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ENFORCING BREACHES OF DIRECTORS' DUTIES BY A PUBLIC BODY AND ANTIPODEAN EXPERIENCES

By Andrew Keay* and Michelle Welsh#

A. INTRODUCTION

If directors in the United Kingdom breach the duties that are imposed on them by the Companies Act 2006, and found in ss.171-177, it is the company which must take action against them in order to secure some sort of relief. The company is the beneficiary of the relief. This has been the law in the UK for well over 150 years and certainly since the decision in the classic case of *Foss v Harbottle*.¹ This is also the position in most common law jurisdictions. The fact that the company has to initiate actions is supported now by s.170(1) of the Companies Act 2006 as it provides that the duties of directors are owed to the company, and not to anyone else, not even the shareholders.² The power to bring proceedings on behalf of a company is vested in the board of directors as the board is generally granted, by the articles of association, the power to manage the company³ and the commencement of legal action would fall within this general power. But there are a host of reasons why a company might not proceed against errant directors and as a consequence the company does not get compensated for the breach and directors are not held to account for their wrongdoing. Included amongst the reasons are: where the whole board or those who control

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¹ *Foss v Harbottle* (1843) 2 Hare 461; 67 ER 189.

² There are rare situations in UK law where directors might owe a duty to shareholders (*Dawson International Plc v. Coats Paton Plc* (No.1) 1988 SLT 854; [1989] BCLC 233). A possible example is when the company is the subject of a takeover offer (eg, *Gething v. Kilner* [1972] 1 WLR 337; *Re a Company* [1986] BCLC 382; *Brunninghausen v Glavanics* [1999] NSWCA 199; (1999) 17 ACLC 1247).

³ For instance, see the Companies (Model Articles) Regulations 2008, SI 2008/3229, reg 2, Sch 1, art 5 (private companies); reg 4, Sch 3, art 5 (public companies).

the board are in fact the wrongdoers, there will be no action commenced; the cost of legal proceedings will be significant; the board is not convinced that the company would have a good chance of succeeding; the miscreant director might well be impecunious and any action that is successful might not produce any benefit for the company; board members might be embarrassed by the breach and do not want it publicised, and the board might even take the view that it is better for business that the breach is not publicised; board members might decide not to take action because they are influenced by the fact that they have become friendly with the miscreant or other members of the board who might support the miscreant.⁴

In the nineteenth century the English courts developed one, and many would argue several, exceptions to the rule in *Foss v Harbottle* that only the company could bring proceedings to seek relief for damage suffered by the company. The courts took the view that not adopting the exceptions would be unfair to the shareholders, who might ultimately lose out if their company did not proceed against wrongdoing directors. With that in mind the courts permitted shareholders to bring proceedings, on behalf of the company, against directors with any relief going to the company. These proceedings became known as derivative actions,⁵ and now the right to bring such proceedings is enshrined in the Companies Act 2006,⁶ and in the companies legislation of most common law jurisdictions.⁷

The right of the company or its shareholders to bring proceedings for a breach of directorial duties obviously entails private enforcement. The UK relies heavily on the private enforcement of breaches of the duties contained in the Companies Act 2006 by way of

⁴ For further discussion, see A. Keay, "An Assessment of Private Enforcement Actions for Directors' Breaches of Duty" (2014) 33 Civil Law Quarterly 76.

⁵ The description being used first in the UK by the Court of Appeal in *Wallersteiner v Moir (No 2)* [1975] QB 373. The description was borrowed from American law.

⁶ Companies Act 2006, Part 11.

⁷ For example, see Corporations Act 2001 (Aust), Part 2F.1A.

derivative actions. Nevertheless, a number of commentators,⁸ as well as government reports,⁹ have argued that the enforcement of breaches of these duties using private mechanisms has generally been ineffective. Perhaps most notably, in the context of breaches of directors' duties, is that only a few derivative actions have been initiated, and this has been the case since these actions were introduced.¹⁰ Because relatively little private enforcement of breaches of directors' duties seems to be occurring in the UK it has been argued that provision should be made in statute for the public enforcement of duties.¹¹ Assuming that there is strength in this argument we must now ask what should this public enforcement look like? The main issue is what kind of action should be provided for in law? In addressing this question the article considers the way that Australia has proceeded in the past 20 years or so in permitting the public enforcement of breaches of directors' duties.

Public enforcement of directors' duties can be achieved via a variety of mechanisms including criminal and civil penalty enforcement regimes. Australia was the first English speaking jurisdiction to introduce statutory duties supported by criminal sanctions when they

⁸ A. Reisberg, *Derivative Actions and Corporate Governance* (Oxford, OUP, 2007); H. Hirt, *The Enforcement of Directors' Duties in Britain and Germany* (Bern, Peter Lang, 2004); J. Parkinson, *Corporate Power and Responsibility* (Oxford, Clarendon Press, 1993) at Chapter 8; D. Ahern, "Directors' duties: broadening the focus beyond content to examine the accountability spectrum" (2011) 33 *Dublin University Law Journal* 116; "We must make boards better" *Sunday Times*, 9 January 2011, R. Garratt; B. Hannigan, "Board failures in the financial crisis : tinkering with codes and the need for wider corporate governance reforms : Part 2" (2012) 33 *Company Lawyer* 35 at 40; Keay, "An Assessment of Private Enforcement Actions" supra n 4. There are also problems in the US in this regard. See. R. Jones and M. Welsh, "Toward a Public Enforcement Model for Directors' Duty of Oversight" (2012) 45 *Vanderbilt Journal of Transnational Law* 343.

⁹ For example, see Department of Business Innovation and Skills, *Transparency and Trust : Enhancing The Transparency of UK Company Ownership and Increasing Trust in UK Business:*, Discussion Paper, July 2013 at para 8.13 and accessible at : https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212079/bis-13-959-transparency-and-trust-enhancing-the-transparency-of-uk-company-ownership-and-increaing-trust-in-uk-business.pdf (accessed 13 August 2013).

¹⁰ Keay, "An Assessment of Private Enforcement Actions" supra n 4. While more actions have been initiated in Australia compared with the UK, the number instituted in Australia has not been substantial (I Ramsay and B Saunders, "Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action" (2006) 6 *Journal of Corporate Law Studies* 397, 423-424) and this notwithstanding that a public regulator, the Australian Securities and Investments Commission, is entitled to bring proceedings against directors for breaches of duty.

¹¹ A. Keay, "The Public Enforcement of Directors' Duties: A Normative Inquiry" (2014) 43 *Common Law World Review* 89.

were introduced in the State of Victoria in 1958.¹² This was followed by the introduction of the civil penalty regime in 1993.¹³ Currently the Australian Securities and Investments Commission (“ASIC”)¹⁴ has the power to investigate possible breaches of the statutory duties. Where criminal conduct is suspected ASIC can refer the matter to the Commonwealth Director of Public Prosecutions (CDPP) for prosecution. If a civil breach is suspected ASIC itself is entitled to bring civil penalty proceedings against directors.

The article considers the possibility of the introduction of similar enforcement regimes in the UK. The argument advanced in this article is that despite the possible advantages that may flow from the introduction of a criminal enforcement regime, such a regime is unlikely to be adopted in the UK. Currently UK law allows a public regulator to seek disqualification orders against directors, however the other orders available under the Australian civil penalty regime, namely pecuniary penalties and compensation orders, are not available generally. As we explain later, there is a Bill before Parliament which seeks to permit courts to make compensation orders in limited cases, namely against directors who are disqualified and we offer some critique of that. The article examines the civil penalty regime that is currently available in Australia and argues that the introduction in the UK of a similar regime providing for the making of the same kind of orders would be beneficial.

¹² Companies Act 1958 (Vic), s 107. This provision was adopted following a report of the Victorian Statute Law Revision Committee on the conduct of the company directors of Freighters Ltd, a public company listed on the Stock Exchange of Melbourne: See Victoria, Parliamentary Debates (9 September 1958) 324 and Report of the Inspector Appointed to Investigate the Affairs of Freighters Limited Pursuant to the Provisions of the Companies (Special Investigations) Act 1940 (17 September 1956). For a discussion of the background to the Freighters’ Report see J Harris, A Hargovan and J Austin, “Shareholder Primacy Revisited: Does the Public Interest have any Role in Statutory Duties?” (2008) 26 Company and Securities Law Journal 355, 360. See also G F K Santow, “Codification of Directors’ Duties” (1999) 73 Australian Law Journal 366.

¹³ The civil penalty regime is contained in Corporations Act 2001 (Aust), Part 9.4B.

¹⁴ Formerly it was known as the Australian Securities Commission and before that the National Companies and Securities Commission.

The article has the following structure. First, consideration is given to whether enforcement should involve criminal or civil penalty proceedings generally. Second, the article examines Australia's public enforcement model with an emphasis on the operation of the civil penalty regime. This is followed by an examination of the Australian Securities and Investments Commission's use of the regime. Fourth, there is an assessment of the regime in the context of UK company law and practice. Finally, some concluding remarks are offered.

One word concerning terminology. The word "company" is generally used in the UK, while Australia tends to use "corporation." While there are historical differences between the terms, they are today generally viewed as being synonyms today and in this article we employ both without intending to differentiate between them.

B. CRIMINAL OR CIVIL PROCEEDINGS

Naturally any public enforcement mechanism could be criminal, civil or a mixture of both. Whilst we do not intend to examine in any detail the policy behind the criminalisation of duties, something that has been embraced recently in New Zealand,¹⁵ we do need to broach whether it would be appropriate to introduce such an approach in the UK. We also need to consider what sort of civil proceedings might be available to a public authority which seeks to enforce breaches of duty, if civil proceedings are preferable.

¹⁵ See the Companies Amendment Act (NZ) 2014. In particular note the new s 138A of the Companies Act 1993.

1. Criminal Sanctions

If adopted, a criminal enforcement regime would allow a public prosecutor to initiate a court based enforcement action against a director who was suspected of breaching the statutory directors' duties, when it is in the public interest to do so. Criminal enforcement regimes adopt stricter evidentiary and procedural rules than civil regimes and the criminal standard of proof is proof beyond reasonable doubt. Following conviction the penalties that may be imposed under criminal enforcement regimes can range from minor sanctions such as suspended sentences to severe sanctions, such as imprisonment. Often fines of varying amounts are also available. Typically criminal enforcement regimes are designed to punish wrongful behaviour; to provide for specific and general deterrence;¹⁶ and to provide for retribution. Incarceration of a defendant can protect the public from the impact of future criminal activity.

Due to the harsh sanctions that can be imposed under a criminal enforcement regime typically they are utilised for the type of offending behaviour that society deems to be the most egregious.¹⁷ In 2011 the Australian Government released an updated version of "A Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers."¹⁸ This guide provides a list of factors that should be considered when determining whether a criminal enforcement regime is appropriate in a given circumstance. According to the guide the relevant factors include: the degree of malfeasance or the nature of the wrongdoing

¹⁶ Commonwealth Treasury, Review of Sanctions in Corporate Law (Discussion Paper, 2007) [2.24], <http://archive.treasury.gov.au/contentitem.asp?ContentID=1182> accessed on 3 November 2014.

¹⁷ D Brown, "Street Crime, Corporate Crime and the Contingency of Criminal Liability" (2001) 149 University of Pennsylvania Law Review 1295, 1330. See also Commonwealth Treasury, supra n 16 [2.4] – [2.7] and [2.18].

¹⁸ Attorney General's Department, Australian Government, A Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers (2011). Available at <http://www.ag.gov.au/Publications/Documents/GuidetoFramingCommonwealthOffencesInfringementNoticesandEnforcementPowers/A%20Guide%20to%20Framing%20Cth%20Offences.pdf>. Accessed 21 September 2014.

involved and whether the relevant conduct involves, or has the potential to cause, considerable harm.¹⁹

The use of criminal sanctions for corporate misconduct is not a new phenomenon. A number of studies have identified a trend in the US from the middle of the last century of increasing criminal liability for both corporate entities and the directors and officers that control them.²⁰ Other scholars have noted that European legislators have increasingly turned to individual criminal liability over the past two decades.²¹ There are various provisions of the UK companies legislation that allow for criminal liability following a breach of some of the obligations imposed on corporate directors.²² Some of these provisions cover circumstances that could also give rise to a breach of the directors' duties.²³ Many jurisdictions, including the UK, the US, Canada and Australia allow for criminal prosecution of directors where the misconduct is serious and involves theft, bribery, fraud or embezzlement. Australia and New Zealand have criminal sanctions for intentional contraventions of some statutory directors' duties.²⁴

Simpson argues that one of the reasons why legislatures are increasingly favouring both corporate criminal liability and individual criminal liability for corporate directors is because it is perceived that a criminal prosecution increases deterrence, when compared with civil

¹⁹ Ibid, 8.

²⁰ S Simpson, *Corporate Crime, Law and Social Control* (Cambridge, CUP, 2002), 18-9.

²¹ D Kerem, "Change we Can Believe In: Comparative Perspectives on the Criminalisation of Corporate Negligence" (2012) 14 *Tennessee Journal of Business Law* 95, 104.

²² For example, engaging in fraudulent trading: Companies Act 2006 s 993.

²³ For a discussion of some of these provisions see B Black, B Cheffins, M Gelter, H J Kim, R Nolan, M Siems and L Prava, "Legal Liability Of Directors And Company Officials Part 2: Court Procedures, Indemnification And Insurance, And Administrative And Criminal Liability (Report To The Russian Securities Agency)" (2008) *Columbia Business Law Review* 1, 148-9.

²⁴ For example, Companies Act 1993 (NZ) s 138A provides that a New Zealand director is criminally liable if he or she exercises powers or performs duties as a director in bad faith towards the company and believing that the conduct is not in the best interests of the company and knowing that the conduct will cause serious loss to the company. See *infra* text to nn 68 - 69 for details of the Australian provisions.

penalty or other types of enforcement actions.²⁵ Arguably this increased deterrence arises because harsher penalties are available under criminal regimes than are available under other enforcement regimes and a greater stigma is associated with a criminal prosecution than is associated with other enforcement actions. The UK Company Law Steering Group identified a further reason why legislatures may favour criminal sanctions for corporate misconduct. If legal requirements are supported by criminal sanctions professional advisors, such as lawyers, have a lever to encourage greater compliance. They can point to the potential for criminal liability when trying to discourage corporate managers from embarking on an endeavour that may put them in a position where they are contravening the law.²⁶

Criminal liability for corporations and individual directors is supported by scholars who argue that white collar crime should be treated as seriously as other types of crimes.²⁷ A failure by corporate managers to comply with their duties can have serious consequences that can be felt by more than just the corporation and its shareholders; it can adversely affect the wider community.²⁸ However, not all scholars support the use of criminal sanctions for corporate misconduct. Criticism levelled at such regimes generally fall into two broad categories; first that criminal sanctions are not appropriate in these circumstances²⁹ and

²⁵ Simpson 2002, supra 20. See also S Watson and R. Hirsch “Empty Heads, Pure Hearts: The Unintended Consequences of the Criminalisation of Directors' Duties” (2011) *New Zealand Business Law Quarterly* 302 at 308 discussing the reasons for the introduction of criminal sanctions for breaches of statutory directors’ duty provisions in New Zealand.

²⁶ Co. Law Review, *Modern Company Law for a Competitive Economy: Completing the Structure* ch. 13 (Department of Trade and Industry, 2000); Co. Law Review, *Modern Company Law for a Competitive Economy - Final Report* ch. 15 (Department of Trade and Industry, 2002).

²⁷ Simpson 2002, supra 20, 11 (although Simpson questions the empirical support for deterrence at 26). See also S Simpson “Making Sense of White-Collar Crime: Theory and Research” (2011) 8 *Ohio State Journal of Criminal Law* 481; T R Tyler, “Reducing Corporate Criminality: The Role of Values” (2014) 51 *American Criminal Law Review* 267, 271 - 2.

²⁸ Australian Law Reform Commission (ALRC), *Securing Compliance: Civil and Administrative Penalties in Australian Federal Regulation*, Discussion Paper No 65 (2002), [3.38].

²⁹ See for example J Coffee, “Paradigms Lost: The Blurring of the Criminal and Civil Law Models – And What Can Be Done About It” (1992) 101 *Yale Law Journal* 1875, 1876; M Bagaric, “The ‘Civil-isation’ of the Criminal Law” (2001) 25 *Criminal Law Journal* 184, 186-7 and 192; and ALRC, supra n 28, [3.37].

second, where criminal regimes are adopted, often they prove to be inadequate.³⁰ The argument that criminal sanctions are inadequate enforcement mechanisms for corporate misconduct is based on a belief that the detection, prosecution and conviction rates are perceived to be too low. Some scholars argue that in the rare cases when sanctions are imposed, they often bear little relation to the harm inflicted or the profits made.³¹ The following section of the article considers an alternate form of public enforcement, civil penalties.

2. Civil Penalties

Civil penalty regimes are similar to criminal regimes in that they allow a public regulator to instigate court based enforcement actions seeking penalties, where it is in the public interest to do so. The orders that may be sought under a civil penalty regime can include pecuniary penalties, disqualification and compensation orders. As is the case with criminal regimes, the orders that may be imposed under civil penalty regimes are designed to punish, to deter, to provide for retribution and in some cases, compensation.³² Disqualification orders may serve an additional purpose of protecting the public from future wrongdoing.³³ While civil penalty regimes share some similar features with criminal regimes, they differ in two important respects. First, the rules of evidence and procedure in civil penalty proceedings are the civil

³⁰ See for example R Tomasic, "Corporate Crime" in D Chappell and P Wilson (eds) *The Australian Criminal Justice System The Mid 1990s*, (1994) 253, 263; H Bosch, "Bosch on Business" (1992) *Information Australia* 1, 1; and 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.

³¹ See for example Tomasic, *supra* 30, 263. See also Simpson 2002, *supra* 20, 49-9 and 56.

³² Commonwealth Treasury, *supra* 16, [2.25]

³³ For example an order disqualifying an unfit director from managing companies can provide protection for future shareholders who may otherwise be impacted by poor management decisions made by that director.

rules³⁴ and the standard of proof is proof on the balance of probabilities.³⁵ Second, incarceration is never available as a sanction under a civil penalty regime.

Often, civil penalty regimes are introduced in an effort to overcome many of the difficulties associated with criminal enforcement regimes. Given that the rules of evidence and procedure are civil and the standard of proof is proof on the balance of probabilities, obtaining a declaration that a contravention of a provision enforced by a civil penalty regime has occurred should be easier than obtaining a criminal conviction.³⁶ Therefore, greater sanction certainty should be associated with civil penalty regimes than is associated with criminal enforcement regimes.³⁷ Greater sanction certainty should lead to an increase in the deterrent effect of the law. Some scholars maintain that this increased deterrent effect should be evident, despite the fact that the sanctions that may be imposed under a civil penalty regime may not be as severe as those available under a criminal regime.³⁸

The deterrent capability of civil penalty regimes was recognised by Gillooly and Wallace-Bruce in 1994 when they examined the use of civil penalty provisions in Australian legislation.³⁹ They argued that because it is perceived that civil penalties can have greater deterrent capacity than criminal sanctions they are often utilised as enforcement mechanisms for key pieces of legislation. The authors argued that:

³⁴ For a discussion of the differences between civil and criminal liability in corporate regulation and where the dividing line should be drawn see S Green, *Lying, Cheating and Stealing: A Moral Theory of White-Collar Crime* (2006) and Simpson 2002, supra n 20.

³⁵ See the discussion of *Briginshaw v Briginshaw* infra text to nn 80 - 84.

³⁶ Gillooly and Wallace-Bruce argue that “[g]iven the difference between the criminal and civil standards of proof, it will be easier to establish a defendant’s liability to civil as opposed to criminal penalties.” M Gillooly and N L Wallace-Bruce, “Civil Penalties in Australian Legislation” (1994) 13(2) *University of Tasmania Law Review* 269, 270. See also Commonwealth Treasury, supra n 16, [2.28].

³⁷ D Brown, “Street Crime, Corporate Crime and the Contingency of Criminal Liability” (2001) 149 *University of Pennsylvania Law Review* 1295, 1330.

³⁸ Simpson 2002, supra n 20, 78.

³⁹ Gillooly and Wallace-Bruce, supra n 36.

[c]ivil penalties have a defined function. They play a crucial role in ensuring compliance with specific provisions of the legislation. In all the Acts examined [by the authors in the article], it is plain that the provisions which may attract a civil penalty are regarded as ‘key provisions’ by the legislature. If those provisions are not complied with, there is a real risk that the aims of the legislation in each case would be defeated... The legislature therefore finds it necessary to particularly encourage compliance with those provisions, not by turning persons who contravene them into criminals nor merely by rendering such persons liable to pay compensation, but rather by employing the convenient ‘half way house’ of civil penalties.⁴⁰

Not only should civil penalty regimes result in increased sanction certainty when compared with criminal enforcement regimes, but the cost of obtaining civil penalties should be less than the cost of obtaining criminal convictions.⁴¹ The cost of enforcement is a valid consideration because usually public regulators have insufficient resources to detect, investigate and enforce every contravention of the law that comes to their attention.⁴² This phenomenon was termed “system capacity overload”⁴³ by John Braithwaite who argued that due to resource constraints many regulators are forced to engage in the “pretence of consistent law enforcement where in practice enforcement is spread around thinly and weakly”.⁴⁴ Civil penalties may be attractive options in these circumstances.

Arguably civil penalty regimes can provide an effective alternative to criminal sanctions in situations where a criminal prosecution is problematic for the reasons outlined above.

However, this is not the only reason why civil penalty regimes may provide a preferred alternative to criminal sanctions. Some scholars believe that the reach of the criminal law

⁴⁰ Ibid 288.

⁴¹ K Mann, “Punitive Civil Sanctions: The Middleground between Criminal and Civil Law” (1992) 101 *Yale Law Journal* 1795, 1798. See also Simpson (2002), *supra* 20, 73 and ALRC, *supra* n 28, [2.62].

⁴² I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (1992) and J Braithwaite, *To Punish or Persuade: Enforcement of Coal Mine Safety* (1985).

⁴³ J Braithwaite, *Regulatory Capitalism: How it Works and Ideas for Making It Work Better* (2009), 92. See also J Braithwaite, “The Essence of Responsive Regulation” (2011) 44 *University of British Columbia Law Review* 475, 487.

⁴⁴ Braithwaite (2009), *supra* 43; H Pontell, “Deterrence: Theory versus Practice” (1978) 16 *Criminology* 3.

should be restricted where regulatory offences are concerned.⁴⁵ These scholars may support the use of civil penalties as an alternative.

Rather than treat civil penalty regimes and criminal sanctions as mutually exclusive alternatives, some scholars favor enforcement regimes that include both of these options. Regulators who are provided with criminal sanctions and civil penalties are able to display a flexible approach to corporate misconduct⁴⁶ and can pursue criminal sanctions for the most serious offences, and civil penalties for less serious contraventions of the law.⁴⁷ These types of overlapping enforcement regimes can protect society from both under-enforcement and over-enforcement.⁴⁸ Civil penalties can be utilised in situations where the conduct, although wrongful, is not severe enough to justify the commencement of a criminal prosecution. In these situations if civil penalties were not available there could be no option for public enforcement and under-enforcement may be the result.⁴⁹ In addition, civil penalties may protect against over-enforcement “by providing a noncriminal punitive sanction for conduct

⁴⁵ See, eg Coffee, supra n 29 and Bagaric, supra n 29.

⁴⁶ Mann, supra n 41, 1863. Michael Gething argues that in relation to the directors’ duties contained in the Corporations Act 2001 (Aust) there is a need for a range of sanctions to allow ASIC to effectively enforce the provisions. See M Gething, “Do we Really Need Criminal and Civil Penalties for Contraventions of Directors’ Duties?” (1996) 24 Australian Business Law Review 375, 376.

⁴⁷ In 1992 Zimring wrote that the use of civil penalties allows the regulator to have greater flexibility in his or her choice of the method of enforcement. In addition, he argued that “[c]ivil regimes ... are meant to be supplements; they add more punishment and deterrence to that imposed in the criminal process and give law enforcers a second chance at punishment if the criminal prosecution misses its mark.” F Zimring, “The Multiple Middlegrounds between Civil and Criminal Law” (1992) 101 The Yale Law Journal 1901, 1905.

⁴⁸ Mann, supra n 41, 1865. See also Simpson (2002), supra 20, 74.

⁴⁹ Ayres and Braithwaite argue that difficulties can arise if a regulator only has a single enforcement option, especially when it is severe, because it is impossible to use it except in situations of the most serious offences. Conversely, when less serious offences occur regulators have no appropriate enforcement mechanisms at their disposal. When only one drastic enforcement mechanism is available regulators “often find themselves in the situation where their implied plea to co-operate or else has little credibility. This is one case of how we can get the paradox of extremely stringent regulatory laws causing under-regulation.” Ayres and Braithwaite, supra n 42, 49. See also T Lochner and B E. Cain, “Equity and Efficacy in the Enforcement of Campaign Finance Laws” (1999) 77 Texas Law Review 1891, 1901.

that otherwise would be pushed into the criminal paradigm because its severity makes it unreasonable to impose only a remedial sanction.”⁵⁰

An enforcement regime that has overlapping criminal sanctions and civil penalties would be supported by those scholars who advocate strategic regulation theory.⁵¹ This theory is premised on the belief that regulated individuals are motivated by a variety of factors and that successful regulatory agencies should be armed with a range of enforcement options, in order to deal with them.⁵²

While civil penalty regimes may be supported by scholars who believe that the criminal law can be an inadequate enforcement mechanism for corporate misconduct and by those who believe that the use of criminal law should be reduced in relation to regulatory contraventions, they are not without their detractors. Some scholars question the acceptability of using the civil rules of evidence and procedure to determine liability to what are in effect penal sanctions. Goldstein argues that the object of civil penalty regimes “seems to be to achieve the state's regulatory purpose unimpeded by the "technical" limits imposed by criminal law or criminal procedure”.⁵³ While imprisonment is not a sanction that is available under a civil penalty regime, usually the imposition of civil penalties inflicts significant hardship on defendants, who are subjected to them. Some scholars argue that no penalty of any kind should be imposed without the protection afforded by the criminal law because this increases the risk that penalties may be wrongly imposed. “Deterrence is not enhanced by punishing the innocent, and even if it were, deterrence would then be bought at too high a

⁵⁰ Ibid.

⁵¹ This theory was developed and expanded by John Braithwaite and Ian Ayres. See Ayres and Braithwaite, *supra* n 42; and Braithwaite, *supra* n 42.

⁵² Ayres and Braithwaite, *supra* n 42, 24.

⁵³ A S Goldstein, “White-Collar Crime and Civil Sanctions” (1992) 101 *Yale Law Journal* 1895.

price.”⁵⁴ However, other scholars support the use of civil penalty regimes in circumstances where modified procedural protection is utilised.⁵⁵ Modified rules have been adopted in Australia. These rules are discussed in the next section of the article which examines the public enforcement of the Australian statutory directors’ duties in detail.

C. THE AUSTRALIAN PUBLIC ENFORCEMENT MODEL

Consideration of developments in Australia is appropriate for a number of reasons. First, Australia is a common law jurisdiction whose legal system and laws are based on UK law. Clearly its corporate law has been derived from that applying in the UK and many developments in Australia, over the years, since Australia became a sovereign nation have mirrored those taking place in the UK. And while Australian corporate law has taken several different paths over the past 20 years its corporate law and practice remain very similar to that applying in the UK. Because of all of this any consideration of the Australian law and practice does not have to take into account the use of a different legal approach, which makes application of Australian law a less complicated issue. Second, while there are differences, the duties to which directors are subject in Australia are very similar to those applicable in the UK. The Australian law on these duties is clearly based on that developed in the UK. Third, in considering changes to corporate law the authorities in each nation consider what developments have occurred in the other. This was patent in the deliberations of the Company Law Review Study Group in the late 1990s when it was charged with undertaking a comprehensive review of UK company law. Likewise, the Australian Joint Parliamentary Committee on Corporations and Financial Services in a report titled, Corporate

⁵⁴ Gillooly and Wallace-Bruce, *supra* n36, 271.

⁵⁵ See for example Mann, *supra* n 41.

Responsibility: Managing Risk and Creating Value,⁵⁶ carefully considered aspects of UK corporate law when considering in whose interests companies should be managed. Fourth, the courts in each jurisdiction regularly consider, cite and even follow judgments delivered in the other. Finally, the social norms and values that apply in Australia are similar to those applicable in the UK. Importantly, unlike the UK, which does not have a corporate regulator, Australia does have one, and one that is robust and reasonably well funded.⁵⁷

Currently Australia directors are subject to fiduciary duties to act in good faith in the best interests of the company, to exercise their powers for proper purposes and to avoid undisclosed conflicts between their personal interests and the interests of their company.⁵⁸ In addition, Australian directors owe a duty at common law to exercise reasonable care, skill and diligence.⁵⁹ These duties have their antecedents in the UK fiduciary and common law duties and the private enforcement mechanisms share much in common with their UK counterparts.

⁵⁶ Australian Joint Parliamentary Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* (2006), [4.43] and [6.174-6.175]. Accessible at http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/completed_inquiries/2004-07/corporate_responsibility/report/report.pdf (accessed 20 February 2014).

⁵⁷ While ASIC is generally perceived to be a robust regulator its performance has been the subject of some criticism. For example ASIC has recently been the subject of an Australian Senate Economics References Committee Enquiry. The Committee's final report was critical of some aspects of ASIC's performance, especially in relation to the regulation of financial advisors: See Australian Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission Final Report* (2012). Available at http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/ASIC/Final_Report/index. Accessed 3 November 2014. While relatively well funded when compared with its predecessor the NCSC, ASIC's budget has recently been cut by \$120 million over the next four years. This will impact on staffing levels and the regulator's ability to undertake enforcement actions. ASIC Annual Report 2013-14, 4. Available at <https://dv8nx270cl59a.cloudfront.net/media/2227467/asic-annual-report-2013-14.pdf>. Accessed 3 November 2011.

⁵⁸ See for example *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286; *Darvall v North Sydney Brick & Tile Co Ltd No 2* (1987) 16 NSWLR 212; (1988) 6 ACLC 184; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821; and *Aberdeen Railway Co v Blaikie Bros* [1854] 1 Macq 461.

⁵⁹ *Daniels v Anderson* [1995] 37 NSWLR 438.

Australian directors are also subject to statutory duties contained in the Corporations Act 2001 (Aust).⁶⁰ The statutory duties, which operate in addition to the common law and fiduciary duties⁶¹ are: the duty to exercise powers and discharge duties with a degree of care and diligence;⁶² the duty to exercise powers in good faith and for proper purposes⁶³; the duty not to misuse position,⁶⁴ and the duty not to misuse information.⁶⁵

Public enforcement of statutory directors' duties has been available in Australia since 1958 when the State of Victoria introduced the first statutory duties to apply in any English speaking jurisdiction.⁶⁶ The relevant provision required directors to; "at all times act honestly and use reasonable diligence in the discharge of the duties of office."⁶⁷ A contravention of the provision constituted a criminal offence for which a maximum penalty of £100 could have been imposed. A compensation order in favour of the company could also have been imposed on the director for any profit made and for any damage suffered by the company as a result of the breach. In the following years similar provisions were adopted by the other Australian states and the content of the duties continued to evolve under various State Acts and, from 2001, under the federal Corporations Act 2001 (Aust). The current provisions are outlined above.

⁶⁰ The current statutory directors' duties are contained in Corporations Act 2001 (Aust) ss 180, 181, 182, 183 and 184. However, in the UK the Companies Act 2006 codified the corresponding common law rules and equitable principles (s 170(3)), although it is accepted that directors might owe other duties (not covered by the Act) given what is said in s 178(2).

⁶¹ Corporations Act 2001 (Aust) s 185.

⁶² A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they: (a) were a director or officer of a corporation in the corporation's circumstances; and (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer: Corporations Act 2001 (Aust) s 180(1).

⁶³ A director or other officer of a corporation must exercise their powers and discharge their duties: (a) in good faith in the best interests of the corporation; and (b) for a proper purpose: Corporations Act 2001 (Aust) s 181(1).

⁶⁴ A director, secretary, other officer or employee of a corporation must not improperly use their position to: (a) gain an advantage for themselves or someone else; or (b) cause detriment to the corporation: Corporations Act 2001 (Aust) s 182(1).

⁶⁵ A person who obtains information because they are, or have been, a director or other officer or employee of a corporation must not improperly use the information to: (a) gain an advantage for themselves or someone else; or (b) cause detriment to the corporation: Corporations Act 2001 (Aust) s 183(1).

⁶⁶ S Brown, *Company Directors* (2nd ed, 1965) 179.

⁶⁷ Companies Act 1958 (Vic) s 107. See supra n 12.

A contravention of some of the Australian statutory directors' duties may give rise to criminal liability. Directors commit a criminal offence if they "(a) are reckless; or (b) are intentionally dishonest; and fail to exercise their powers and discharge their duties: (c) in good faith in the best interests of the corporation; or (d) for a proper purpose."⁶⁸ Directors commit a criminal offence if they use their position or certain types of information dishonestly "(a) with the intention of directly or indirectly gaining an advantage for themselves, or someone else, or causing detriment to the corporation; or (b) recklessly as to whether the use may result in themselves or someone else directly or indirectly gaining an advantage, or in causing detriment to the corporation."⁶⁹ Criminal prosecutions are instigated by the Commonwealth Director of Public Prosecutions (CDPP) on referral from ASIC. There is no criminal liability for contravention of the duty of care and diligence.⁷⁰

In 1987 the Australian Senate Standing Committee on Legal and Constitutional Affairs (the "Cooney Committee") conducted a review into the duties and obligations of directors, and the effectiveness of their enforcement. At that time a contravention of the statutory duties could result in criminal sanctions or compensation orders. The findings of the review conducted by the Cooney Committee were published in *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*, (1989) ("Cooney Report").⁷¹ This report highlighted the deficiencies in the enforcement of the directors' duty provisions that existed at that time.

⁶⁸ Corporations Act 2001 (Aust) s 184(1).

⁶⁹ Corporations Act 2001 (Aust) ss 184(2) & (3).

⁷⁰ Corporations Act 2001 (Aust) s 180.

⁷¹ Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*, (1989) ("Cooney Report").

In particular, the Cooney Report noted that there was community discontent because some perceived the sanctions to be inconsistent and inappropriate⁷² and despite the availability of custodial sentences the courts appeared reluctant to impose them.⁷³ At the other end of the spectrum was the belief that competent persons may be discouraged from taking on directorships because of the perceived harshness of the criminal provisions. The Cooney Committee considered the possibility of decriminalising the directors' duty provisions but dismissed this possibility and decided to recommend the retention of criminal penalties for conduct that is genuinely criminal in nature, such as where company directors act fraudulently or dishonestly, and the introduction of civil penalties for breaches where no criminality was involved.⁷⁴ These recommendations were accepted by the Australian Government. In responding to the report the relevant government minister stressed the Government's view that the enforcement of the duties of directors was important because a breach of these provisions could have adverse consequences for many stakeholders including shareholders, other directors, creditors, employees and the general community.⁷⁵ The Government recognised the need to ensure that criminal liability should flow only when the conduct was genuinely criminal in nature and that appropriate mechanisms should be made available to the regulator so that non-criminal contraventions of these provisions could be treated as such.⁷⁶ The civil penalty regime was enacted to implement these recommendations⁷⁷ and it came into operation on 1 February 1993.

The Australian civil penalty regime gives ASIC standing to take court based proceedings alleging that directors have breached their statutory duties. ASIC can seek both a declaration that a contravention has occurred and civil penalty orders. The available orders are pecuniary

⁷² Ibid [13.4].

⁷³ Ibid [13.6].

⁷⁴ Ibid [13.5, 13.8 and 13.2].

⁷⁵ Commonwealth, Parliamentary Debates, Senate, 28 November 1991, 3611 [10] (Senator Richardson).

⁷⁶ Ibid, 3611 [10].

⁷⁷ Explanatory Memorandum, Corporate Law Reform Bill (1992) (Aust), [61 and 114].

penalties up to a maximum of AUD \$200,000 (£110,000), disqualification orders for unlimited periods of time and compensation orders, for the benefit of the company against which the offending conduct occurred.⁷⁸ Some permanent disqualification orders have been made.⁷⁹ The civil rules of evidence and procedure apply to civil penalty proceedings⁸⁰ and while the standard of proof is proof on the balance of probabilities,⁸¹ usually the courts apply the modified Briginshaw⁸² standard of “reasonable satisfaction.”⁸³ This modified standard requires the courts to:

proceed cautiously in a civil case where a serious allegation has been made or the facts are improbable. If the finding is likely to produce grave consequences, the evidence should be of high probative value. The Briginshaw test focuses attention on the standard of the evidence required to prove the case to the ordinary civil standard -- it is not a change in the standard of proof. There is no third standard of proof in the common law.⁸⁴

⁷⁸ Corporations Act 2001 (Aust) ss 1317J, 1317G, 1317H(1), and 206C. Corporations can apply for compensation orders under the civil penalty regime. Corporations cannot apply for pecuniary penalties or disqualification orders. Corporations Act 2001 (Aust) ss 1317J(1) & (2).

⁷⁹ For example permanent disqualification orders have been imposed on Dennis Terracini, former director of Elm Financial Services Group, Shaun Oliver White and Nicole Elaine White both former directors of PFS Groups and Donald Maxwell, former director of Procorp Investments: ASIC v Elm Financial Services Pty Ltd [2005] NSWSC 1065, (2005) 55 ACSR 544; ASIC v White & Ors [2006] VSC 239, (2006) 58 ACSR 261 and ASIC v Maxwell [2006] NSWSC 1052, (2006) 24 ACLC 1,308.

⁸⁰ Corporations Act 2001 (Aust) s 1317L.

⁸¹ Corporations Act 2001 (Aust) s 1332.

⁸² Briginshaw v Briginshaw (1938) 60 CLR 336 at 368.

⁸³ Ibid [3.49].

⁸⁴ L De Plevitz, “The Briginshaw Standard of Proof in Anti-Discrimination Law: Pointing with a Wavering Finger” (2003) 27 Melbourne University Law Review 308, 311. A clear statement of the Briginshaw principle was provided in Neat Holdings Pty Ltd v Karajan Holdings Pty Ltd [1992] HCA 66, (1992) 110 ALR 449. In a joint judgment Mason CJ, Brennan, Deane and Gaudron JJ stated: “The ordinary standard of proof required of a party who bears the onus in civil litigation in this country is proof on the balance of probabilities. That remains so even where the matter to be proved involves criminal conduct or fraud. On the other hand, the strength of the evidence necessary to establish a fact or facts on the balance of probabilities may vary according to the nature of what it is sought to prove. Thus, authoritative statements have often been made to the effect that clear or cogent or strict proof is necessary “where so serious a matter as fraud is to be found”. Statements to that effect should not, however, be understood as directed to the standard of proof. Rather, they should be understood as merely reflecting a conventional perception that members of our society do not ordinarily engage in fraudulent or criminal conduct and a judicial approach that a court should not lightly make a finding that, on the balance of probabilities, a party to civil litigation has been guilty of such conduct. (citations omitted)” at (1992) 110 ALR 449, 449-50.

The purpose of this article is to examine whether consideration should be given to the adoption in the UK of an enforcement model similar to that which is available in Australia. This necessarily involves consideration of the possibility of criminalising the duties of directors in the UK. The first thing to say is that it is highly unlikely that the UK Government would consider embracing a criminalisation of duties in the form that exists in Australia and it is even less likely that it would introduce one that is akin to that which now exists in New Zealand. Outside of clearly criminal activity such as theft, UK law has not criminalised many requirements imposed on directors.⁸⁵ Certainly the uproar in the corporate world that occurred in New Zealand on the announcement that the Government there would introduce criminal offences for breach of directors' duties would pale into insignificance compared with the adverse reaction that would be very likely to occur in the UK if similar action were taken in the UK.

As it is unlikely that the introduction of criminal sanctions would be given serious consideration in the UK, the balance of this article considers the possibility of the adoption in that jurisdiction of some of the elements of the Australian civil penalty regime. For reasons we outline below we believe that it is possible that the introduction of some of these elements may be worthy of consideration. When considering whether such a regime ought to be introduced UK authorities would likely be interested in the way that the Australian regime has operated in practice. Accordingly, the following section of the article examines ASIC's use of the civil penalty regime including the types of applications ASIC has issued and the types of orders it has sought.

⁸⁵ An example of an offence in the present UK legislation is that provided for under s 183. It covers a breach of s 182. This provision requires directors to declare their interest in an existing transaction or arrangement that the company has entered into.

D. ASIC'S USE OF THE CIVIL PENALTY REGIME

1. Types of Applications Issued by ASIC

In the 21 years since the Australian civil penalty regime came into operation the ASIC media releases indicate that ASIC commenced civil penalty proceedings alleging a contravention of the statutory directors' duties on 38 occasions.⁸⁶ Prior to 2000 nearly all of these types of civil penalty applications were issued against directors of proprietary (private) companies. However, this has changed in recent years with 17 of the 29 civil penalty applications issued since 2000 involving public company directors. Many of the civil penalty applications issued by ASIC were issued against high profile defendants. For example, civil penalty applications were issued against the directors of the HIH group of companies,⁸⁷ the James Hardie Group of companies,⁸⁸ the Australian Wheat Board Ltd,⁸⁹ GIO Australia Holdings Ltd,⁹⁰ Centro Properties Limited,⁹¹ and One.Tel Ltd.⁹²

The cases issued prior to 2000 were relatively simple in that many of them were restricted to allegations of contraventions of the statutory directors' duty provisions. In recent years the applications have become more complex. Many of these cases have multiple defendants, some of which are corporate entities and some of which are natural persons.

⁸⁶ Source: ASIC media releases issued between 1 February 1993 and 1 February 2014 (available at ASIC, Media Releases and Advisories <http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Media%20and%20information%20releases%20Home%20Page>).

⁸⁷ Re HIH Insurance Ltd (in prov liq): ASIC v Adler [2002] NSWSC 171, (2002) 41 ACSR 72.

⁸⁸ ASIC v Hellicar [2012] HCA 12.

⁸⁹ ASIC v Lindberg [2012] VSC 332; ASIC v Ingelby [2012] VSC 33.

⁹⁰ Vines v ASIC [2007] NSWCA 75.

⁹¹ ASIC v Healey [2011] FCA 717

⁹² ASIC v Rich 2003 NSWSC 85.

In half of the applications issued since 2000 not only did ASIC allege that the directors breached their duties; it also alleged that other provisions of the Act had been contravened. Examples of other provisions that were alleged to have been contravened include: provisions governing financial benefits to related parties of public companies; continuous disclosure requirements;⁹³ insider trading; corporate financial reporting requirements; misleading and deceptive conduct in relation to shares and financial products;⁹⁴ the operation and promotion of illegal or unlicensed property financing schemes or managed investments schemes; various financial services laws and the promotion of investment schemes without required disclosure documents. In many of these cases ASIC alleged that the statutory duties had been breached by directors because they had exposed their companies to potential liability for contravention of these other provision of the Corporations Act 2001 (Aust).⁹⁵ This approach, allows ASIC to hold directors to account for the misbehaviour of their companies.⁹⁶

A little over half of the civil penalty applications issued since 2000 were issued against directors of insolvent companies. Many of these cases are based on allegations that the directors misused their position to gain an advantage and/or that the company had provided unauthorised financial benefits to related parties by transferring corporate assets to the directors or related third parties prior to the liquidation. In some of the cases involving insolvency the directors were involved in running illegal or unregistered financial services business or managed investment schemes.

⁹³ See for example ASIC v Macdonald [No 11] [2009] NSWSC 287, (2009) 256 ALR 199; ASIC v Citrofresh International (No 2) [2010] FCA 27, (2010) 77 ACSR 69; and ASIC v Fortescue Metals Group Ltd [2011] FCAFC 19, (2011) 190 FCR 364.

⁹⁴ See for example ASIC v Sydney Investment House Equities [2008] NSWSC 1224, (2008) 69 ACSR 1.

⁹⁵ For a discussion of these cases and ASIC's approach see A Herzberg and H Anderson, "Stepping Stones – From Corporate Fault to Directors' Personal Civil Liability" (2012) 40 Federal Law Review 181.

⁹⁶ Ibid.

However, it is important to note that many civil penalty applications have been issued against directors of companies that are not insolvent. Examples of the type of misconduct alleged to have occurred in these applications include a failure to comply with continuous disclosure requirements, misleading and deceptive conduct; failure to exercise duties with care and diligence in approving financial reports; and the misuse of information. One case involved an allegation that company directors breached the duties they owed to their company by allowing it to enter into contracts with the Iraqi Grain Board whereby it paid AUD\$126.3 million (approximately £69.2 million) in breach of UN sanctions.⁹⁷

We now explore two civil penalty applications in more detail as usual examples of the use of the regime; the James Hardie case and the Centro case. In 2007 ASIC commenced civil penalty proceedings against corporate defendants and the directors of James Hardie Industries Ltd (JHIL), a publicly listed company. Solvency was not an issue. The proceedings related to events surrounding a complex restructure that JHIL undertook in 2001 that comprised a series of transactions designed to quarantine it from present and future liabilities to tort claimants who had been harmed by its subsidiaries manufacture of asbestos. The restructure involved the establishment of a company, Medical Research & Compensation Foundation Ltd (MRCF), with a board independent of JHIL, to act as trustee of a trust fund established to compensate current and future asbestos victims. Control of the assets of the former JHIL subsidiaries was transferred to MRCF to meet the victim's claims. The board of MRCF was assured that the James Hardie Group would continue to provide funds to the trust to meet the needs of future asbestos claimants.

As is required under the Australian continuous disclosure requirements JHIL made an

⁹⁷ This civil penalty proceeding was issued against six former directors and officers of AWB Limited. See ASIC media release 07-332 "ASIC launches civil penalty action against former officers of AWB". Available at <http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2007-releases/07-332-asic-launches-civil-penalty-action-against-former-officers-of-awb/>. Accessed 3 November 2014.

announcement to the ASX and issued subsequent press releases about the restructure. The problem was that the announcement gave the false and misleading impression that an effect of the restructure was that MRFCF would have access to sufficient funds to meet current and future asbestos-related claims. This impression was reinforced by JHINV's Managing Director, Macdonald, in a number of presentations he made to overseas institutional investors in which he claimed that the restructure had “ring-fenced” JHINV's asbestos liability, which would be taken care of by a “fully funded” Foundation. In about 2004 it became apparent that the compensation foundation was substantially under-funded and would soon run out of money to meet future claims.

ASIC's civil penalty proceedings alleged that the executive and non-executive directors had breached their statutory duty of care. This complex litigation involved two appeals to the Australian High Court. The ultimate finding in this matter was that the corporate defendants had contravened the Corporations Act 2001 (Aust) by making misleading or deceptive statements in relation to the adequacy of the funding of the foundation and by failing to comply with their continuous disclosure obligations⁹⁸ JHIL's managing director, Macdonald, its chief financial officer, Morley, its company secretary and general counsel, Shafron, and all seven non-executive directors were found to have breached the statutory duty of care by failing to take reasonable care when they approved the draft ASX announcement.

Macdonald, the Managing Director breached his duty by failing to advise the Board that the external consultants' reviews of the financial modelling of future asbestos claims were limited and that the claims contained in the announcement in relation to the adequacy of the compensation funding were too emphatic. In addition Macdonald was found to have negligently approved the final ASX announcement.

⁹⁸ ASIC v Macdonald (No 11) [2009] NSWSC 287; ASIC v Hellicar [2012] HCA 12.

Morley, the CFO contravened the statutory duty of care by failing to advise the board that the external consultants' reviews of the cash flow model were limited in nature and did not involve reviews of the key assumptions underlying the modelling. Shafron, the company secretary and general counsel contravened the duty of care by failing to advise JHIL's board and its chief executive officer that the ASX announcements were based on inappropriate cash flow modelling assumptions and failed to draw attention to the deficiencies in actuarial reports. He also failed to advise the board and its managing director of the need to disclose to the ASX all material aspects of the company's restructuring arrangements.

The non-executive directors were ultimately all held to have breached the duty of care. The Court was satisfied that the non-executive directors knew or ought to have known that if the announcement was misleading there was a risk that JHIL would face legal action, this would have an impact on its reputation and there would be a negative impact on its share price. The Court was satisfied that the directors had approved the draft ASX announcement even though they must have been aware it contained misleading statements. A reasonable person occupying the office of a non-executive director of a company in JHIL's circumstances would not have behaved in this manner.

McDonald was disqualified from acting as a director for 15 years and was ordered to pay a pecuniary penalty of \$350,000 (£192,000). Shafron and Morley were disqualified for 7 and 2 years respectively and ordered to pay pecuniary penalties of AUD \$75,000 (£41,000) and AUD \$20,000 (£11,000)⁹⁹ respectively. The seven non-executive directors were disqualified from acting as directors for periods ranging from 23 months to 27 months and were ordered to pay pecuniary penalties ranging from AUD \$20,000 (£11,000) to AUD \$25,000 (£13,500).

⁹⁹ Morley v ASIC [No 2] (2011) [2011] NSWCA 110, (2011) 83 ACSR 620, [5].

In 2009 ASIC issued civil penalty proceedings against the directors of Centro Properties Group, a group of entities listed on the Australian Securities Exchange (ASX). Like the James Hardie matter, insolvency was not a factor in this case. The Court held that the directors of the listed entities failed to comply with the statutory duty of care when they approved the 2007 financial reports of two entities which were later found to contain material omissions.¹⁰⁰ The consolidated balance sheets of the two entities failed to disclose short-term liabilities by classifying them as non-current liabilities. The amounts misclassified were AUD \$1.5 billion (£0.8 billion) and AUD \$500 million (£273 million). In addition, the notes to the financial statements of one of the entities failed to disclose post-balance date guarantees of short-term liabilities of an associated company of about US\$1.75 billion. Justice Middleton of the Federal Court held that the company's directors had breached their duty of care in failing to ask questions about the accuracy of these financial reports, had not taken all the steps necessary to ensure the accounts were accurate, and had not acted upon information they should have known about the financial position of the company.¹⁰¹

Declarations of contravention were made against all directors. One director was ordered to pay a pecuniary penalty of AUD \$30,000 (£16,300) and the former Chief Financial Officer was disqualified from managing corporations for two years.¹⁰² No penalties were imposed on the other directors despite declarations of contravention having been made against them. The failure to impose penalties on some of the directors has been the subject of criticism.¹⁰³

¹⁰⁰ ASIC v Healey [2011] FCA 717 [8], (2011) 196 FCR 291, 296 [8].

¹⁰¹ Ibid.

¹⁰² ASIC v Healey (No 2) [2011] FCA 1003, (2011) 196 FCR 430.

¹⁰³ V Comino, "James Hardie and the Problems of the Australian Civil Penalties Regime" (2014) (37) 1 University of NSW Law Journal 195. 196. Note Comino is also critical of the penalties imposed on some of the directors of James Hardie Industries, (at 196).

2. Types of Orders Sought by ASIC

As stated above, the orders that are available under the Australian civil penalty regime are pecuniary penalty, disqualification and compensation orders. The primary purpose of the pecuniary penalty is to punish the contravening director and to provide personal and general deterrence.¹⁰⁴ Disqualification orders remove unfit directors from office, thereby providing protection for the public against future misuse of the corporate structure¹⁰⁵ by such unfit directors.¹⁰⁶ A disqualification order may also involve aspects of personal and general deterrence and can have a punitive effect.¹⁰⁷ The aim of the compensation order is to obtain recompense for the company that has suffered a loss as a result of the director's breach of duty.

The order that has been the most sought by ASIC is the disqualification order, followed by pecuniary penalties and compensation orders.¹⁰⁸ The fact that disqualification orders are highly sought after indicates that ASIC's priority in issuing proceedings alleging a contravention of the directors' duty provisions is to protect the larger community by removing unfit directors from office. ASIC also prioritises deterrence. Both pecuniary penalties and disqualification orders are designed to be punitive and to send a deterrent message to the market and in all but one of the civil penalty applications issued by ASIC in

¹⁰⁴ ASIC v Adler (No 5) [2002] NSWSC 483, (2002) 20 ACLC 1,146; ASC v Donovan (1998) 28 ACSR 583; and Trade Practices Commission v CSR Limited (1991) ATPR ¶41-076.

¹⁰⁵ See Santow J in ASIC v Adler (No 5) [2002] NSWSC 483, (2002) 20 ACLC 1146 where his Honour referred to a number of cases including ASIC v Hutchings [2001] NSWSC 522, (2001) 19 ACLC 1,454; ASIC v Pegasus Leveraged Options Group P/L [2002] NSWSC 310; ASC v Forem-Freeway Enterprises [1999] 120 FC 28, (1999) 17 ACLC 511, 520; and ASC v Donovan [1998] 120 FC 55, (1998) 28 ACSR 583, 602.

¹⁰⁶ See Santow J in ASIC v Adler (No 5) [2002] NSWSC 483, (2002) 20 ACLC 1146 where his Honour referred to ASC v Roussi [1999] FCA 618, (1999) 32 ACSR 568, 570; and ASIC v Papotto [2000] WASC 201, (2000) 35 ACSR 107, 112.

¹⁰⁷ ASIC v Rich (No 2) [2003] NSWSC 186, (2003) 21 ACLC 672; and ASIC v Plymin (No 2) [2003] VSC 230, (2003) 21 ACLC 1237, 1241. See also ASIC v White [2006] VSC 239, (2006) 58 ACSR 261, 265-7; ASIC v Vines [2006] NSWSC 760, (2006) 58 ACSR 298, 311-2, 333, 346; ASIC v Maxwell [2006] NSWSC 1052, (2006) 24 ACLC 1308, 1338; and ASIC v Beekink [2007] FCAFC 7, (2007) 61 ACSR 305, 314-5.

¹⁰⁸ For a discussion of the orders imposed between 1993 and 2013 see M Welsh, "Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia" (2014) 42 (1) Federal Law Review 217.

the last 21 years the regulator sought either one or both of these orders.¹⁰⁹ A compensation order has never been the sole order sought.

3. Problems with the Australian Civil Penalty Regime

The Australian civil penalty regime has not been without its difficulties. One of those is the imposition of low penalties in some recent cases, including the Centro case discussed above. Other difficulties highlighted by Comino include evidential and procedural difficulties that she argues impacts on ASIC's ability to make effective use of these provisions.¹¹⁰ Recently the courts have afforded defendants in some civil penalty cases procedural protections that are more akin to the protections usually afforded to defendants in criminal trials. For example despite the fact that s 1317L of the Corporations Act states that civil rules of evidence and procedure apply in civil penalty proceedings, the High Court of Australia held in *ASIC v Rich*¹¹¹ that the privilege against exposure to penalties and forfeiture applied. Legislative amendments have subsequently removed this privilege in relation to civil penalty applications seeking disqualification orders but the privilege remains for proceedings in which pecuniary penalty orders are sought.¹¹²

Comino highlights other cases where ASIC has faced procedural problems in recent years. For example in the James Hardies case discussed above the New South Wales Court of Appeal held that in order to discharge its duty of fairness ASIC was required to call all material witnesses.¹¹³ While this finding was ultimately overturned by the Australian High

¹⁰⁹ In *ASIC v Warrenmang Limited* [2007] FCA 973 the only order sought against the defendant director was a declaration of contravention.

¹¹⁰ Comino, *supra* n 103, 197-8.

¹¹¹ *Rich v ASIC* [2004] HCA 42.

¹¹² Corporations Act 2001 (Aust) s 1349, inserted by Corporations Amendment (Insolvency) Act 2007 (Aust) sch 2 item 12. This amendment came into force on 31 December 2007

¹¹³ *Morley v ASIC* [2010] NSWCA 331, (2010) 274 ALR 205.

Court on appeal the initial decision and the extra time and expense it caused ASIC to incur in appealing the matter supports Comino's contention that;

in a number of recent cases when ASIC has chosen to bring civil penalty proceedings, instead of those proceedings being the cost-effective and timely enforcement response to contravening conduct initially contemplated, proceedings have been expensive ... Moreover, they underscore the uncertainty surrounding the applicable rules of procedure in civil penalty cases and lack of consistency in the manner that cases are dealt with by different courts and judges.¹¹⁴ (citations omitted)

Comino calls for legislative intervention to resolve these issues.¹¹⁵ If the introduction of a similar enforcement regime is contemplated in the UK lessons should be learnt from the Australian experience and consideration should be given to resolving these procedural issues prior to the adoption of such a regime.

E. APPLICATION OF THE CIVIL PENALTY REGIME TO THE UK

A civil penalty regime of the type embraced by Australia provides powerful weapons. This part of the article assesses whether those weapons should be adopted in the UK, either totally or partially, and what obstacles there might be to such adoption.

Clearly the UK position has been, in general terms, to keep hard law in the form of regulation to a minimum. Perhaps this is the UK staying true to its laissez-faire foundations, developed in the Victorian era. This approach is maintained notwithstanding the enactment of the Companies Act 2006 which constitutes the longest piece of legislation in UK statutory history. The preference for soft law, where possible, is seen in the fostering of the Code system for corporate governance, first conceived by the Report of the Committee on the

¹¹⁴ Comino, *supra* n 103, 199-200.

¹¹⁵ *Ibid*, 201.

Financial Aspects of Corporate Governance (commonly known as “the Cadbury Report”),¹¹⁶ and now found in the UK Corporate Governance Code 2014,¹¹⁷ which provides effectively for self-regulation.¹¹⁸ It is a stark characteristic of UK company law and practice that unlike most countries around the world, it does not have a corporate regulator. It relies on a number of bodies whose remit touch on aspects of corporate law, but there is no regulator in the form of the Securities Exchange Commission in the United States, or, the subject of much of what has been said thus far, ASIC. This might be surprising given the fact that during the late 1980s and early 1990s the UK experienced several corporate scandals and disasters, such as those affecting Maxwell Communications, and the pension losses sustained by its employees, Polly Peck and Bank of Commerce and Credit International. This period was marked by the operations of companies whose Australian counterparts were labelled as “corporate cowboys.”¹¹⁹ And in Australia the problem resulting from well-known companies acting less than scrupulously led to the decision to address the ills of the corporate world more seriously by eventually establishing the ASIC and funding it reasonably well (certainly when compared with its predecessor, the ill-fated National Companies and Securities Commission).

It is interesting to note that no actions have been brought in the UK against any of the directors of any of the financial institutions that either collapsed or needed bailing out of problems as a result of the Global Financial Crisis, save in one case and mentioned below.

This is notwithstanding that several reports have questioned the actions of the boards of directors involved in these companies. For instance, in relation to the bank HBOS, even

¹¹⁶ 1 December 1992, London, Gee. Accessible at : <http://www.ecgi.org/codes/documents/cadbury.pdf> (accessed 27 June 2014).

¹¹⁷ Financial Reporting Council “The UK Corporate Governance Code” (September 2014) and available at <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf> (accessed, 24 September 2014).

¹¹⁸ The foremost characteristic of it is that it provides for a “comply or explain” approach.

¹¹⁹ This was a term frequently used in the later 1980s and early 1990s in Australia. It was used by Trevor Sykes when referring to some banks in Australia following deregulation in the 1980s (“Australia’s Banking Industry” and available at : <http://www.abc.net.au/money/currency/features/feat3.htm> (accessed, 26 May 2014).

though it was concluded by the Parliamentary Commission on Banking Standards that the Bank's board "had abrogated and remitted to the executive management the formulation of strategy, a matter for which the Board should properly have been responsible,"¹²⁰ no director was subject to action. The reasons for this are to be found in respect of enforcement, although concern was voiced that the law, in any event, might not have favoured a claim. One cannot help thinking that if the collapses that were seen in the UK had occurred in Australia ASIC would have taken some action against one or more directors. This is probably because ASIC has had a more aggressive approach to enforcement than the now defunct Financial Services Authority ("FSA"),¹²¹ or any other government bodies, had, and arguably there has been in Australia a greater willingness to see public intervention in commercial and corporate operations than in the UK,¹²² again perhaps an indication that the UK retains a very laissez-faire approach.

There appears to be a public perception that directors, and particularly directors of banks, have got away and are getting away with not being called to account for what they have done or not done. The UK government has indicated in the past that it would take action against the directors of the Royal Bank of Scotland ("RBS") by looking to have them disqualified.¹²³ But this has not happened.¹²⁴ Apart from action taken by the FSA against one director of HBOS, no action has been taken against directors of the UK banks that failed in the Global

¹²⁰ Parliamentary Commission on Banking Standards, "An accident waiting to happen: The failure of HBOS" Volume 1, 4 April 2013, HL144, HC705 at para 92 and available at:

<http://www.publications.parliament.uk/pa/jt201213/jtselect/jtscbs/144/144.pdf> (accessed, 22 May 2014).

¹²¹ A number of reports have documented the failures of the FSA in terms of regulation and enforcement.

¹²² For further discussion of Australia's approach see Welsh, *supra* n 108108.

¹²³ J. Quinn, "Vince Cable: RBS report recommends prosecution" Sunday Telegraph, 17 June 2012.

¹²⁴ Mr Jonny Cameron, RBS Executive Director and Chairman of RBS's Global Banking and Markets Division came to a settlement with the FSA whereby he "committed not to perform any significant influence function in relation to any regulated activity or to undertake any further full-time employment in the financial services industry. As part of this settlement, the FSA agreed it would not take any disciplinary action against Mr Cameron. The FSA did not make any findings of regulatory breach against Mr Cameron and he did not make any admissions." (Financial Services Authority, The failure of the Royal Bank of Scotland: Financial Services Authority Board Report, December 2011, at p 33 and available at : <http://www.fsa.gov.uk/static/pubs/other/rbs.pdf> (accessed, 26 May 2014).

Financial Crisis. This is notwithstanding the fact that commentators have suggested that there might well have been breaches committed by some directors. For example, it has been submitted by some corporate governance authorities that the Northern Rock board did not act with due diligence before it was subject to the first “run” on a UK bank since the mid-nineteenth century.¹²⁵ This view accords with that of the Chair of the Treasury Committee of the House of Commons when he said that the chief executive officer of Northern Rock was “asleep at the wheel” when the Bank collapsed.¹²⁶

Shareholders of banks that have disappeared, such as Northern Rock (whose business was sold by the UK government to Virgin Money), and subsequent boards of banks that have continued, such as RBS, have decided, for whatever reason, not to take any action against directors. Following an enforcement process that began in March 2009, the FSA concluded, in December 2010, and in relation to the board of RBS, that the issues investigated did not warrant it taking any enforcement action. In line with the FSA’s general approach to enforcement this was announced in a one-page press release. Subsequently, the FSA was pressed by the House of Commons’ Treasury Committee to prepare a more substantial reflection on enforcement and it did so in a report, *The Failure of the Royal Bank of Scotland: Financial Services Authority Board Report*¹²⁷ in December 2011. Unsurprisingly, the Report justified the decision of the FSA not to recommend any enforcement proceedings in relation to any directors.

As discussed earlier, the Australian civil penalty regime involves pecuniary penalty orders, compensation orders and disqualification orders. It has been said that disqualification orders

¹²⁵ See R. Tomasic, “Corporate rescue, governance and risk-taking in Northern Rock : Part 2” (2008) 29 *Company Lawyer* 330 at 332.

¹²⁶ Quoted by R. Northedge, “The rise of John McFall, credit crisis figure” *Sunday Telegraph*, 16 December 2007 and referred to in R. Tomasic (2008), *supra* n 125, 332.

¹²⁷ Available at : <http://www.fsa.gov.uk/static/pubs/other/rbs.pdf> (accessed, 26 May 2014).

against directors are the most important of the penalties that courts in Australia can order.¹²⁸ The UK already has a disqualification process that is reasonably robust and well-used. As in Australia, the regime for disqualification in the UK plays an important role in the regulation of companies and their directors,¹²⁹ and can have a significant effect on the life of a director. Directors can be disqualified from acting as such for up to 15 years. In fact in the UK disqualification is effectively the only public intervention in dealing with wrongdoing or lax directors.¹³⁰ There are actions presently available to regulators in relation to directors and officers of banks, such as taking away a person's approved person status, and this is almost akin to disqualification. But this procedure is not used frequently.

There are a number of disqualification orders made each year by UK courts. There are also a large number of undertakings given by directors to the Secretary of State for Business, Innovation and Skills not to act as a director for an agreed period of time. The following table sets out the number of orders made between 2008 and 2013 as well as the basis for the making of the orders.¹³¹

¹²⁸ Jones and Welsh, *supra* n 8, 394.

¹²⁹ In Australia the regime is contained within the Corporations Act 2001 (Aust) (ss 206A-206HB) whereas in the UK a separate statute (Company Directors' Disqualification Act 1985 ("CDDA")) applies the regime.

¹³⁰ Save for possible prosecutions for offences prescribed in the Companies Act 2006. There are very few of these.

¹³¹ July 2013 at p58 and accessible at :

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212079/bis-13-959-transparency-and-trust-enhancing-the-transparency-of-uk-company-ownership-and-increasing-trust-in-uk-business.pdf (accessed 7 May 2014).

	2008-09	2009-10	2010-11	2011-12	2012-13
Disqualifications following investigation by official receivers in compulsory liquidation cases. ¹³²	528	540	577	408	351
Disqualifications following the investigation of reports of misconduct by company directors from insolvency practitioners acting under appointments in insolvency. ¹³³	676	781	794	692	618
Disqualifications following the investigation of a live company where misconduct by its directors has been revealed. ¹³⁴	29	10	15	12	4
Disqualifications on conviction of a criminal offence. ¹³⁵	48	57	49	39	58
Total disqualifications.	1281	1388	1437	1151	1031

An examination of the above figures reveals that during this period most disqualification orders imposed in the UK were imposed on directors of insolvent companies or on directors who had committed a criminal offence. In addition, the number of disqualification orders imposed on directors of live companies in situations where misconduct by them had been revealed has decreased markedly in recent years. This form of disqualification is the one that has the most in common with the disqualification provision available under the Australian civil penalty regime. What is different however is that the UK provision allows for a maximum period of disqualification of 15 years whereas the Australian provision is unlimited.¹³⁶

¹³² The disqualifications are likely to have been based on s.6 of CDDA. This provision allows for the disqualification of directors who are unfit because of the fact that they have been directors of companies that have become insolvent.

¹³³ The disqualifications are likely to have been based on s.6 of CDDA

¹³⁴ The disqualifications are likely to have been based on s.8 of CDDA. This provision permits the disqualification of directors who are unfit after their companies have been subject to investigation.

¹³⁵ These orders would have been made under any of ss 2-5 of the CDDA. These provisions permit, for instance, disqualification where directors have been convicted of indictable offences or breached companies legislation.

¹³⁶ As noted above some permanent disqualification orders have been imposed by the Australian courts.

While the UK has a disqualification provision, what it obviously lacks is power for a court to be able to order a financial penalty or a compensation order against a director following the breach of the statutory duties. Recently, the Government has been concerned¹³⁷ that creditors, in particular, who are the ones who usually lose out the most if a company becomes insolvent, do get some form of compensation from directors where the latter have breached their duties, a matter to which we will return shortly.

It is interesting that the New Zealand government, before putting forward its programme for criminalisation of directors' breaches of duty, countenanced civil penalty orders, but rejected them. The two primary reasons given were that the introduction of such orders provides: "too great a risk of people being deterred from taking on directorships" and would place "the regulator in the position of second-guessing the soundness of directors' business decisions."¹³⁸ It is likely that a similar reaction would be registered in the UK to the introduction of a civil penalty regime.

However, the empirical evidence concerning the likely deterrence factor of tightening up legislation relative to directors' duties has been mixed over the years. It has been submitted that it is not possible to determine whether the fear that potential enforcement overly deters directors such that it discourages individuals from assuming posts as directors unless they are

¹³⁷ See, Department of Business Innovation and Skills, Transparency and Trust : Enhancing The Transparency of UK Company Ownership and Increasing Trust in UK Business Discussion Paper, July 2013 and accessible at : https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212079/bis-13-959-transparency-and-trust-enhancing-the-transparency-of-uk-company-ownership-and-increaing-trust-in-uk-business.pdf (accessed 7 May 2014); Department of Business Innovation and Skills, Transparency and Trust : Enhancing The Transparency of UK Company Ownership and Increasing Trust in UK Business : Government Response, April 2014, and available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/304297/bis-14-672-transparency-and-trust-consultation-response.pdf (accessed, 23 May 2014).

¹³⁸ Office of the Minister of Commerce, Cabinet Paper to the Chair of the Cabinet Economic Growth and Infrastructure Committee: Securities Law Reform, February 2011, at [206] and referred to in Watson and Hirsch, *supra* n 25, 120.

inefficiently compensated¹³⁹ is in fact well-founded. There is some dated evidence pointing to a deterrent effect,¹⁴⁰ although this study did not address public enforcement issues. Joan Loughrey refers to empirical research which indicates that criminal sanctions might have some chilling effect on directors' decision-making, but it did not establish that this caused over-deterrence, nor that civil enforcement would have similar effects.¹⁴¹ Certainly it would appear that the empirical evidence in Australia is mixed, but it does not provide clear evidence that directors feel deterred from accepting directorships because of the possibility of civil penalty orders.¹⁴² Most surveys are not specific in that they have not sought views on civil penalties, but merely sanctions in general. In his judgment in *ASIC v Healey*¹⁴³ (the Centro litigation) discussed in some detail earlier in the article, Middleton J rejected the idea that his judgment would lead to directors heading for the exit door.¹⁴⁴ His Honour said that: "Directors are generally well remunerated and hold positions of prestige, and the office of director will continue to attract competent, diligent and intelligent people."¹⁴⁵

If a civil penalty regime in the mould of that in Australia were implemented in the UK then it would be necessary, both as a matter of fairness and to garner support for its creation and operation, that the legislation adopts the Briginshaw standard that has been applied by the courts in Australia, as mentioned earlier. In drafting the provisions consideration should also be given to the procedural difficulties that have arisen in the Australian context. Also, any civil penalty regime would need to ensure that the penalties, while substantial, were not

¹³⁹ C. Riley, "The Company Director's Duty of Care and Skill; The Case for an Onerous but Subjective Standard" (1999) 62 *Modern Law Review* 697 at 712.

¹⁴⁰ J. Coffee, "No Exit?: Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies" (1988) 53 *Brooklyn Law Review* 919 at 927.

¹⁴¹ J. Loughrey, "Breaching the Accountability Firewall: Market Norms and the Reasonable Director" (2014) 37 *Seattle University Law Review* 989, 994 and referring to R. Baldwin, "The New Punitive Regulation" (2004) 67 *Modern Law Review* 351, 361-363.

¹⁴² Watson and Hirsch, *supra* n 25, 121.

¹⁴³ *ASIC v Healey* [2011] FCA 717.

¹⁴⁴ *Ibid*, [14].

¹⁴⁵ *Ibid*.

overly harsh or else courts might be reluctant to impose them.¹⁴⁶ In fact one of the advantages that the UK might have over Australia in adopting civil penalties is that of consistency as most cases are brought in a single jurisdiction, namely England and Wales, whereas in Australia there are courts in nine different jurisdictions that hear applications for orders, and there is some concern over consistency in Australia.¹⁴⁷

Is it likely that the UK government would support the introduction of wider civil penalties as foreshadowed here? The possibility of the UK embracing a similar civil penalty regime to that which applies in Australia might have been thought to be fanciful at one time, but in recent times we have seen clear intentions from the Government to look at providing new approaches for dealing with errant directors. A civil penalty regime is a different animal from a regime that would introduce criminal sanctions, and its proposal, while it would be subject to criticism and not insubstantial opposition, is not likely to precipitate the same emotive response that we have seen in New Zealand with the criminalisation of breaches of duty. New Zealand commentators have noted the problems that criminalisation might bring, particularly the fact that courts do not like to convict where there is an absence of dishonesty, and they have given support to the imposition of a civil penalty regime on the basis of it being a kind of middle way.¹⁴⁸ This could well be a way of presenting civil penalties to UK commerce.

Certainly we think that there is more chance now than ever for the UK to introduce an Australian style regime. A disqualification regime already exists, but what about the other elements found in the Australian scheme? In the Department of Business Innovation and Skills Discussion Paper of July 2013, *Transparency and Trust: Enhancing The Transparency*

¹⁴⁶ Jones and Welsh, *supra* n 8, at 392-393.

¹⁴⁷ V. Comino, "Australia's 'company watchdog': the Australian Securities and Investments Commission and the civil penalty regime" [2014] *Journal of Business Law* 228 at 248.

¹⁴⁸ Watson and Hirsch, *supra* n 25.

of UK Company Ownership and Increasing Trust in UK Business, the Department floated the idea of strengthening the enforcement of rules applying to directors.¹⁴⁹ The Paper also adverted to the fact that the disqualification of directors, which aims to provide protection to the market and consumers, did not provide redress for those who often lose out from the kind of conduct that led to directors' disqualification.¹⁵⁰ The implementation of a power for a court to order compensation to those who have suffered loss would meet this concern. The focus of the Department's Paper appeared to be on protecting creditors, but it was stated in the Paper that: "We need to find ways to increase trust in our regime by ensuring that if directors...act fraudulently or recklessly they personally run the risk of being required to compensate those suffering loss as a result."¹⁵¹ This statement is wider than showing concern only for creditors. There is an indication here that the Government is certainly concerned about shareholders in solvent companies who indirectly lose out if their companies' directors act wrongly and cause their companies loss. It might also be interpreted by some as demonstrating concern for a wider group of stakeholders.

The Discussion Paper did advert to the Australian regime and particularly to the fact that the regime may provide for a civil penalty award and compensatory awards.¹⁵² The Paper did mention compensation for creditors, but, as we have seen, the Australian regime is not limited to compensation orders for creditors.

In the Government's Response to the comments of respondents to its Discussion Paper it stated that two-thirds of responses broadly supported the proposal to give courts the power to

¹⁴⁹ Department of Business Innovation and Skills, Discussion Paper of July 2013, Transparency and Trust: Enhancing The Transparency of UK Company Ownership and Increasing Trust in UK Business, [8.6]. Available at : https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212079/bis-13-959-transparency-and-trust-enhancing-the-transparency-of-uk-company-ownership-and-increaing-trust-in-uk-business.pdf (accessed 7 May 2014).

¹⁵⁰ Ibid, [11.1].

¹⁵¹ Ibid, [11.4].

¹⁵² Ibid, [11.3].

make compensatory awards against those directors who were disqualified.¹⁵³ The Department has said that it wishes to see directors who have failed to act according to acceptable standards to be held financially accountable for the loss that they have caused to creditors, and it will seek to give power to the courts to make compensation orders against disqualified directors in appropriate cases.¹⁵⁴

The views of the Department have now been included in provisions of the Small Business, Enterprise and Employment Bill (“the Bill”), which has been laid before Parliament. If the Bill becomes law then s 98 will provide for the inclusion of a new provision in the Company Directors’ Disqualification Act 1986, namely s 15A. This provision will enable courts to order a director to pay compensation to his or her company as a contribution to its assets; or to order the payment of compensation to specified creditors of the company on the condition that the director is disqualified pursuant to an order or undertaking and the conduct leading to the disqualification order or undertaking has caused loss to one or more creditors of an insolvent company of which the director has at some time been a director. This is laudable but it will not address some of the shortcomings which we have mentioned in this article. First, the new legislation will not provide any help to those who lose out in companies where directors are not disqualified. This could occur in one of two kinds of cases. First, where the Secretary of State does not think that there are sufficient grounds for disqualification or it is thought that the construction of a case for disqualification is not warranted given the other claims on Departmental funds, and so no petition for disqualification is made. Second, a petition for disqualification fails because a judge does not think that the order is warranted, but the judge would be willing to order compensation for those who lost out because of the

¹⁵³ Department of Business Innovation and Skills, Transparency and Trust : Enhancing The Transparency of UK Company Ownership and Increasing Trust in UK Business : Government Response, April 2014, [267]. Available at : https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/304297/bis-14-672-transparency-and-trust-consultation-response.pdf (accessed, 23 May 2014).

¹⁵⁴ Ibid, [273].

director's actions. The second shortcoming that is not addressed in the Bill is courts are not permitted to make any compensation order where the company is not insolvent. This, therefore, lays the burden squarely on shareholders in solvent companies to take any action to recover a loss sustained by the company. So, even if the Bill becomes law, shareholders would still have to institute derivative actions against miscreant directors and they have been reluctant to do so.¹⁵⁵ Also, as we have mentioned earlier, ASIC has enforced duties against directors of solvent companies, and arguably to good effect. For instance, in the *Centro* case it could be argued that the action taken has provided "a wake-up call" to directors who have, inter alia, failed to examine financial papers sufficiently, and may well encourage more vigilance amongst directors when it comes to approving financial reports.

It might be said that permitting compensation orders in relation to insolvent companies is meritorious because it is designed to relieve the plight of long-suffering creditors, and we would fully assent to that. Also the point might be made that if enforcement were extended to solvent companies then a government body would be doing the work that should be done by the shareholders. But as argued elsewhere, the shareholders who are not likely to take action, because of the many obstacles put in front of them, are those who are vulnerable and perhaps worthy of protection.¹⁵⁶ The public has a concern for the integrity of the corporate governance system that operates in the UK, and directors' duties are an important element in that system. In addition the enforcement of breaches of duty is a significant aspect of the accountability of directors. Some courts have considered the notion of community expectations in the context of directors' duties,¹⁵⁷ and the public expects directors to be accountable. It has been submitted: "that the statutory duties [of directors] perform a higher

¹⁵⁵ See Keay, "An Assessment of Private Enforcement Actions" supra n 4.

¹⁵⁶ Keay, "The Public Enforcement", supra n 11, at 99.

¹⁵⁷ For instance, see *ASIC v Rich* [2003] NSWSC 85 at [71].

function than merely serving the interests of the shareholders.”¹⁵⁸ It might be said that the duties perform a public interest function in prescribing minimum standards of behaviour for those involved in the management of companies.¹⁵⁹ Furthermore, and, perhaps, more importantly:

if action is not taken then not just the shareholders might lose out. Other stakeholders can suffer.

Further, if the breach were to affect the liquidity of the company in some way then this might lead to insolvency and that would potentially have a greater effect on all stakeholders.¹⁶⁰

Breaches of duty can lead to a plethora of ramifications, such as employee redundancies, closure of offices and plants and thereby affecting local communities and the payment of reduced tax to the taxation authorities. As drafted the Bill is only concerned with the plight of creditors, and, it is submitted, there should be a concern for a wider range of stakeholders, and certainly the shareholders.

Leaving the provision in the Bill aside, we note also that there was no comment in the Government’s Response to comments it received in relation to its discussion paper concerning civil penalty orders. It has been said by one commentator who was discussing these provisions in the context of Singapore that the use of such a mechanism would be the best response to breaches of the director’s duty of care and skill as “this will secure regulatory compliance by ensuring that the court has ample scope to deliver a proportionate sanction in the circumstances of every contravention.”¹⁶¹ The commentator’s discussion was limited to breaches of duty of care and skill but there did not appear to be any intention to

¹⁵⁸ J. Harris, A.Hargovan and J. Austin “Shareholder Primacy Revisited: Does the Public Interest Have Any Role in Statutory Duties?” (2008) 26 *Company & Securities Law Journal* 355 at 366.

¹⁵⁹ *Ibid*

¹⁶⁰ Keay, “The Public Enforcement” *supra* n 11, at 99.

¹⁶¹ T. Liao, “Is Criminalising Directorial Negligence a Good Idea?” (2014) 14 *Journal of Corporate Law Studies* 175 at 207.

exclude breaches of loyalty duties from what he was saying. We submit that issues relating to duties of care, in the context of this matter, are no different than those relating to the duties of loyalty.

F. CONCLUSION

This article considered the possibility of the introduction of additional public enforcement mechanisms in the UK for the enforcement of directors' duties. For the reasons outlined in this article we conclude that the introduction of criminal sanction is unlikely to be countenanced. Therefore, the proposal in this article is to introduce in the UK enforcement mechanisms akin to those that are available under the Australian civil penalty regime. This proposal goes beyond what was suggested by the Department of Business Innovation and Skills and, as it would apply to directors of solvent companies, it also goes beyond what is being provided for in the Small Business, Enterprise and Employment Bill. Notwithstanding this, our proposal is based on the same reasoning as contained in the Department's Discussion Paper and in the Bill. The present system is not working well, is subject to a degree of contempt from the general public, and the present provision for the enforcement of breaches needs to be supplemented. In particular the introduction of pecuniary penalty orders, in addition to the likely introduction of compensation orders together with the existing disqualification, could well make directors take the performance of their duties more seriously and deter them from committing breaches of duty.

The implementation in the UK of such a regime to complement the public enforcement of breaches of directors' duties would go some way to answering the challenges of some that the

UK is not serious about enforcing breaches of duty.¹⁶² The use of a public enforcement regime that is able to be implemented in appropriate situations adds credibility to a nation's oversight of corporate affairs. Public enforcement should not exclude opportunities for private enforcement; the two forms should complement each other as they tend to do in Australia.

¹⁶² For instance, see B Garratt, "We must make board better" Sunday Times, 9 January 2011. Garratt referred to the FSA's report on the Royal Bank of Scotland as "a whitewash."