CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

30 March 2012

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Dear Treasury

Exposure Draft — Personal Liability for Corporate Fault Reform Bill 2012

Chartered Secretaries Australia (CSA) is the independent leader in governance and risk management. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency.

Our Members have primary responsibility to develop and implement governance frameworks in public listed, unlisted and private companies, and not-for-profit and public sector organisations. In listed companies they have primary responsibility to deal with the Australian Securities Exchange (ASX) and interpret and implement the Listing Rules. Our Members have a thorough working knowledge of the operations of the markets and the needs of investors, as well as compliance with the Corporations Act (the Act). We have drawn on their experience in our submission.

COAG principles

CSA welcomes the amendment of Treasury (non-taxation) portfolio legislation to comply with the Council of Australian Government (COAG) principles[i] that aim to ensure that derivative liability is imposed on directors and other corporate officers in accordance with principles of good corporate governance and criminal justice, and is not imposed as a matter of course. Derivative liability provisions impose criminal liability in situations where directors may not be aware of, or have the ability to prevent, the commission of an offence by the company. They also often require directors to prove their innocence, which is a reverse of the burden of proof as it operates under the criminal law.

CSA supports the principle that, where companies contravene statutory requirements, liability should be imposed in the first instance on the company itself, and that personal criminal liability of a corporate officer for the misconduct of the corporation should be limited to situations where the officer knowingly encourages or assists the commission of the offence or is reckless in attending to their duties as a corporate officer, thus allowing the offence to occur (accessorial liability).

The COAG principles were agreed following the report to the government by the Corporations and Markets Advisory Committee (CAMAC) in 2006[ii] that:

> The Committee identified two principal areas of concern:
> - a marked tendency in legislation across Australia to include provisions that impose personal criminal sanctions on individuals for corporate breach by reason of their office or role within the company (rather than their actual acts or omissions) unless they can establish an available defence
> - considerable disparities in the terms of personal liability provisions, resulting in undue complexity and less clarity about requirements for compliance.

CAMAC noted that its concern was with the 'overreach in the treatment of individuals where the company is in breach of the law, together with lack of harmony in the standards of personal responsibility required under various provisions'. It noted that this move to overreach was not new and referred to various inquiries dating back to 1989.

The COAG principles were approved over two years ago. However, there is little evidence of accord with their spirit across jurisdictions. A report commissioned by the COAG Reform Council published in 2011 reviewing the application of COAG's directors' liability principles found that[iii]:

> Based on our review there were 697 Relevant Provisions in all jurisdictions at the date of the Audits [p 13]... No jurisdiction identified all Relevant Provisions. Together the jurisdictions identified 77% of all Relevant Provisions. [p 35] ... Most jurisdictions did not address the Automatic & Blanket Liability principle at all and retained blanket liability provisions without amendment. Where the Audits did identify a provision as containing blanket liability, there was no consistency in the recommendations to amend (or not amend) the provisions to narrow their scope.... In addition, many jurisdictions overwhelmingly relied on the Public Policy principle to justify retention of the provisions reviewed. However, the majority of the Audits: did not provide an explanation of the public policy reasons relied upon; or where they did provide reasons, establish a compelling or convincing basis for retaining the provision. [p 37]
>
> *The material in square brackets supplied by CSA.*

The same report reviewed the Commonwealth audit which identified 53 provisions, of which only 17 were identified for repeal or amendment. It also identified an additional 11 provisions which the Commonwealth audit failed to identify. While the analysis in the report of the audit recommendations said some were valid, there was insufficient information to determine the validity of all the recommendations (pp 61-63).

The Bill

CSA is of the view that the exposure draft of the Personal Liability for Corporate Fault Reform Bill 2012 (the Bill) does not achieve the aim of the COAG principles. The amendments proposed by the Bill are limited.

According to the government's explanatory comments on the Bill, the scope of the review of director liability provisions has been restricted because, 'While quite a number of provisions may, at first glance, appear to be derivative liability provisions, many are in fact a form of accessorial liability, and therefore fall outside the scope of this review. Additionally, a number of provisions were identified which, while imposing a derivative liability, were justified on strong policy grounds'.

CSA notes that no explanation has been provided as to why some provisions are considered derivative liability and others accessorial liability and therefore outside the scope of this review. The CAMAC report set out strict criteria for such a distinction, stating that:

> The Committee considers that:
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> - liability for breach of a legal requirement by a company should fall in the first place on the company itself. It should not be assumed that appropriately weighted monetary or other penalties will not have an impact on shareholders and others who have a stake in the success of a company or will not influence the behaviour of those individuals who control and manage the company, whether through their being held accountable by shareholders or otherwise
> - in addition, an individual who is personally implicated in such a breach—who helps in or is privy to the misconduct—should be exposed to personal liability as an accessory in accordance with ordinary criminal law principles.
>
> Beyond the approach supported above, the Committee considers that great care should be taken in considering any extension of personal liability for the breach of a law by a company. Proper account should be taken of the individual rights of corporate officers—and how their proposed treatment compares with the way other citizens, including individuals involved in the governance of non-corporate organisations, are dealt with—as well as the interest in promoting corporate compliance with relevant statutory requirements.
>
> The Committee acknowledges that in some circumstances a legislature may judge it appropriate to go beyond accessorial liability and impose a duty on a specified individual to ensure that a company complies with a particular legislative requirement. In effect, provisions of this kind impose a form of strict liability upon a designated officer. The Committee considers that any such provision should be confined to responsibility for ensuring that a company complies with a specific operational or administrative requirement, such as the filing of a return by a particular date. It should not extend to areas where compliance requires the exercise of significant judgment or discretion.[iv]

The CAMAC report also provided a model provision proposed for use in circumstances where a legislature sees a need to make a designated corporate officer personally responsible for the discharge of a specified obligation (p 42).[v]

CSA is of the view that the Bill is not in accord with the spirit of the COAG principles, which were informed by the CAMAC report. While the government has promised a second tranche of legislation this month which it says will contain all proposed amendments on directors' liability, we understand from Treasury that none of those amendments will relate to the Corporations Act. Therefore, the only reduction in criminal liability provisions in the Corporations Act are contained in this Bill, which amends s 188, that currently imposes liability on company secretaries for a company's breach of specified sections of the Corporations Act relating to administrative requirements, to make it a civil penalty provision, rather than an offence provision.

CSA supports this amendment. Indeed, CSA is of the view that the relief provided is of great note given the significant increase in the severity of penalties.

CSA also notes that the explanatory material accompanying the Bill does not contain any explanation as to the public policy reasons for:

- retaining criminal liability for a failure to notify ASIC of the personal details of a director, alternate director or secretary on their appointment, when their personal details change, or when they cease acting as a director or secretary within 28 days after the date on

which the change occurs (ss 205B(1), (2), (4), (5))) or failure to lodge an annual report with ASIC (s 319(1)))
- why other sections in the Corporations Act attaching criminal liability to officers are being retained
- how the decisions for the amendments contained in this Bill relate to the COAG principles.

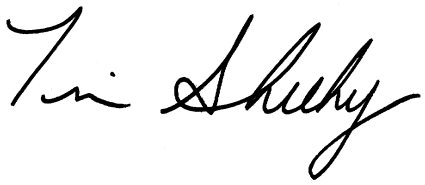
CSA is strongly of the view that the onus should be on the Commonwealth, state and territory governments to justify the retention of a criminal provision, with rigorous standards to be met to ensure they are consistent with the overall COAG principles. In each instance, the explanatory material should clearly indicate how the COAG principles template was applied to each provision to conclude that public policy dictates the retention of a criminal provision.

CSA also strongly recommends that the Commonwealth, state and territory governments endeavour to simplify the plethora of legislation imposing criminal liability on officers, consistent with the COAG principles.

To date, it is not apparent that such rigour has been applied.

In preparing this submission, CSA has drawn on the expertise of the members of our national policy committee, the Legislation Review Committee. We are more than happy to discuss with you the issues highlighted in this submission.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE

End notes

[i] On 7 December 2010, COAG agreed to a set of six principles for the imposition of personal criminal liability for directors and other corporate officers in circumstances of corporate fault (COAG Principles). The Principles are that:

1. Where a corporation contravenes a statutory requirement, the corporation should be held liable in the first instance.
2. Directors should not be liable for corporate fault as a matter of course or by blanket imposition of liability across an entire Act.
3. A 'designated officer' approach to liability is not suitable for general application.
4. The imposition of personal criminal liability on a director for the misconduct of a corporation should be confined to situations where:
    a. there are compelling public policy reasons for doing so (for example, in terms of the potential for significant public harm that might be caused by the particular corporate offending);
    b. liability of the corporation is not likely on its own to sufficiently promote compliance; and
    c. it is reasonable in all the circumstances for the director to be liable having regard to factors including:

i. the obligation on the corporation, and in turn the director, is clear;
ii. the director has the capacity to influence the conduct of the corporation in relation to the offending; and
iii. there are steps that a reasonable director might take to ensure a corporation's compliance with the legislative obligation.

5. Where principle 4 is satisfied and directors' liability is appropriate, directors could be liable where they:
    a. have encouraged or assisted in the commission of the offence; or
    b. have been negligent or reckless in relation to the corporation's offending.
6. In addition, in some instances, it may be appropriate to put directors to proof that they have taken reasonable steps to prevent the corporation's offending if they are not to be personally liable.

[ii] Corporations and Markets Advisory Committee, *Personal liability for corporate fault*, September 2006. The report was prepared in response to the reference to the Advisory Committee in July 2002 by the then Parliamentary Secretary to the Treasurer of issues relating to directors' duties and personal liability.

[iii] Corrs Chambers Westgarth, *Directors' liability reform: Analysis of the application of COAG's directors' liability principles — Report*, Council of Australian Governments Reform Council, August 2011.

[iv] Corporations and Markets Advisory Committee, *Personal liability for corporate fault*, September 2006. The Report states on pp 33-35: 'The Committee is of the view that, as a general principle, individuals should not be made criminally liable for misconduct by a company except where it can be shown that they have personally helped in or been privy to that misconduct, that is, where they were accessories. There was strong support for this position in submissions. The Committee is concerned about the trend in various pieces of legislation to treat directors or other corporate officers as criminally liable for misconduct by their company unless they can make out a relevant defence. Provisions of this kind are objectionable in principle and unfairly discriminate against corporate personnel compared with the way in which other people are treated under the criminal law:

- the deeming of individuals to be guilty of an offence, by reason of an office they hold or a role they play, unless they can establish a defence, offends ordinary notions of fairness
- the reversal of the onus of proof inherent in such provisions is contrary to the general presumption of innocence in criminal law
- the fact that someone is a corporate officer should not subject that person to criminal liability in a way that an individual in other circumstances, or an individual in a responsible position in a non-corporate organisation, would not be so subject
- the fact that a corporate officer may be able, in the circumstances of a particular case, to make out a relevant defence and thereby avoid conviction does not remove the seriousness of the risk to reputation and the apprehension, effort and expense to which he or she is subject by being exposed to criminal liability on a prima facie basis
- as a practical matter, whatever justification there may be, in the context of a small or closely-held company, for treating the individuals who run the company as personally responsible for its conduct, this approach becomes increasingly problematic in the case of larger corporate organisations. It does not fit at all well with the current Australian preferred governance model of boards constituted by a majority of non-executives
- an undue skewing of personal liability provisions, towards the interests of corporate compliance at the expense of individual fairness, will discourage people from accepting board or managerial positions in corporate enterprises.

Apart from objections in principle to this extended form of personal liability, the range and disparity in the form of the deeming provisions found in various pieces of legislation create complexity and work against clear understanding and effective compliance.'

[v] Corporations and Markets Advisory Committee, *Personal liability for corporate fault*, September 2006, p 38: 'A corporation must appoint an individual [or individuals] within the corporation to be a designated officer [for particular designated purposes]. If the corporation

fails to appoint a designated officer, each director of the corporation is taken to be a designated officer. A designated officer must take reasonable steps to ensure compliance by the corporation with its obligations under the Act [in relation to those designated purposes]. A designated officer is liable for non-compliance unless that person establishes [on the balance of probabilities] that he or she took all reasonable steps to prevent the non-compliance.'