



**The Law Society
of New South Wales**

ACN 000 000 699



FAXED

29/5/07

Our Ref: GJD:LW
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28 May 2007

The Executive Officer
Review of Sanctions or Breaches of Corporate Law
Corporations and Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir,

Re: Review of Sanctions in Corporate Law

I refer to the Discussion Paper published 5 March 2007 entitled 'Review of Sanctions in Corporate Law' (Discussion Paper). The Law Society welcomes the opportunity to make a submission.

The Discussion Paper has been reviewed by the Law Society's Business Law Committee (Committee). The Discussion Paper has not been considered by the Council of the Law Society, and the views expressed are those of the Committee alone.

The Committee has not sought to make detailed comment on all issues raised in the Discussion Paper and comments are based on general principles.

Set out below are certain views expressed by the Committee; for ease of reference headings contained in this letter have been numbered to correspond with the numbering of the chapters contained in the Discussion Paper.

1. Responsive regulation and responsible risk taking

- 1.1 The *Corporations Act* sets down a fairly onerous framework for regulating corporate activity and financial services. While proportionality and clarity across the enforcement regime is necessary, the Committee is of the view that it is not for the law to micro manage.
- 1.2 While it is difficult to provide empirical data, the Committee believes that the onerous responsibilities and sanctions placed on directors by corporate law and other laws have resulted in many competent persons refusing to become non-executive directors of corporations where directors have to rely upon management.
- 1.3 There is now a greater drift of directors away from traditional corporate directorships and into private equity.

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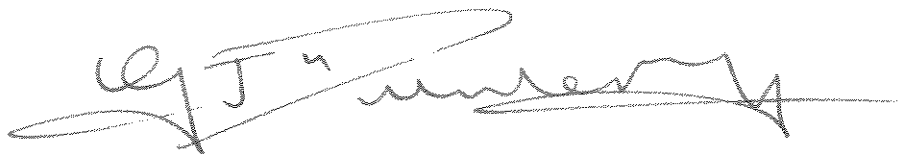


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- 1.4 Notwithstanding section 180(2) (Business Judgment Rule), section 189 (Reliance on information or advice provided by others) and the ASX corporate governance requirements, such persons are concerned that:
- (a) non-executive directors have to rely upon management for information and implementation;
 - (b) if management does not keep the directors fully informed of problems then directors have no opportunity to redress them; and
 - (c) action or inaction by directors is judged by regulators, courts and media with '20-20 Hindsight'.
- 1.5 Therefore the Committee welcomes this Review and the proposal for introducing a general defence (see paragraphs 3.1 and 3.2 below).

2. Criminal, civil and administrative sanctions in corporate law

- 2.1 For the reasons set out in paragraphs 2.18 – 2.21 and paragraphs 2.33 – 2.35 of the Discussion Paper, the Committee believes that criminal sanctions should only apply to wrongdoing that is serious or substantial, ie. because:
- (a) the wrongdoing would have an effect or potential effect on the market that warrants the strongest deterrent or punishment; or
 - (b) market participants would expect an element of retribution for the wrongdoing.
- 2.2 Accordingly the Committee believes that greater use should be made of civil sanctions for breaches of corporate law (including strict liability offences). The regulatory regime should be aiming for clearer and more consistent classification of offences, culpability standards, penalties and remedies. It is important that the appropriate sanction be applied as it was intended to the particular offence and that this application be consistent across the regimes.
- 2.3 The Committee is not convinced that it is necessary to increase civil penalty amounts in order to strengthen the deterrent value of civil sanctions. The effect of a civil sanction on a person's reputation and standing in the business community, with resulting consequences for that person's income-earning potential, is significant and should not be ignored.
- 2.4 The Committee urges Treasury to further consider the need to draw a clearer distinction between sanctions imposed on a corporation and those circumstances where an individual (be it a director or officer for example) associated with certain corporate behaviour is then subject to sanctions. With personal liability in circumstances of corporate fault, greater care is required in defining what are appropriate standards of culpability to avoid even further moral disconnect and sense of unfairness. The Committee prefers to see greater efforts made to address the more complex problem of corporate liability for corporate fault.
- 2.5 For the reasons set out in paragraphs 2.52 and 2.53 of the Discussion Paper, the Committee does not believe that the *Corporations Act* should prescribe rules of procedure that must be adopted by the courts in civil proceedings. There is scope however to better define and indeed make clearer when a court should apply civil or criminal sanctions, and again, this approach needs to be consistent.



3. Better defining the contravention

3.1 For the reasons set out in paragraphs 3.4 and 3.9 – 3.12 of the Discussion Paper, the Committee supports the view that a general defence also apply as a defence to actions brought in relation to equivalent duties at common law or in equity, and support the introduction of a 'rational belief' test in s181 where the actions or decisions of officers meet the proposed criteria set out in paragraph 3.2 of the Discussion Paper, being where they act:

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

3.2 The Committee believes that such a general defence should apply to the 'core' duties in sections 180 – 183 and section 588G. This would be particularly important for the insolvent trading provisions of section 588G. Under the current regime of personal liability and limited defences, directors inevitably transfer control to an external administrator (which often significantly affects the value of the corporation) rather than take actions that they believe would enable the company to trade out of its financial difficulties.

3.3 The Committee therefore believes that, for the reasons set out in paragraph 3.18 of the Discussion Paper, section 181 (Duty to act in good faith and for a proper purpose) should be amended, by introducing the concept of 'rational belief', to make it consistent with section 180 (Duty to apply care and diligence) and particularly the Business Judgment Rule in subsection 180(2).

3.4 For the reasons set out in paragraphs 3.21 and 3.23 – 3.26 of the Discussion Paper, the Committee believes that sub-paragraph 189(b)(ii) should be amended by deleting:

'after making an independent assessment of the information or advice, having regard to the director's knowledge of the corporation and complexity of the structure and operations of the corporation',

and substituting:

'after making proper inquiry if a reasonable person in the circumstances would have a suspicion for the need for inquiry'.

4. Next Steps

The Law Society through its Business Law Committee would greatly appreciate the opportunity to take part in the roundtable discussion and, if appropriate, the advisory group, through the procedures set out in paragraphs 4.2 – 4.4 of the Discussion Paper.

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

Yours faithfully


Geoff Dunlevy
President