

**CHAPTER 10****ENFORCEMENT - GENERAL**

10.1 Ethical conduct is the best guarantee of decent corporate life. Peer pressure makes for proper behaviour. The legislature need only provide criminal and civil sanctions when ethical standards are low or when they are not met.

**Ethics**

10.2 Ethics are morals tempered with experience. They provide standards by which people in a particular occupation should conduct themselves. They have a high profile in callings such as medicine and law. It is vital they are developed for, and practised by, company directors.

10.3 Directors are expected to make their companies profitable. The community depends upon a successful corporate sector for its well being. Shareholders look to a return on their investments. Creditors want to be paid. Employees depend upon sound enterprises for their livelihood.

10.4 Were a code of ethics to develop for directors it would include a requirement that they use their best endeavours to make their companies profitable. It would also include one that they do so with morality. Moral conduct pays due regard to how it will affect others, whether they be shareholders, employees, creditors, or the community generally.

10.5 Were it possible to build up amongst directors a code of ethics which they faithfully followed, troubles in the corporate sector would be much diminished. Neither case law nor legislation can instil morality, and morality tempered with experience is the

best guarantee of the sort of conduct that the community is entitled to expect of directors.

10.6 Submissions to the Committee recognised this. The Institute of Directors in Australia stated that

[t]he duties of a director in Australia, as spelt out in Section 229 of the Companies Code, are capable of fulfillment only by persons of integrity.<sup>1</sup>

10.7 The Institute said the community wants business

to be conducted in an ethical way which recognises that the common good must not be subverted to promote the profit of individuals or enterprises. Business needs to be conducted in a way which will enhance the economy and in so doing enhance the way of life of all associated with it.<sup>2</sup>

The Institute endorsed this attitude.<sup>3</sup>

10.8 The Committee notes a reported comment of Mr Bosch:

In the last few years the competitive pressures generated by deregulation and concurrent social change led to an erosion of values.<sup>4</sup>

10.9 The Committee sees the growth of an ethical code for directors as essential for both the corporate sector and the community. Directors' ethics are bound up with corporate and business ethics in general. Community support is vital for the

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1. *Submission from Institute of Directors in Australia, p 6 (Evidence, p 124).*

2. *Submission from Institute of Directors in Australia, p 5 (Evidence, p 123).*

3. *Submission from Institute of Directors in Australia, p 5 (Evidence, p 123).*

4. *Carew, Edna, 'Search for Skeletons after the Bull's Feast', Triple A, December 1987-January 1988, p 67.*

successful operation of any company, so companies must conduct themselves in accordance with community attitudes. Increasingly the community is demanding that corporations, and their leaders, look beyond a narrow economic objective.

10.10 Legislation is not an appropriate means of achieving 'morality'. Legislation is results-oriented, is often assessed in terms of increased costs, and tends to encourage a minimal response. For these reasons, a code of ethics for directors should be developed. The increased use of audit committees to scrutinise a company's accounts and financial dealings should assist in deterring unethical conduct.

10.11 The Committee recommends that company directors' professional associations, such as the Company Directors' Association of Australia and the Institute of Directors in Australia, take steps to develop and promote a code of ethics for company directors.

#### Enforcement of the law

10.12 The Committee has emphasised the need for ethical conduct. In addition, laws governing the corporate sector are necessary. Laws are made to be obeyed. To gain obedience they carry sanctions. Submissions received by the Committee suggested that the adequacy of law enforcement is a more important issue than the adequacy of the law itself.<sup>5</sup>

10.13 The aims of law enforcement are many and varied. Not all of them are discussed here. Suffice to say that one obvious aim is to deter conduct which, either inherently or by categorisation, is undesirable.

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5. *Eg submissions from Company Directors' Association of Australia, p 3 (Evidence, p 82); Mayne Nickless Ltd, p 9 (Evidence, p 381); Professor Fisse, p 13; Evidence, pp 153-6 (Mr Harper, Mr Head).*

10.14 Proper regulation of the corporate sector is best achieved through a range of penalties to meet the range of particular circumstances that might arise. To illustrate, regulatory infringements are appropriately dealt with by pecuniary penalty, fraudulent conduct by criminal penalty. At times, financial compensation will be appropriate; on other occasions, disqualification of directors may be appropriate.

### **Australia's corporate regulatory system**

10.15 Enforcement of the law applicable to the corporate sector is the responsibility of a number of bodies. These include the National Companies and Securities Commission (the NCSC), the Corporate Affairs Commissions in the States, the Trade Practices Commission, occupational health and safety agencies, pollution control agencies, consumer affairs agencies and drug and medical evaluation authorities. Regulatory bodies have both civil and criminal remedies at their disposal. Most rely on civil rather than criminal remedies.<sup>6</sup>

10.16 The NCSC was established as part of the co-operative companies scheme which came into operation in 1980.<sup>7</sup> It is responsible for the policy and administration of the codes which regulate the Australian companies and securities industry pursuant to a formal agreement between the Commonwealth and the States ('the formal agreement') which established the co-operative companies scheme.<sup>8</sup> It is funded jointly by the Commonwealth and the States.

10.17 The Ministerial Council for Companies and Securities,

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6. *Law Reform Commission, Sentencing: Penalties, Discussion Paper No 30, September 1987, para 286.*

7. *The National Companies and Securities Commission Act 1979 commenced on 1 February 1980 - Gazette, No 57, 1980, p 1. The Companies Act 1981 commenced on 1 July 1982.*

8. *See Schedule to the National Companies and Securities Commission Act 1979.*

established under the formal agreement,<sup>9</sup> consists of the ministers responsible for administering the law relating to companies and securities in each of the States, the Northern Territory and the Commonwealth. It reviews the operation of the legislation and oversees and controls the implementation of the co-operative scheme.<sup>10</sup>

10.18 Each State or Territory<sup>11</sup> party to the formal agreement has set up its own regulatory body, usually known as a Corporate Affairs Commission. These State and Territory bodies are subject to the direction of the NCSC.<sup>12</sup> Generally, the State and Territory bodies carry out various registration and investigation functions.

#### **National corporations legislation**

10.19 Legislation to establish a new national corporations scheme, in place of the co-operative scheme, was passed by the Parliament on 23 May 1989<sup>13</sup> and assented to on 14 July 1989. At the time of writing, the new legislation is under challenge in the High Court. Part of that legislative package, the Australian Securities Commission Act 1989, sets up the Australian Securities Commission (ASC). The ASC will be responsible for the administration of the new national scheme. The ASC will eventually replace the NCSC although the functions of the ASC will be implemented gradually and the ASC and NCSC will co-exist for some time.

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9. National Companies and Securities Commission Act 1979, Schedule, Part VII.

10. National Companies and Securities Commission Act 1979, Schedule, Part VIII.

11. *The Northern Territory became a party to the formal agreement on 28 January 1986. Its implementing legislation came into operation on 1 July 1986.*

12. National Companies and Securities Commission Act 1979, Schedule, c137(1).

13. *House of Representatives, Votes and Proceedings, No 121, 23 May 1989, at pp 1229, 1230-43.*

10.20 The NCSC is empowered to make findings of unacceptable conduct; the ASC is required to submit any conduct it considers unacceptable to the Corporations and Securities Panel for decision. The ASC cannot determine that issue itself. Its powers are accordingly less than those of the NCSC to which it is otherwise comparable.

### **Adequacy of enforcement**

10.21 Mayne Nickless Limited told the Committee that

any problems and deficiencies in companies and securities regulation in Australia go to the enforcement of those laws not their adequacy.<sup>14</sup>

This view was endorsed by others who made submissions in similar terms.<sup>15</sup>

10.22 The Company Directors' Association of Australia said that

[s]ome instances of alleged corporate misbehaviour not being prosecuted, are due to lack of will on the part of the authorities or inadequate policing mechanisms, rather than inadequate law ...<sup>16</sup>

10.23 The Association said further that

some calls for increased liability upon directors might be usefully re-directed towards more effective application of the existing law.<sup>17</sup>

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14. *Submission, p 9 (Evidence, p 381).*

15. *Eg submissions from Mr MacKinnon MLA, para 1.1; Professor Fisse, p 13; Evidence, pp 153-6 (Mr Harper, Mr Head).*

16. *Submission, p 3 (Evidence, p 82).*

17. *Submission, p 3 (Evidence, p 82).*

10.24 It is necessary that laws be complied with if they are to be respected, and new law will be ineffective where compliance is lacking. A survey of major Australian regulatory agencies shows that, for those agencies, trying to achieve compliance with the law is

fundamentally seen as a matter of persuasion, negotiation, or simply tapping people on the shoulder to remind them to do what they know they should do. Not only the use of enforcement, but even the threatened use of ... enforcement ... is generally viewed as an adversarial breakdown indicative of failure by the regulatory agency. The enforcement tools are seen as important primarily as a background which gives the agency authority; secondly, they are seen as bargaining chips in negotiation for compliance when faced with resistance; thirdly, and least importantly in the eyes of Australian regulatory managers, they are seen as tools to achieve specific or general deterrence.<sup>18</sup>

#### **Actions by the NCSC**

10.25 Professor Baxt told the Committee:

If you want to protect your small investor ... you have to ensure that the people who administer the law have the resources to deal with these matters. If you look at what the NCSC has been doing over the last few years you will see that they have been spending nearly all their time on takeovers and they have not had time to look at these issues [ie directors' duties to the shareholders]. They have not had the resources; maybe they have not had the interest; maybe the takeover area is just too interesting. But the fact of the matter is that these areas have been left alone.<sup>19</sup>

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 18. *Grabosky, Peter and Braithwaite, John, Of Manners Gentle - Enforcement Strategies of Australian Business Regulatory Agencies, Oxford University Press, in association with Australian Institute of Criminology, Melbourne, 1986, p 191.*

19. *Evidence, pp 352-3.*

10.26 Professor Baxt suggested that one way of ensuring protection of shareholders and others whose interests are affected would be

to set up a stronger authority (either the NCSC or some replacement body) with adequate funding to bring litigation.<sup>20</sup>

10.27 He said:

If we go the 'NCSC route' adequate funds must be provided for it or its replacement to administer the law effectively and to pursue breaches vigorously.<sup>21</sup>

10.28 Justice Kirby, President of the New South Wales Court of Appeal, has also seen fit to comment on the role of the NCSC. Justice Kirby pointed out that litigation concerning companies typically involves large financial stakes, the careers and livelihood of officers and employees and the resolution of intricate and novel legislative provisions. He said:

In these circumstances, it might have been expected that, at least in appropriate cases, the court would have the assistance of the Commission appointed to administer the legislation, which has an interest in the uniform and principled interpretation of the Codes.<sup>22</sup>

Justice Kirby acknowledged 'the limits of time and resources' but expressed regret that the NCSC had neither intervened nor agreed to assist the court in the particular instance.<sup>23</sup>

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20. *Submission, para 51 (Evidence, p 207).*

21. *Submission, para 51 (Evidence, p 208).*

22. *North Sydney Brick & Tile Co Ltd v Darvall and Ors (1986) 5 NSWLR 681 at 684.*

23. *Ibid at 684-5. See also Advance Bank Australia Ltd v FAI Insurance Ltd (1987) 9 NSWLR 464 at 470.*



10.29 In a recent New South Wales case in which a shareholder attempting to challenge a decision of the company was not represented on appeal, the NCSC did intervene, after some prompting from the court.<sup>24</sup> Justice Kirby said:

Decisions of this kind may be followed in other States ... Because of the cumbersome machinery for amending the Codes, it is difficult to overcome a determination later found to be inconvenient. That is why the intervention of the NCSC was particularly necessary here.<sup>25</sup>

10.30 Justice Rogers agreed with Justice Kirby:

[W]hilst I fully appreciate that the NCSC must keep to its priorities in the allocation of limited resources, it makes the proper development of company law very difficult when on important questions a Court has to reach its conclusion on the basis of argument from one side only.<sup>26</sup>

10.31 The NCSC has said that it intends to adopt a higher profile in future in enforcing directors' duties. The NCSC's Deputy Chairman, Mr Charles Williams, said in May 1989:

In the last few months, revelations of the misdeeds of directors and executives of some companies have been nothing short of horrific. Based on what I have seen so far, directors will be charged with major infringements of all of the four offence provisions in section 229 of the Companies Code. That is, people will be charged with failing to act honestly, failing to exercise a reasonable degree of care and diligence, with making improper use of information acquired from the company and with improperly gaining an advantage for themselves or another person while acting as

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24. *Catto v Ampol Ltd* (unreported, NSW Court of Appeal, 28 April 1989).

25. *Ibid*, transcript, Kirby P, p 9.

26. *Ibid*, Rogers A-JA, p 7.

directors.<sup>27</sup>

10.32 At least one judge, Justice Brooking of the Victorian Supreme Court, has adopted an active role in ensuring that information concerning possible breaches of company law is put before the NCSC. In Knightswood Nominees Pty Ltd v Sherwin Pastoral Company Ltd,<sup>28</sup> Justice Brooking said:

While the Court cannot and should not seek to constitute itself a regulatory agency in the interests of shareholders generally and of commercial morality, there will be occasions when some step is appropriate.<sup>29</sup>

He ordered, on his own initiative, that information obtained by a shareholder under section 265B of the Code (Corporations Act, s319) (which allows the court to make information available to a shareholder) be disclosed to the NCSC.<sup>30</sup>

10.33 Justice Brooking said that the NCSC

has many claims on its limited resources. The public interest will be served by requiring the plaintiff to make available to the Commission a convenient summary of the results of the inspection as well as making available upon request the detailed information.<sup>31</sup>

10.34 The Committee endorses and encourages action such as this.

10.35 If the NCSC, or the appropriate regulatory agency, is prepared where necessary to prosecute directors who breach their obligations under the companies legislation, then it will be

27. 'Directors - How to Sort Out the Professionals from the Others', speech given to Institute of Directors in Australia, Victorian Branch, by Mr Charles M Williams, Deputy Chairman, NCSC, Melbourne, 31 May 1989.

28. (1989) 7 ACLC 536.

29. *Ibid* at 543.

30. See s265B(1)(d).

31. (1989) 7 ACLC 536 at 543.

necessary only to set precedents by way of test cases in order for it to be clear to all and sundry that these obligations are to be met. Mr Williams said:

I think there are grounds for believing that some of this year's crop of charges will result in convictions, and hopefully there will be some directors who end up in jail.

It will be the conviction of directors which would bring into sharper focus the current agenda for directors ...<sup>32</sup>

10.36 The Company Directors' Association and others<sup>33</sup> specifically addressed the question of the resources available, in particular, to the NCSC and the States' corporate affairs bodies. Mr Williams has also commented on the 'lack of enforcement resources' and has noted the 'difficulty of securing convictions'.<sup>34</sup>

10.37 Professor Baxt told the Committee:

If you did give the regulators - the NCSC - the money to run these cases, all they would need is two or three big victories, and I think the message would get through that you really cannot try that tactic.<sup>35</sup>

10.38 Professor Fisse said:

There seems no real solution to this problem [ie of minimal resources available for investigation and enforcement] other than to provide more resources. In practice the

32. 'Directors - How to Sort Out the Professionals from the Others', speech given to Institute of Directors in Australia, Victorian Branch, by Mr Charles M Williams, Deputy Chairman, NCSC, Melbourne, 31 May 1989.

33. Eg submissions from Company Directors' Association of Australia, p 3 (Evidence, p 82); Mayne Nickless Ltd, p 9 (Evidence, p 381); Professor Fisse, p 13; Professor Baxt (Evidence, p 344).

34. 'Directors - How to Sort Out the Professionals from the Others', speech given to Institute of Directors in Australia, Victorian Branch, by Mr Charles M Williams, Deputy Chairman, NCSC, Melbourne, 31 May 1989.

35. Evidence, p 351.

problem is sometimes alleviated by using the in terrorem effect of news releases or informal publicity as a cheap and fast alternative to prosecuting offenders but this is hardly an acceptable substitute for the administration of justice by due process of law.<sup>36</sup>

10.39 Publicity is not an alternative to proper legal process. The maintenance and protection of a free and competitive market place requires an active NCSC and ASC, vigilant in the interests of the shareholder. A strong NCSC, ASC and Corporations and Securities Panel are essential for the health and vitality of the corporate sector. They must be adequately funded and in a position to appoint staff of the highest quality. The Committee recommends that the NCSC, the ASC and the Corporations and Securities Panel receive the funding necessary for them to be as active, effective and vigilant as possible.

10.40 State Corporate Affairs Commissions raise money from fees charged on the lodgment and registration of company instruments. Professor Baxt told the Committee that these State bodies 'have enormous resources and they are not using them'.<sup>37</sup> He said substantial sums were raised on the registration of business names but not applied to the Commissions' investigatory sections.<sup>38</sup> The Committee agrees that funds derived from the corporate sector should be used to achieve compliance with the law as it applies to that sector.

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36. *Submission, p 13.*

37. *Evidence, p 348.*

38. *Evidence, p 348.*