30 March 20112

The Manager
Governance and Insolvency Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via Email: personalliabilityforcorporatefault@treasury.gov.au

Dear Sir/Madam,

The Corporations Committee of the Business Law Section of the Law Council of Australia (**Committee**) would like to thank the Treasury for the opportunity to comment on the exposure draft of the *Personal Liability for Corporate Fault Reform Bill 2012* (the **Draft Bill**).

1. Executive Summary

The Committee strongly supports the recommendations of the Corporations and Markets Advisory Committees (**CAMAC**) in its report *Personal Liability for Corporate Fault (September 2006),* and supports in principle the approach taken by the Council of Australian Governments (**COAG**) to ensure that there is a comprehensive review of relevant statutes across all jurisdictions where the statutes create either **derivative** liability or a reversal of onus of proof. However, the Committee is of the view that there is room for enhancing the recommendations of COAG to ensure a more appropriate response to strict liability and related legislation. This view is reflected in its submission.

Whilst the Committed expressed in its letter of 20 May 2011 its concerns in relation to the approach that was taken by the Commonwealth in the confidential draft legislation proposed at that time, the Committee appreciates the fact that this is a matter that does require a careful consideration of all relevant issues. This review process has taken a very long time – nearly seven years since the CAMAC report – and the Committee is hopeful that the review process will be completed before the end of 2012.

2. Corporations Act

The Committee believes that the absence of the need for substantial amendments in the Corporations Act reflects its broad conformity with the general principles for derivative liability that have been adopted.

The Committee notes that of the 29 amendments to the Corporations Act proposed by the Draft Bill:

(a) 14 amendments, in its view, relate to non-substantive matters or deal with minor typographical amendments; and

(b) eight recommendations relate to the table of penalties in Schedule 3.

2.1 Amendments in relation to section 188

The Committee welcomes the changes sought by the Draft Bill in relation to removing criminal liability for breaches of section 188(1) and (2).

However, in the Committee's view, the Draft Bill's proposed amendments to section 188(3) are limited in substance and should go further. Effectively, the Draft Bill proposes to change the defence to a breach of section 188(1) or (2) of taking "*all reasonable steps*", to taking "*reasonable steps*". This very minor change retains the reverse burden of proof and derivative liability, contrary to the principles and approach adopted by COAG and CAMAC. These principles could be implemented in relation to section 188 if the section was significantly amended to remove or minimise the strict derivative liability imposed on secretaries (and directors), including the reverse onus imposed by the "reasonable steps" defence (rather than just removing the word "*all*").

For example, the Committee would support s188 being replaced with an obligation on company secretaries (and directors, as relevant) to take reasonable steps to ensure the relevant company's compliance with the relevant sections listed in section 188(1) (compare section 344(1) in the context of financial statements). This would accord more closely with the COAG and CAMAC principles and recommendations and would eliminate the reverse onus of proof currently imposed on officers regarding the reasonable steps defence.

2.2 Other proposed amendments

The Committee notes that section 1302 (and section 271) has been repealed by the *Personal Property Securities (Corporations and Other Amendments) Act 2010*. Accordingly, the amendments proposed by the Draft Bill to section 1302 (and the related amendments to section 188) are now unnecessary.

The Committee welcomes the amendments proposed by the Draft Bill to section 254Q(13).

2.3 Suggestions for additional amendments to the Corporations Act

The Committee believes that there are two further provisions of the Corporations Act that need to be amended to take into account the principles enunciated by CAMAC and reflect the commitment of COAG to reform this area.

Sections 1308 and 1309 of the Corporations Act

Sections 1308 and 1309 of the Corporations Act are miscellaneous liability provisions that have grown over the last 40 years in a way that imposes potential liability on a director that would not have been contemplated when first included in the Corporations Act.[1]

[1] This prohibition has developed organically over many years. Originally a criminal offence was created for any person "wilfully" making or authorising a misstatement in a document required by or for the purposes of the companies legislation – see section 375 of the *Companies Act* 1961 of each Australian state. The change from wilfulness to a misstatement made with knowledge in current section 1308(2) and the addition of liability for misstatements "without having taken reasonable steps" in current section 1308(4) was contained in the *Companies Code* 1981 of each Australian state (see paragraph 877 of the Explanatory Memorandum of the *Companies Bill*). The extension of liability to statements based on information

These sections can operate in a way that imposes potential liability on directors as officers that is inconsistent with and undermines more expressly drafted director liability provisions of the legislation that may also impose derivative liability on a director for relevant conduct.[2] The sections also operate in a different way to the more appropriate miscellaneous liability provisions of Part 7.2, Division 2 that imposes potential director liability through accessorial liability. In potentially imposing liability on directors pursuant to these sections, the legislation uses the relatively imprecise description of a person or officer who "authorises" or "permits" the making of a statement.[3] The term "authorise", as an indicator of liability for the role of the director in the governance structure, has been removed in other contexts and replaced by accessorial liability.[4]

It is uncertain whether directors who abstain, vote against or who are not present in a vote on certain conduct would be liable as "authorising" the conduct, or whether directors generally would be liable for any conduct engaged in by management under delegated authority. The boundaries of "permitting" conduct are similarly uncertain. For example, whether "permitting" conduct only applies to an individual who has the authority to prevent the commission of the offence, or applies to all relevant individuals by imposing an obligation to monitor and identify where offending conduct is engaged in and report this to someone who does have authority to prevent the commission of the offence. This fails to meet the derivative liability principles by imposing liability on persons who may have no knowledge of the relevant conduct and individuals who are not true accessories to the prohibited conduct.

In order to be consistent with the general thrust of the general principles for determining derivative liability the Committee supports the removal of the references to "authorises"[5] and "permits"[6] in these sections.[7]

3. Proposed amendments to other Commonwealth legislation

3.1 Pooled Development Funds Act (Cth) 1992

The Committee welcomes the amendments proposed by the Draft Bill to the *Pooled Development Funds Act (Cth) 1992*

3.2 Foreign Acquisition and Takeovers Act (Cth) 1975

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containing misstatements in current section 1308(3) and section 1308(5) was contained in the *Corporations Law* (see paragraph 3901 and 3903 of the Explanatory Memorandum to the *Corporations Bill* 1988).
The development of section 1309 commenced later than section 1308 but since that time has closely followed its lead. The antecedent provision was first inserted in the companies legislation as section 375A (titled "False Reports") in 1971 by the *Companies (Amendment) Act* 1971 (NSW) (No 61 of 1971). Section 375A provided that an "officer" who with "intent to deceive" makes or furnishes or knowingly and wilfully "authorises or permits" a misstatement to a director, shareholder, auditor or a prescribed stock exchange was guilty of an offence. The *Companies Code* 1981 removed the intent to deceive and wilfulness elements and replaced them with a knowledge test (as with current section 1309(1)) and a "without having taken reasonable care test" (as with current section 13909(2)). The expansion of liability from officers to employees was made by the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act* 2004 and arose from Recommendation 2 of the HIH Royal Commission (see paragraph 5.571, 5.578 and 5.579 of the Explanatory Memorandum to the Bill).

[2] For example director liability for financial statements pursuant to section 344, director liability for disclosure documents pursuant to Part 6D and Part 7.9, director liability for takeover documents pursuant to Part 6D.3, and accessory liability for Part 6DCA.

[3] See *NRMA v Morgan* (1999) 31 ACSR 4-35 at 796-9 for a discussion on meaning of "authorising" a statement.

[4] See for example the legislative history of the current section 728 (3).

[5] In sections 1308 (2) to (5) and 1309 (1) to (3). Section 1308 (6) could then be removed.

[6] In sections 1309 (1) to (3).

[7] The Committee would also support the deletion of these sections in their entirety on the basis they overlap with Part 7.2, Division 2.

The Committee would like to see further, more wholesale reforms made to directors' liability under the *Foreign Acquisition and Takeovers Act (Cth) 1975* (**FATA**).

The Draft Bill proposes to amend section 31(1) of the FATA by introducing the concept of an officer "authorising or permitting" the commission of an offence by a corporation. For the reasons discussed above in relation to sections 1308 and 1309 of the Corporations Act, this test is unsatisfactory and should not be included in the act.

More broadly in relation to the FATA, the Committee considers that the COAG principles have not been applied in full to directors' liability under the FATA. In particular, it is questionable whether (as per Principle 4) liability of the corporation is not sufficient to promote compliance with the FATA, considering that the act chiefly deals with the divestment of assets. The Committee suggests that specific director liability is unnecessary under the FATA and that existing criminal law principles of accessorial liability would be sufficient to prosecute any wrong doing by officers of relevant corporations.

Accordingly, the specific director liability provisions in the FATA should be removed.

3.3 Insurance Contracts Act (Cth) 1984

The Committee has some concerns regarding the proposed amendments to the *Insurance Contracts Act (Cth) 1984* (**ICA**).

The explanatory document for the Draft Bill states that the aim of repealing the existing section 76A of the ICA and inserting a new section 11DA is to impose personal liability only when the director, employee or agent (**relevant individual**) has intentionally been involved in the relevant offence. However, the amendments impose liability on a relevant individual where that individual "permits or authorises" the insurer to "engage in conduct".

The first concern to the Committee is the imprecise description of "authorising" or "permitting" conduct. The reason for this concern is outlined above in relation to section 1308 and 1309 of the Corporations Act.

Adding to this ambiguity, the Draft Bill also provides that "engaging in conduct" incudes omitting to perform an act. A relevant individual who "permits" a company to "omit to perform an act" could encompass a very broad range of persons and circumstances where an individual has no knowledge of (or involvement in) the offence (contrary to COAG Principle 5).

The Committee would therefore advocate that references to "permits or authorises" be removed and replaced with accessorial liability.

Furthermore, the Draft Bill provides that a director, employee or agent may be convicted of the offence (being an offence of derivative liability for the breach by the company) without the company being convicted of (or even prosecuted in respect of) the relevant offence first.[8]

However it is an essential element of the individual's liability that the relevant insurer has in fact committed the relevant offence.[9] It is unfair and indeed contrary to the logical

[8] Proposed new section 11DA(3)(b).
[9] Proposed new section 11DA(1)(d).

operation of derivative liability for an individual to be liable without the company needing to be convicted (or at least successfully prosecuted) first. In particular:

(a) the company may be able to establish a successful defence to such a prosecution, thereby removing any liability of the relevant individuals. In the interests of justice insurers must be given the opportunity to defend such allegations, rather than being found to have committed an offence in their absence; and

(b) individuals may not have sufficient (or indeed any) relevant knowledge to successfully defend such a charge (for example, if the individual has ceased to be engaged by the company or if the company is otherwise unwilling to provide such information to the individual)

This amendment not only runs counter to the principles and recommendations of CAMAC and COAG, but also heightens the risk of wrongful conviction. It also raises the fundamental issue of an insurer being found to have committed an offence (which is an essential element of an individual's liability) without the insurer being prosecuted for the offence and having an opportunity to resist the charges or establish a defence.

The Committee therefore recommends that the proposed new section 11DA(3)(b) of the IC be removed.

4. Suggested formulation of director derivative liability provisions

To the extent that Treasury maintains the imposition of specific liability on directors, the Committee recommends that in the interests of ensuring optimal drafting, the model provision proposed by the Australian Law Reform Commission (and supported by CAMAC) should be adopted.

The ALRC model as set out by CAMAC is as follows:

"*Where a corporation contravenes a relevant provision, the prosecution must prove the following physical and fault elements in any criminal action against an individual in consequence of that contravention:*

(a) 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; [This could be replaced with "director"] and

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

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

(d) the individual failed to take all reasonable steps to prevent the contravening conduct."

The Committee believes that this proposed model provides a cogent and reasonable formulation for director liability and is supported by both ALRC and CAMAC. Accordingly, the Committee recommends that this model provision be used as the basis for all derivative liability provisions.

5. Conclusions

The Committee welcomes Treasury taking steps to implement the directors' liability reforms that have been proposed over the last seven years. However the Committee advocates for the submissions set out in this letter to be incorporated into this reform process.

If you would like to discuss this submission further, please contact Professor Bob Baxt on 03 9288 1628 or via email: bob.baxt@freehills.com.

Yours sincerely,

Margery Nicoll
Acting Secretary-General