

REVIEW OF SANCTIONS IN CORPORATE LAW

1. Responsive regulation and responsible risk taking

Decision making by boards of directors is often based on a wide range of matters, including relevant regulatory issues. There is no doubt that directors do take into account issues such as taxation, workplace, environmental and a wide range of other laws (including relevant sanctions) when making decisions, especially decisions about where to locate a business.

Generally, AICD considers that decision making by directors is based on the assumption that laws will be complied with. However, given the choice between two jurisdictions for locating a new business, commercial considerations will often result in the jurisdiction with the less onerous regime being chosen. We often see this where a choice is to be made between two states and where other considerations are generally equal.

In the same way, where the choice between Australia and another comparable jurisdiction where corporate regulation is perceived to be less onerous, international investors will choose that other jurisdiction. Certainly we believe that Australia is considered internationally to be a country with high levels of corporate regulation. Having said that, AICD doubts that penalties and sanctions which may be imposed on directors and officers would alone influence such a decision but, rather, would be considered along with other areas of corporate regulation and the legislative environment more generally.

In terms of local impact, while there is no shortage of directors willing to step up to lead major Australian companies. However, more senior and experienced directors and potential directors (most particularly recently retired senior executives) are shying away from taking on high profile positions, especially in the listed environment, because of concerns of potential personal risks of liability or, even if they are able to defeat claims, of severely damaged reputations. The question many recently retired senior executives ask themselves is why they would accept a risky position, such as director of a high profile company, which could place their hard earned reputations and their retirement benefits at risk.

The evidence that this is happening can be seen from the willingness of many potential well regarded director candidates to take up positions on Boards of companies owned or controlled by private equity investors, away from the public environment.

The trend of various legislatures throughout Australia to make directors and senior executives personally liable for corporate fault is impacting on corporate decision making and entrepreneurship by creating an environment which encourages more cautious and conservative decision making. In saying this, AICD does not single out the sanctions regime in the *Corporations Act*, although, as we note below, there is considerable room for improvement especially in areas where directors should be afforded defences where they have acted responsibly and where no such defences currently exist.

The final observation we want to make is that many directors are forming the view that there is no longer a fair balance between risk and reward, with the risks directors take exceeding by a margin the rewards they can earn from holding office. The consequence is likely to be a smaller and potentially less experienced pool of company directors for our corporate community to draw upon. Moreover, those directors who have moved from the public to private (meaning private equity) environment indicate that the balance between risk and reward (especially given the ability for them to participate in the company's success through significant share and option holdings) is a much more favourable one.

2. Criminal, civil and administrative sanctions

2.1 Criminal sanctions

AICD supports the criminal regime currently applying in section 185 of the *Corporations Act* which makes corporate personnel liable to criminal offences for breaches of sections 181, 182 and 183 where they have acted dishonestly or recklessly. We do not support situations where directors are exposed to strict liability, no matter how serious the consequences.

We especially support the approach taken in section 184 of not exposing directors who breach section 180 to criminal sanctions. To do so would potentially expose directors and officers to criminal sanctions for negligence and that would be highly inappropriate as an offence of criminal negligence for directors would discourage many from continuing to act.

2.2 Administrative sanctions

The paper identified a number of *Corporations Act* sections which carry anachronistic sanctions and are clearly in need of reform, whether to bring them under the civil penalty regime, or, as suggested under a new administrative sanction regime. We attach a copy of our recent submission to Treasury detailing our serious concerns regarding the infringement notices regime application to continuous disclosure breaches.

3. Better defining the contravention

3.1 General protection for directors

AICD very strongly supports the introduction of a general defence for directors.

The defence suggested (which is intended to apply consistently to Corporations Act offences by directors), is proposed to be available where directors act:

- in a bona fide manner;
- within the scope of the corporation's business;
- reasonably and incidentally to the corporation's business; and
- for the corporation's benefit.

Having considered this proposal, AICD does not support this formulation of the defence, especially the second and third elements, as we do not understand why the conduct must be within the scope of, or reasonably incidental to, the corporation's business before the defence can be relied on.

We prefer a model which requires directors to establish that they have:

- acted in good faith;
- informed themselves about the subject matter to the extent that they reasonably believe appropriate; and
- which they reasonably believe is in the best interests of the corporation.

As can be seen, this formulation is based on the existing business judgment rule defence in section 180(2). However, AICD prefers to express the requirement to act 'bona fide' as a requirement to act 'in good faith'. We have also omitted the requirement to act for a proper purpose. We are concerned that inclusion of the expression could lead to uncertainty as to when the defence might be available. Little or nothing is lost from the omission of the expression because before being able to avail themselves of the defence, the requirements for directors to act in good faith and have a rational belief that what they are doing is in the best interests of the company ensure that directors will indeed be acting for a purpose consistent with the best interests of the company and its shareholders.

AICD also does not favour a defence which contains a requirement that the directors have no material personal interest in the subject matter under consideration. While we accept that it is quite inappropriate for directors to be able to avail themselves of the defence where their judgment is impaired by a conflict of interest, that will not be the case under the proposed defence because the proposal requires the director, among other things, to

have acted in good faith and rationally believe that what they are doing is in the best interests of the company. This avoids an unfortunate situation where a director who has acted perfectly properly, is unable to take advantage of the defence, merely because such a conflict exists.

We note that the four elements of the defence proposed in the Treasury paper also do not include a requirement that the director have no material personal interest in the matter.

AICD believes that the defence should be available for each of the following sections:

Section No	Provision
S 181	Officers to act in good faith in the best interests of the company and for a proper purpose
S 182	Officer or employee making improper use of position
S 183	Officer or employee making improper use of information
S 197	Potential liability for debts of trustee company where right of indemnity is lost
SS 295(4) and 303(4)	Director's declaration regarding the accounts
S295A	CEO and CFO declaration regarding accounts
SS 299, 299A, 300 and 300A	Contents of Annual Director's Report
S 588G	Director's duty to prevent insolvent trading
S 670A	Liability for misstatements in or omissions from takeover documents
S 674(2A)	Person involved in a contravention by a listed company of its continuous disclosure obligations
S 728	Liability for misstatements in or omissions from prospectuses or other disclosure documents
SS1041A - 1041G	Market manipulation, false trading, and related conduct
S 1043A	Insider trading
S 1041H	Person engaging in conduct in relation to a financial product or service which is misleading or deceptive
S 1307	Falsification of books
S 1308	(1) Advertising false or misleading statements about share capital ; and (4) failing to take reasonable steps to ensure that a statement required by the Act or is lodged under the Act is not misleading in a material respect
S 1309	Giving false or misleading information to director, member or auditor or failing to take reasonable steps to ensure it is not false or misleading
SS 12CA - 12CC ASIC Act	Engaging in unconscionable conduct in relation to certain financial services transactions
SS 12DA - DC ASIC Act	Making false or misleading representations in relation to financial products

One section where difficulty might arise is section 181 where the requirements of the section are such that a director must act in good faith in the best interests of the company and for a proper purpose. The defence, as proposed, could be applied to this section, but (especially if, as proposed in the Treasury paper, the language of section 181 is brought into line with the business judgment rule defence), there seems to be considerable overlap between the language of the offence and the defence.

In relation to sections 182 and 183, while we support the adoption of the defence, its application to conduct which has been characterised as 'improper' requires some consideration.

AICD strongly supports the general defence being made available under section 588G. We do not believe that it would encourage insolvent trading. One of the problems with the current provision is that sometimes directors are just too cautious where a company is experiencing liquidity problems and choose to call in an administrator to protect themselves (before the company is insolvent) when the interests of shareholders would have been better served by the company continuing to trade. For the sake of uniformity, the new general defence should replace the business judgment defence and should be in addition to the existing defences to section 588G.

3.2 Inconsistent approach

AICD considers that section 181 should be made consistent with the business judgment defence in section 180(2). This is so that the requirement for directors to act in the best interests of the company is replaced with a requirement that they act in a manner which they rationally believe to be in the best interests of the company.

3.3 Review of section 189

AICD considers that the original formulation of section 189(b)(ii) is preferable so that directors are only required to make enquiry before relying on advice from others if the circumstances indicate the need for enquiry, rather than being obliged to make an independent assessment of the information. We agree that given the uncertainty around the meaning of what an 'independent assessment' requires, it would be preferable to return to the original drafting.

3.4 Obligation to keep financial records

There would appear to be benefits in making section 286 consistent with section 344.

3.5 Drafting of offence provisions

The maximum penalties for breach of the law should be set out in the relevant section rather than in a schedule at the back of the *Corporations Act*.

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