

CHAPTER 13

SANCTIONS AGAINST DIRECTORS

13.1 Directors are subject to a range of legal sanctions for breaches of the companies legislation. Where they breach their fiduciary duties, they may be subject to equitable remedies. In this chapter, the focus will be on those sanctions contained in the legislation.

13.2 The Companies Code and Corporations Act provide for civil remedies (damages, compensation) and criminal penalties. They provide that a director may be disqualified from office. Legislation in various States¹ allows for community service orders to be made in respect of certain offences against the companies legislation.

13.3 The Companies Code contains many penalty provisions applicable to directors. Recently, the Deputy Chairman of the NCSC, Mr Charles Williams, commented that 'the ... Corporations [Act] ... includes 154 offences which directors may commit, of which 149 involve criminal sanctions'. He compared this with 148 obligations imposed on directors under the existing Companies Code. He noted that many of the penalties had been increased.²

13.4 Professor Baxt made the point that people may feel disinclined to take on directorships because of the penalties to which they would potentially be subject.³ Concern was also expressed in the course of the Committee's inquiry that the

1. See, eg, Community Service Orders Act 1979 (NSW), Penalties and Sentences Act 1985 (Vic), Criminal Law (Sentencing) Act 1988 (SA).

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

3. Evidence, p 357 (Professor Baxt).

penalties provided in the Companies Code demonstrated little consistency.⁴ Concern was expressed that many of the penalty provisions were inappropriate.⁵

Criminal sanctions

13.5 Generally the submissions made to the Committee approved of criminal penalties for company directors where they had acted fraudulently or dishonestly but not otherwise.⁶ The criminal law will deal with most offences involving fraud and dishonesty.⁷ An auditor who gave evidence to the Committee said the criminal penalties helped to 'focus the view of directors', although he also expressed the view that the civil remedies were 'probably more important'.⁸

13.6 Although many sections of the Companies Code and Corporations Act provide for gaol terms, in lieu of or in addition to monetary penalties, it appears that courts are reluctant to impose them.⁹ When gaol terms are provided for breach of the law but the courts are disinclined to impose them because they seem too draconian, the law tends to fall into disrepute. The modest fines which are imposed instead cause some discontent in the community.

13.7 On the other hand, the increased risk of going to gaol that comes with being a director is a disincentive to take on that role. People who would otherwise make good directors may decline a directorship because of this risk.

4. Evidence, p 421 (Mr Hulett).

5. Eg Evidence, p 356 (Professor Baxt).

6. Eg, Evidence, pp 357 (Professor Baxt); 421 (Chairman, Mr Webber); 495 (Dr Pascoe); 625 (Mr St John).

7. Eg, false accounting (s85(1), Crimes Act 1958 (Vic)), obtaining financial advantage (s82, Crimes Act 1958 (Vic)) or property (s81, Crimes Act 1958 (Vic)) by deception, falsifying books of account (s83(1)(a), Crimes Act 1958 (Vic)), theft (s72, Crimes Act 1958 (Vic)), forgery (common law).

8. Evidence, p 10 (Mr Richardson).

9. Evidence, p 102 (Mr Peters).

13.8 Professor Fisse said there was no reason to depart from the present approach of the law, that is, 'to use the range of sentences available generally in the criminal law':¹⁰

For relatively minor offences a fine or probation may be entirely appropriate. For more serious offences community service orders may be warranted ... For the most serious range of offences jail may be necessary to reflect the gravity of the particular offence committed.¹¹

13.9 The Committee agrees that a range of criminal sanctions should be available to meet the range of circumstances of a criminal nature that can arise.

Decriminalisation of company law

13.10 Professor Baxt, arguing in favour of 'decriminalisation' of company law, said:

If I were rewriting the Companies Act I would decriminalise a lot of it. I think there are far too many criminal penalties in areas where there should not be. Take the duty to act with care, [section] 229; there are criminal penalties there which seem strange. ... I query just why you want criminal penalties in some of the situations where they are not major problems - failure to file accounts, et cetera. Certainly you can penalise them [ie directors] monetarily but keep the criminal element out of it.¹²

13.11 Professor Fisse said that the proposal to decriminalise company law seemed 'extreme and unfounded'.¹³ He presented an alternative position:

10. *Submission, p 13.*

11. *Submission, p 13.*

12. *Evidence, p 356.*

13. *Submission, p 13.*

The main trouble with the offence under s. 229(2) as it now stands is that it is defined in terms of negligence rather than in terms of subjective blameworthiness. Generally speaking, the approach adopted in our system of criminal justice is to require proof of guilty intention, knowledge or recklessness, especially where the offence carries the possibility of a jail sentence. The sensible course, in my opinion, would be to redefine the offence under s. 229(2) accordingly. Thus, criminal liability for breaches of s. 229(2) could be confined to situations where a corporate officer knows or is aware of the likelihood that his or her conduct falls short of the standard of care expected. This approach would make the offence narrower in scope and yet would retain criminal liability in the worst instances of violation.¹⁴

13.12 The criminal law is a necessary means of enforcing proper behaviour. Where offences are genuinely criminal in nature, criminal sanctions are appropriate. They are only appropriate in those circumstances. The Committee recommends that section 229(2) of the Companies Code, or its equivalent, be amended so that criminal liability under that section only applies where conduct is genuinely criminal in nature.

Civil remedies

13.13 Professor Fisse used the term 'pyramid of enforcement' to describe the present system,

with civil measures at the base of the pyramid for the general run of cases, and criminal liability at the apex for the more exceptional instances of law-breaking.¹⁵

13.14 Where a breach of the law does not involve criminality,

14. *Submission, p 14.*

15. *Submission, p 15.*

a civil penalty¹⁶ may be appropriate.¹⁷ Proof of the breach would have to be established on the civil onus (that is, on the balance of probabilities) and there would be no stigma of criminal conviction attaching to the director. In appropriate circumstances, people who suffered loss as a result of the breach could simultaneously bring a claim for damages in the proceedings taken to recover the penalty.

13.15 The Committee recommends that civil penalties be provided in the companies legislation for breaches by directors where no criminality is involved, and, in appropriate circumstances, people suffering loss as a result of a breach be enabled to bring a claim for damages in the proceedings taken to recover the penalty.

Level of penalties

13.16 Penalties must suit the offence. They will have no deterrent value if their level is insufficient. Criminal penalties are not appropriate unless criminality is involved. Civil penalties must be commensurate with the wrong done. Damages should reflect the loss suffered.

13.17 The Company Directors' Association said to the Committee:

The annual reports of State [Corporate Affairs] Commissions show a multiplicity of prosecutions of directors of small companies for minor administrative offences. In the great majority of cases, no community disadvantages result from these breaches.¹⁸

16. Such as applies, eg, under s178 of the Industrial Relations Act 1988 - see Gapes v Commercial Bank of Australia Ltd 27 ALR 87 - and the Trade Practices Act 1974, Part IV.

17. See submission from Professor Fisse, p 15, who saw some point in the introduction of a 'regime of civil penalties' in certain circumstances as a 'complementary approach'.

18. Submission from Company Directors' Association of Australia, p 3 (Evidence, p 82).

13.18 The argument seems to be that some administrative procedures required by the law are trivial or unnecessary and the failure to carry them out should not attract a penalty. The companies legislation requires a number of administrative procedures. It is proper that these provisions be enforced. The lodging and filing of documents is essential for the shareholders' and the community's proper access to corporate information. Failure to meet necessary requirements should be penalised. Penalties for breaching such requirements, as with all penalties, should be measured to fit the offence. If provisions are not to be enforced, they should be repealed. There is no scope for half measures. An 'on the spot' fining system could account for minor breaches of an administrative nature in a suitable way.

13.19 In April 1986, the PERIN (Penalty Enforcement by Registration of Infringement Notice) system commenced operation in Victoria.¹⁹ This system is a fully computerised method of processing infringement notices. When people have committed relatively minor offences, where there is a fixed penalty, they are able to pay the penalty, or make suitable payment arrangements, without a conviction being recorded against them. A person retains the right to have the matter determined in a court, if he or she chooses.²⁰

13.20 The Committee recommends that a system of on-the-spot fines for minor offences, such as the Victorian PERIN system, be introduced into the administration of company law.

13.21 The enactment of the close corporations legislation will

19. See *Magistrates (Summary Proceedings) Act 1975, Part VIIA.*

20. See, also, 'Directors - How to Sort Out the Professionals from the Others', speech given by Mr Charles M Williams, Deputy Chairman, NCSC, to the Institute of Directors in Australia, Victorian Branch, Melbourne, 31 May 1989. Mr Williams urged support for the introduction of a scheme such as the PERIN scheme and noted developments in various States along these lines.

relieve small organisations of some of the onerous requirements of the companies legislation which are more appropriately aimed at public companies. It may be that the number of breaches of administrative requirements will decrease when small organisations can incorporate under the close corporations legislation. In any event, an on-the-spot fining system is appropriate where minor offences are involved.

Community service orders

13.22 Community service orders are orders by a court to perform designated work with a public purpose within the community. They may be made against company directors in relation to certain offences under the companies legislation. For example, in New South Wales, when an offence is punishable by a gaol sentence, a court may impose a community service order.²¹ Community service orders do not appear to apply to bodies corporate.²²

13.23 Professor Fisse submitted that community service orders are 'less drastic than jail sentences and yet more severe than fines'.²³ They are more severe because the individual involved is required to expend some personal effort in his or her spare time and this cannot readily be indemnified by the company. This contrasts with the imposition of fines which may be met by the company, either directly or indirectly.²⁴

13.24 If suitable work were available for community service orders,²⁵ then community service orders would be appropriate for

 21. Community Service Orders Act 1979 (NSW), s4. See also, eg, Penalties and Sentences Act 1985 (Vic), Part V, Criminal Law (Sentencing) Act 1988 (SA), Part VI.

22. Submission from Professor Fisse, p 30.

23. Submission, p 31.

24. Submission from Professor Fisse, p 31.

25. Eg, in NSW, the Minister approves the kind of work that may be done as part of a community service order - see Community Service Orders Act 1979 (NSW), s3, definition of 'community service work'.

company directors in certain circumstances. Suitable work could involve devising an accounting system for a charity or helping set up a community organisation, for example.

Disqualification

13.25 Given the opportunity for error and fraudulent conduct by company directors, and the absence of any requirement for formal qualifications, disqualification or prohibition provisions²⁶ are of considerable importance in protecting the public interest. Under section 222 of the Companies Code (Corporations Act, s224), the director must vacate his or her office in certain circumstances which include where the person has not obtained or ceases to hold the relevant share qualification, becomes an insolvent under administration, is convicted of certain offences or becomes subject to certain court orders or notices from the NCSC.

13.26 Evidence was given to the Committee that disqualification from office was the greatest threat to directors, notwithstanding possible gaol sentences and financial penalties, and therefore was an effective sanction.²⁷

13.27 It is appropriate that there be a range of sanctions available to enforce company directors' duties and obligations. A range of sanctions provides a means whereby sanctions may be tailored to the circumstances. Disqualification is an appropriate sanction as part of that range.

The Senate
Parliament House
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Barney Cooney
Chairman

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26. See, eg, Companies Code ss222, 562 (Corporations Act, ss224, 599).

27. Eg, Evidence, pp 103 (Mr Yeomans), 156 (Mr Head).