CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

12 August 2005

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Executive Director
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Dear Mr Kluver

Personal Liability for Corporate Fault
Discussion Paper

Chartered Secretaries Australia (CSA) welcomes the opportunity to comment on the discussion paper *Personal Liability for Corporate Fault*.

CSA is Australia's peak membership body for governance professionals, and considers itself fully qualified to respond to these matters. In Australia, CSA has over 8,500 members and affiliates working as company secretaries, governance professionals and other officers in corporations, who advise their boards on matters of governance.

Members of CSA have a thorough working knowledge of directors' and officers' duties and the *Corporations Act 2001*.

In respect of the discussion paper, CSA comments:

The distinction between direct and derivative liability

Implications of the current law: impact on corporations and individuals

CSA has reservations about the concept of derivative liability, especially where people have no power to influence the offence committed by the body corporate, but are held liable by reason of their formal position in the corporation, rather than for any actual acts or omissions. CSA prefers the concept of accessorial liability, as a form of direct liability for intentional and knowing participation in a corporate breach.

Notwithstanding this, CSA acknowledges that derivative liability is already recognised in various Commonwealth, state and territory statutes and that the social goal of a responsible corporate compliance culture is desirable.

CSA would like to point to some of the practical implications of the application of derivative liability. Under most state occupational health and safety (OH&S) and environmental legislation, if an individual is injured at work or if an environmental incident occurs on (or emanates from) a company's premises, the company will almost certainly be guilty of an offence. Under most state legislation, once a company has committed an offence, the directors and officers will be deemed also to have committed an offence, unless they can prove that they were not in a position to influence the relevant conduct or that they exercised all due diligence to prevent the relevant conduct.

Consider the example of a company with thousands of people employed at multiple sites using heavy mobile equipment, or a labour hire company with thousands of employees working on thousands of client sites in a variety of occupations. Directors could potentially be liable to prosecution if an unfortunate safety or environmental incident were to take place, despite having no knowledge of, or ability to ameliorate, the circumstances giving rise to the incident, no matter how seriously the directors take their responsibilities and no matter how much time they spend focusing on safety and environmental issues.

For example, it is important to differentiate between foreseeable and/or preventable accidents, such as that which occurred at the Esso gas plant explosion at Longford in Victoria in 1998, and those accidents that cannot be prevented and where people are injured without any person being responsible for the injury, such as when a hydraulic line ruptures, despite the fact that it is well-maintained.

CSA also believes that any consistent principle of derivative liability imposed on directors and officers, or extended to a wider category of persons, ought not extend the current forms of derivative liability to be found in various Commonwealth, state and territory statutes.

CSA strongly recommends that any further reform of the *Corporations Act* in the future or introduction of other legislation that has a bearing on corporations, directors and officers should not add to the existing complexity. That is, CSA recommends that new statutes should not impose further derivative liability on directors and officers. If further amendments to the *Corporations Act* are proposed in the future, consideration should be given to whether the derivative liability provisions in other legislation are still appropriate

Is it necessary to go beyond accessorial liability and impose individual derivative liability?

CSA recognises that to the extent that derivative liability creates potential liabilities on the part of directors and officers, it provides significant incentives for directors and officers to put in place effective risk-management arrangements to ensure that the corporation complies with its obligations. It has been suggested that 'accessorial liability alone may not create sufficient incentive, given that the general principles of this type of liability require a person to have actual knowledge, or be wilfully blind, about certain corporate conduct' (page 19 of the CAMAC discussion paper).

Individual fairness

Limiting derivative liability to directors and officers

One argument is that derivative liability should be limited to directors and officers with the power to influence corporate conduct, that is, the persons attracting personal liability for a corporate breach should be those who have both the authority to make decisions about the organisation as a whole and the power to enforce them. In practice, there are few individuals in a corporation with the power to make these decisions.

For example, an OH&S Manager may have a broad scope of responsibility for OH&S, and may make recommendations concerning OH&S issues to the executive committee of a corporation, but may not have the power to make critical decisions concerning OH&S and enforce them. In this example, if the executive committee did not approve recommendations made by the OH&S Manager, the OH&S Manager should not be exposed to derivative liability for any breach of statutory safety requirements which resulted.

Another example concerns risk managers and compliance managers in financial services corporations. They are likely to report to more senior managers and, ultimately, to a member of the executive committee, which has the power to make and enforce decisions concerning these areas of responsibility. The risk and compliance managers should not be held liable for any breach of legislation as a result of actions or inactions by the executive committee, when they have not had the power to make and enforce the relevant decisions.

Expanding derivative liability to a wider category of persons

An alternative argument is that derivative liability should be extended to a wider category of persons.

Directors and officers could potentially be held liable by reason of their formal position in the corporation, rather than for any actual involvement in acts or omissions, and despite having made every effort to ensure OH&S or environmental compliance frameworks have been developed and effectively implemented and observed. CSA notes that, in Australia, there is no similar provision as exists in the United States in relation to a 'responsible corporate officer' doctrine (analogous to derivative liability) which permits a defendant to raise a defence that he or she was 'powerless' to prevent or correct the violation.

There is, therefore, an argument for personal liability for any breach of OH&S or environmental legislation attaching to the person whose acts or omissions caused the breach, rather than to directors and officers by virtue of their position in the corporation. Limiting the scope of derivative liability to directors and executive officers may thwart safety efforts in corporations, as those responsible for particular worksites or groups of employees do not necessarily take 'ownership' of the safety obligations. Indeed, this reflects the position under most state OH&S and environmental legislation.

CSA's position

CSA does not support persons being subjected to derivative liability merely because of their position in a corporation, where the breach was caused by conduct outside of their control and they made reasonable efforts to ensure that appropriate compliance systems and processes are in place. At the senior executive level, individuals generally monitor the performance of others; they cannot be involved in the day-to-day implementation of processes and systems.

While a uniform approach to derivative liability across Australia would be highly desirable, any extension to the liabilities that already exist would add complexity to an already complex area and would be highly undesirable.

CSA strongly recommends that any common form of derivative liability should apply equally to government business enterprises (GBEs) as to corporations. A consistent principle should carry through, regardless of the sector in which the entity operates.

CSA also notes that, if additional liabilities are introduced beyond those which apply to directors and officers, inequity may be introduced. Directors' and officers' liability insurance (D&O) policies provide insurance coverage for directors and officers but, at present, may not provide coverage for other employees. There are many limitations on the extent of coverage that insurance companies will provide beyond directors and officers, with the result that other employees may not have the benefit of insurance coverage. Individuals should be entitled to the benefit of insurance coverage against the risk of personal liabilities, yet imposing derivative liability on individuals other than directors and officers may place some individuals at risk without the benefit of insurance.

Have respondents encountered in practice any problems with disparate Commonwealth, state and territory statutes that impose individual liability and provide for various defences?

To date, while it could be said that CSA members have not encountered any problems in practice with disparate Commonwealth, state and territory statutes that impose individual liability and provide for various defences, CSA members note that the existing variety of standards and tests contained in legislation imposing derivative liability makes compliance much more difficult to manage than it would be under a uniform approach. Currently there is a great deal of legislation in Australia, requiring corporations to respond to differing standards and tests, and this involves an allocation of resources and the attendant costs of such allocation.

CSA welcomes the efforts of the Corporations and Markets Advisory Committee (CAMAC) to seek a uniform approach to derivative liability in Australia and in developing and applying a legislative template for imposing derivative liability. .CSA strongly supports one consistent principle and one common form of derivative liability. Having a common form would promote compliance and reduce compliance costs by removing the need for corporations to respond to differing standards and tests. However, it seems to CSA that a uniform approach, without the imposition of additional liabilities, could only be achieved with the support of the states.

Should the ALRC template be adopted, either as proposed by the Commission or with any modifications?

If a uniform approach were to be implemented, with the support of the states, CSA recommends the use of the Australian Law Reform Commission (ALRC) template, rather than the state templates also put forward as potential models.

CSA's preference for the ALRC template is based on the fact that:

- it requires proof that an individual was in a position to influence the outcome
- it puts the burden of proof on the prosecution, not the defence, notwithstanding that it recognises that the defence must show that all reasonable steps were taken to prevent a breach of the statute
- derivative liability is attached to 'an individual, by whatever name called', rather than only to directors and senior managers. However,CSA supports including a specific reference to directors
- use of the phrase 'the individual knew that…the contravening conduct *would* occur ' is consistent with ensuring that the burden of proof rests with the prosecution.

CSA does not object, having regard to the problem raised, to the defendant having an evidential onus to provide prima facie evidence of having taken one or more reasonable steps (for the reasons stated in para 9.6 of the Discussion Paper on page 47), but from that point, the onus should be on the prosecution to negate that evidence beyond reasonable doubt. Such a regime would have the effect of requiring the prosecution to prove (in each case beyond reasonable doubt):

- recklessness or negligence as to the likelihood of the company's contravening conduct occurring, and
- that the director/officer failed to take reasonable steps to prevent the conduct.

Should the state or territory representative template be adopted?

CSA does not support the state or territory representative template as one to be adopted.

Should the alternative state template be adopted?

CSA does not support the alternative state template as one to be adopted.

Should some other general derivative liability template be adopted?

CSA does not support some other general derivative liability template as one to be adopted.

Should there be a business judgment rule defence?

If derivative liability is extended through the organisation on the basis of the ALRC template, there is no need for a business judgment defence. The ‘reasonable steps’ criterion in the ALRC template is a sufficient defence. The business judgment rule focuses on directors’ duties within a corporation, whereas the legislation reviewed in the CAMAC paper deals with a corporation’s external regulatory compliance obligations. Furthermore, the business judgment rule applies to civil liability only, not criminal prosecutions.

Who should have what burden of proof in relation to reasonable steps?

See our comments above for who should have the burden of proof in relation to reasonable doubt. Our recommendations relate to the fact that, while still placing a significant burden on directors and officers to do the right thing, a framework as recommended by CSA would provide more certainty for those individuals subject to derivative liability than the tenuous link between 'crime' and punishment that exists currently.

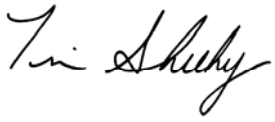
Should some other responsible officer derivative liability template be adopted?

CSA does not support this at this time, but notes that the US ‘responsible corporate officer’ doctrine permits a defendant to raise a defence that he or she was ‘powerless’ to prevent or correct the violation.

Further information

In preparing this submission, CSA has drawn on the expertise of the members of its two internal national policy committees. We would welcome the opportunity to meet with you to discuss any of our views in greater detail. Please call me if you would like to set up a meeting. I can also arrange a meeting with our members.

Yours faithfully



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