entitled *Business Regulation Action Plan for Future Prosperity*, new legislation should 'not be introduced when the existing requirements are not being enforced'. The use of derivative liability provisions in such cases is, in effect, an abrogation of the government's proper enforcement role and involves a transfer of costs from the government (or the community at large) to corporate officers. This should only occur where there is a sound policy foundation, rather than just on the basis of budgetary expediency.

In this context, the Committee argues that derivative liability provisions should not be included automatically in all new Bills, but serious consideration should be given to whether such a provision is really necessary to ensure corporate compliance, or whether rigorous enforcement of the legislation on its own should be adequate. Once that test has been satisfied, and only then, should personal liability be imposed. In those cases where derivative liability is considered necessary, then the Committee strongly urges the use of a uniform provision of the kind contemplated by the Discussion Paper.

Templates for reform

In the Discussion Paper, CAMAC presents and seeks comment on three templates designed for use in legislation where the legislators see fit to impose derivative liability on company directors and other officers.

The Committee supports very strongly a model based on the ALRC template. The Committee prefers that model because it respects one of the fundamental principles of our legal and political system, namely the right of any citizen to be regarded as innocent until proven guilty. The representative template reverses the onus of proof and deems an officer to be guilty unless he or she proves the availability of a defence. The problem with this approach can be readily seen in the case of those laws which impose prison terms on company officers who are liable.

Furthermore, any laws imposing liability on company officers should also require those prosecuting the offence to make out the charge to the criminal standard of proof. Again, this is especially significant where there are potential prison terms for offenders.

There have been significant developments in the duties of care skill and diligence imposed on directors in Australia over the last decade. The Committee believes that those developments properly reflect community expectations in terms of the responsibility of directors in the context of modern corporations, particularly listed corporations where there is a significant distinction between the roles performed by directors and management. As such the Committee believes these principles are a good starting point for determining the minimum policy position applicable to a regime of derivative criminal liability imposed on directors and officers for corporate conduct.

Case law such as *Daniels v Andersen* (1995) 16 ACSR 607 and *Re HIH Insurance Ltd v Adler* (2002) 41 ACSR 72 make it clear that the director's proper role is that of guiding and monitoring management of the company with the following features:

- the director must be familiar with the fundamentals of the business in which the corporation is engaged;
- a director is under a continuing obligation to keep informed of those activities;
- directorial management requires a general monitoring of the corporate affairs and policies by way of attendance at board meetings;
- a director must maintain familiarity with the financial status of the corporation by regular review of financial statements.

Against this background, in the absence of suspicion or being put on notice of a deficiency, a director is entitled to delegate management tasks and to rely on management in discharging director responsibilities.

The Corporations Committee considers that the ALRC template best reflects a policy approach consistent with these principles.

There is one qualification the Committee would place on its support for a uniform template. If the representative template were chosen as the uniform template (and, for the reasons given above, the Committee would oppose that), the Committee considers that in cases of more serious charges against company officers, it would be quite inappropriate for the onus of proof to be reversed, and the onus of establishing guilt should be placed very clearly on the prosecution.

Responsible officer template

Whilst this template has some attraction, because the person whose job it is to ensure compliance is the person who is exposed to liability, there may be many reasons why persons who are made responsible officers may not be able to do their jobs, including not being properly trained or otherwise to have appropriate skills for the job, being starved of funds, not having recommendations acted upon or not having direct line responsibility for the breach concerned.

The Committee has some doubt about whether such a template could be made to work fairly in practice and whether or not it might be used by other directors or employees, who may have greater culpability, to avoid liability altogether – by appointing the so-called "Vice-President for Going to Jail".

Direct liability

Laws which impose direct personal liability on company officers, such as industrial manslaughter laws, especially those which impose prison terms need very careful consideration. The Committee does not support any law which make directors or other officers personally liable where an event, such as a workplace injury or death occurs, unless they have a duty to take action to prevent the occurrence and materially failed in that duty. While mere negligence of the civil kind may well result in civil consequences for the officer concerned, in the Committee's view, it should not be sufficient for a criminal charge against a company officer. The Committee considers that the higher standard of criminal negligence should be required before a director should be found liable in such situations. For the reasons outlined above the Committee considers that this template risks imposing a higher standard of conduct than that reflected in contemporary community expectations of directors.

Definition of Officer

In order to achieve any level of uniformity, it is essential also that the term 'officer' is uniformly defined. It is noteworthy that in the three templates three different approaches are taken. The ALRC template applies to an 'individual, by whatever name called and whether or not the individual is an officer of the corporation' who, 'is concerned, or takes part, in the management of the corporation'. The representative template simply applies to a 'director or other person who is concerned, or takes part, in the management of the corporation'. The alternative template applies only to 'an officer of the body corporate'.

This issue has been canvassed fairly widely in the context of Corporations Act duties and responsibilities in recent times and it seems to the Committee that there is a strong argument for imposing personal liability on the same group of corporate officers as the duties in sections 180 and 181 of the Corporations Act, (i.e. directors and other officers) as that expression is now defined.

Defences

Regardless of the template selected, the Corporations Committee believes that some defences are necessary as well. While some protections are already built into the

ALRC template, the Committee considers that it is still appropriate, at the least, to provide a due diligence defence (which most company directors would already be familiar with in other places) as well as a defence based on reasonable reliance on information provided by others (such as is found in section 189 of the Corporations Act).

These comments are consistent with the observations as to contemporary expectations concerning care and diligence of directors and officers outlined above.

Other observations

There are a number of other issues on which the Corporations Committee would like to comment. These include the following:

- The Committee would prefer uniformity of laws imposing personal liability on company officers to be global, not just limited to the four legislative areas reviewed by CAMAC. All laws imposing personal liability on officers should contain standard provisions across jurisdictions. This minimises the cost to companies and their officers which operate in more than once jurisdiction of understanding their liabilities – because they do not have to consider a variety of different but similar formulations of a duty and defences to liability – and increases the ease and hence likelihood of compliance.

- The Committee would support a business judgment rule defence in applicable situations. The Committee agrees with CAMAC's view that such a defence should not be available where a clear statutory obligation is imposed and that obligation is breached. However, such a defence (in a modified form) may be appropriate in some situations, but the directors (or other officers) have adopted the particular practice in question, exercising their judgment, believing on reasonable grounds, that practice is appropriate (and in this would be similar if not co-extensive with a "due diligence" or "reasonable reliance" defence). The defence seems more suited to laws imposing direct liability than laws imposing derivative liability.

- The Committee considers that governments should apply all laws imposing derivative liability on officers not only on private enterprise bodies, but also on officers of public sector bodies that are engaged in business activities, to the extent that they engage in such activities - and this view applies not only to the letter of the law, but also to its effective enforcement. There are no good policy reasons for maintaining any distinction. The Committee believes that considerable legislative amendments are likely to be necessary to make all existing derivative liability provisions apply to public sector personnel. If governments are unable or unwilling to apply derivative liability to their own personnel, then they should not expect higher standards from the private sector.

Conclusion

As said at the outset, the Corporations Committee favours the adoption by the Commonwealth and all States and Territories of a template for imposing derivative liability laws on corporate officers. Any such model must be fair and consistent with the underlying principles of justice in Australia, in particular, the onus of proof should reside with those prosecuting the offence and they should need to make out their case to the criminal standard of proof.

If such an outcome can be achieved, the costs and regulatory burden placed on companies carrying on business in Australia will be considerable reduced and we will see some real corporate law economic reform.

If you would like to discuss this submission, please contact the Chairman of the Corporations Committee, John Keeves on (08) 8239 7119.

Yours faithfully

Peter Webb.

Secretary-General

30 September 2005.