Original Article

LEGAL LANDMARKS: THE COMPANIES ACT 2006 AND ITS SIGNIFICANCE FOR DIRECTORS IN UK COMPANIES

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Abstract: The United Kingdom's Company Law Steering Group (CLRSG) initiated a review of the UK company law from 1998 to 2001, resulting in a recommendation to codify directors' duties into statute, which led to the introduction of the Companies Act 2006 (2006 Act). Chapter 2 of Part 10 of the 2006 Act codified the general duties of directors to their respective companies. These statutory duties encompass obligations to act within their powers, promote the success of the company, exercise independent judgment, exercise reasonable care, skill, and diligence, avoid conflicts of interest, decline benefits from third parties, and declare interests in proposed transactions or arrangements. These duties are owed to the company as a whole, rather than to individual shareholders. However, in exceptional circumstances, such duties may be owed to individual shareholders. This article explores the intricacies of directors' duties as codified in the 2006 Act, the exceptions where shareholders may have recourse, and the implications for corporate governance.

Keywords: UK company law, directors' duties, statutory duties, corporate governance, Companies Act 2006.

Introduction

In between 1998 and 2001 the Company Law Steering Group ("CLRSG") was engaged to review UK company law. CLRSG recommended that directors‟ duties, which were created by common law rules and equitable principles should be codified into statute. [1]

Flowing from the work of CLRSG, the Companies Act 2006 ("2006Act") was introduced in 2007, which saw directors "duties codified in it. Chapter 2 of Part 10 of the 2006 Act has the general duties of directors that they owe to a company. These statutory duties are:duty to act within powers;[2] duty to promote the success of the company;[3] duty to exercise independent judgment;[4] duty to exercise reasonable care, skill and diligence;[5] duty to avoid conflicts of interest;[6] duty not to accept benefits from third parties;[7] and duty to declare interest in proposed transaction or arrangement.[8]

These statutory duties are owed to the company and not to shareholders individually.[9] That said, the proper claimant in relation to a wrong perpetrated to a company can be enforced by the company, and notby an individual shareholder as stated in Foss v Harbottle.[10] Notwithstanding this, it is possible for these duties to be owed to a shareholder in exceptional circumstances.[11]

If these directors "duties are breached, the board of directors acting in the stead of the company are empowered by the articles[12] to elect to take action against the director(s).However,if no claim is brought by the directors,

A

Original Article

shareholders may use other private enforcement measures to seek to enforce the breach of duties by the directors. These private enforcement measures include: derivative claim, unfair prejudice petition and proceedings by administrators or liquidators. Derivative claims allow a shareholder to bring an action against a director on behalf of a company. In respect of the statutory derivative claim, permission must be sought from a Court in order bring such an action. Shareholders have taken few actions in respect of derivative claims because of the many disincentives that befall them.These are principally the costs involved in bringing such a claim, which can be high,[13] and the procedural processes involved can be daunting for shareholders. On the other hand, an unfair prejudice petition under section 994 of the 2006 Act can be used by an individual shareholder against a company where the company‟s affairs have been concluded in a manner that is unfairly prejudicial to all or someone of the shareholders.[14] It is a remedy for shareholders in response to either personal wrongs or in relation to corporate
Another mechanism available for enforcing breaches of directors‟ duties is proceedings by liquidators and administrators.
Although directors‟ duties have now been given statutory force in the 2006 Act,no public enforcement was provided for breach of these duties.
Unlike it is in Australia, no public body was given a legal backing to enforce breaches of directors‟ duties. In the UK, the formal private enforcement of directors‟ duties is noticeably absent and there is little formal public enforcement of directors‟ duties.
The director disqualification regime under the Company Directors Disqualification Act 1986 ("CDDA 1986"), operates as one possibility of indirect public enforcement of directors‟ duties. The director disqualification regime allows a director to be disqualified from promotion, management or participation in a company after he or she has been involved in the affairs of an insolvent company. The directors‟disqualification regime for holding directors accountable for their duties to some extent is helping to regulate directors‟ conducts. The use of directors‟ disqualification for regulating directors‟ conduct still requires much to be desired. For example, a director who is involved in misconduct may not be disqualified until the company goes into insolvency. If a company goes into insolvency, under section 6 of CDDA 1986 the Insolvency Service can apply to a court of competent jurisdiction to disqualify the directors from serving in the capacity of a director for a specified period of time on the ground of unfitness to be involved in a company. With respect to section 6 of CDDA 1986, it is possible for an undertaking to be accepted by the Insolvency Service.[18] Further, a director disqualified can apply to the court to make the ban more selective by being allowed to remain as a director of named companies. Where this is allowed the deterrent effect on a director may not be achieved.
Given the fact that there appears to be fairly little private enforcement of breaches of directors‟ duties in the UK, a number of academics and commentators have advocated for public enforcement of directors‟ duties. Professor Keay has submitted that there is the need for public enforcement of directors‟ duties by a public authority so that there is an enhancement of corporate governance in the UK. These commentators are of the view that public enforcement of directors‟ duties will complement the weakness of private enforcement and as result have advocated for alternative mechanisms for directors‟ accountability.
Australia is one of the commonwealth jurisdictions which has been using public enforcement for directors‟ duties for over two decades now. Both public enforcement and private enforcement exist alongside one another in Australia. In the light of the calls by academics and commentators for some external enforcement of directors‟ duties, Australia will serve as a model to examine.
This dissertation will assess whether the UK needs public enforcement for breaches of directors‟ duties under the 2006 Act. It is structured in the following. It examines the efficacy of private enforcement of directors‟ breach of their duties. That is to what extent has private enforcement been effective in enforcing breaches of directors‟

A

Original Article

duties. Secondly, the dissertation examines how directors‟ disqualification regimes are being used to hold directors accountable for breach of their duties. Thirdly, it examines the public enforcement for breaches of directors‟ duties in Australia and as to whether the UK may adopt such modality of enforcement. Fourthly, it explores arguments for and against the introduction of public enforcement mechanisms including experience of public enforcement in Australia. Finally, there are some concluding remarks.

Chapter 1

Assessing the Efficacy of Private Enforcement of Directors' Breach of Duties

1.1. Proceedings by the Board of the Company

Directors‟ duties are owed to the company. This means that those duties are not owed to persons other than the company. However, there are exceptional circumstances where directors may owe a duty to shareholders.

The erstwhile fiduciary duties have been codified in the 2006 Act. Consequently, where there is a breach of directors‟ duties, it is the company which is vested with the power to institute proceedings to seek relief for any breach of directors‟ duties. This rule was dyed-in-the-wool in Foss v Harbottle. The board of directors of a company have the power to bring proceedings on any matters that affect the company under the articles, and that also pertain to their general power to manage the company. This method of private enforcement has not been effective. Firstly, the board may shield the wrongdoer board member because he or she is an established member of the board of directors. Secondly, any action the board takes would have to be measured in the light of section 172 of the 2006 Act, in respect of the duty to promote the success of the company, and from case law, the board may consider that it is not in the interest of the company to litigate. Finally, the board may not bring proceedings against a wrongdoer of the company because of the reputational risk that such proceedings will have on the company and the board itself.

1.2 Derivative Proceedings

According to Scarlet, derivative claims are heavily relied upon as a private enforcement mechanism for breach of directors‟ duties in the United States, a jurisdiction similar to the UK. Derivative claims have served as the principal mechanism for enforcing directors‟ breach of duties.Following the Company Law Steering Group‟s ("CLRSG") review of company law in the United Kingdom (UK), derivative claimshave been codified among other provisions. Derivative claimsare not a new concept to English company law, indeed it was a creature of the common law. Derivative claims are found at Part 11 of the 2006 Act.

In Foss v Harbottle it was established that where a wrong has been committed against a company by its directors or by third parties, the company itself is the proper claimant to bring an action. Often the decision as to whether to sue or not is vested in the directors who run the company. Derivative proceedings permit a shareholder of a company to institute what is referred to by the 2006 Act as a derivative claim against the director(s).

The current position is that, a member of a company may institute a derivative claim against a director(s) only in respect of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company. The action may be against the director or another person (or both).[32] That said, a derivative claim may be brought for an alleged breach of statutory directors‟ duties.

In Iesini v West strip Holdings Limited, it was said that a derivative claim, as defined by section 260(3) is not, however, confined to a claim against the "insiders" (for example, a director of the company or person connected to such a director of a company). A derivative claim may be brought against a person who had dishonestly assisted or knowingly received in relation to a breach of duty.

There is no requirement to show that the delinquent director profited or benefited from the breach of duty and this is in contrast to the common law position (see Daniels v Daniels). Many commentators have alluded to the fact

A

that the inclusion of "default" on the part of directors would widen the scope of wrongs for which derivative claims can be brought.

1.2.1 Who may bring a derivative claim?

The 2006 Act expressly provides who is able to bring a derivative claim against company directors for breach of their duties. That is, only members of the company have the right to bring a derivative claim. It is settled that a member is a shareholder who has his or her name on the register of shareholders.

However, the claimant to a derivative claim need not have been a member of the company at the time the conduct in question took place.[37]Under section 260(5) of 2006 Act, it suggests that a member includes a person who is not a member but to whom shares in the company have been transferred but not formally registered or shares have been transmitted by operation of law.

1.2.2 The two-stage procedure in derivative proceedings

The First Stage

The 2006 Act laid down a two-stage procedure for a claimant to seek permission of the court to bring the derivative claim. At the first stage, the claimant is required to make a prima facie case for permission to continue a derivative claim.[38] The court considers the application based on the evidence filed by the claimant only, without requiring evidence from the defendant. The court must dismiss the application if the supporting evidence filed by the claimant does not establish a prima facie case for giving permission.[39] Where the claimant is successful at the first stage by virtue of being able to establish a prima facie case, the court may require the company to provide evidence at the second stage.[40]

The need for the claimant to establish a prima facie case is very significant to the first stage. The question is, what constitutes a prima facie case? The test is quite familiar to legal practitioners since it had been the main test in interim applications. That said, the prima facie case of which section 261 (1) of 2006 Act refers to is a prima facie case „for giving permission". This essentially entails a decision that there is a prima facie case both that the company has a good action and that the claim arose out of a director" default or breach of duty. Keay and Loughrey (2010) have argued that despite prima facie being a well-known concept, its meaning still remains vague. It has been suggested by Gibbs that satisfying the prima facie case requires merely establishing at least a 0 per cent chance of success. This position of Gibbs stems from the Australian court"s approach in the case of Australian Broadcasting Corporation v Lenah Game Meats Pty Ltd. However, Tang argued that a more than 0 per cent is inconsistent with the American Cyanamid, where the principle in the Australian Broadcasting Corporation was in turn taken from.

The UK Courts have not discussed what prima facie means and what is required of a claimant to establish a prima facie case. It has been suggested that in order to establish a prima facie case, the claimant would have to show that there is a substantial chance of success at the final hearing.In the American Cyanamid case, it was posited that to establish a prima facie case, an applicant in an injunction application had to establish a greater than 50 per cent chance of success. In other words, the claimant must demonstrate to the court that he or she has a credible case; a substantive claim; a genuine triable issue; or that his case is worthy of being heard in full.

At the first stage, the court must have regard to the factors set out in section 263(3) of the 2006 Act in deciding whether to grant a permission for a claimant to continue derivative proceedings.In Wishart, the court said that the factors set out in s. 268(1), (2) and (3) which are equivalent to section 263(2) and 263(3)ofthe 2006 Act should be taken into account to determine whether or not the application should be granted. This position has been followed in cases such as Stimpson v Southern Landlords Association; Iesini[1] and Cullen Investments Ltd v Kauri

[1] Iesini v Westrip Holdings Ltd [2009] EWHC 2526.

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Investments Limited.

The need to consider the aforesaid factors under section 263(2) and (3) makes the first stage a big hurdle to get through. It is observed that the factors in section 263 of the 2006 Act have not been consistently applied, as was seen in Franbar Holdings Ltd v Patel.

b. The Second Stage

The second stage is the phase before the substantive action starts. If it is apparent that some directors would seek to continue the claim, the second stage will become activated. At this stage, the court may require the company to provide evidence in respect of the derivative proceedings. From the first stage, if it appears to the judge that the claimant has no prima facie case, then the court is duty bound to refuse the claim at the second stage. According to Lewison J. in Iesini, the second stage is not simply a matter of establishing a prima facie case, something more would be required. In Fanmailuk.com v Cooper, Mr Robert Englehart QC said that on an application under section 261 it would be "quite wrong … to embark on anything like a mini-trial of the action". No doubt that is correct; but on the other hand not only is something more than a prima facie case required. "Section 263(2) set out a list of the matters which the court must have regards to in deciding whether to grant permission and the circumstances in which the court is bound to refuse permission. That is to say, the court must refuse a claimant permission to continue a claim if it considers that:

a) a person under a duty to promote the success of the company will not continue the claim; and

b) the act or omission which gave rise to the claim has been ratified by the company before it occurred or ratified by the company since it occurred.

c) For the purposes of helping the court form a good opinion, section 263(3) and 263(4)of the 2006 Act provide discretionary factors which must be considered at the second stage. The court must have regard to the following:

d) whether the shareholder is acting in good faith;

e) the importance that a person acting under a duty to promote the success of the company would attach to continuing the claim;

f) whether the act or omission has been ratified by the company before it occurred or after it occurred;

g) whether the company has decided not to pursue the claim;

h) whether the shareholder has an alternative remedy; and

i) the views of independent shareholders of the company. **1.2.3 Discretionary factors to continue a derivative claim**

a. Duty to promote the success of the company

Directors are under a duty to promote the success of the company. In taking a decision for the company, regard must be had to its long term consequences; the impact on employees; the community and the environment and the interests of creditors and shareholders among others.[57] This is an objective test compared with the common law position of the same duty. At common law, if a director believes in good faith that a decision will promote the success of the company, that will suffice.

This duty to promote the success of the company is mentioned under section 263(2)(a) and 263(3)(b) of the 2006 Act,as part of the matters that the court must take into account.

Section 263(3)(b) of the 2006 Act requires the court to consider the importance that a person acting in accordance with section 172 would attach to continuing a derivative claim. That is, the court should assess whetheror not it is likely that the hypothetical director would be more inclined to regard the pursuit of derivative claim less important or not. Further, thecourt wouldalso take into accountthe several factors discussed below.There have been different judicial interpretations given to the application of this factor. In Franbar Holdings Ltd v Patel,

A

Original Article

William Trower QC sitting as a Deputy Judge of the High Court said that, "the hypothetical director acting in accordance with section 172 wouldtake into account a wide range of considerations when assessing the importanceof continuing the claim".[2]The hypothetical director is expected by the court to consider a wide range of factors such as:

a) the prospects of success of the claim;
b) the ability of the company to make a recovery on any award of damages;
c) the disruption which would be caused to the development ofthe company‟s business by having to concentrate on the proceedings;
d) the costsof the proceedings; and
e) any damage to the company‟s reputation and business ifthe proceedings were to fail.

Lewison J said that the weighing of these considerations isessentially a commercial decision which the court is illequipped to take, except in a clear case.[60]

On the contrary, in Iesini[61] the judge said that, section263(2)(a) will apply only where the court is satisfied that no director acting in accordance with section 172 would seek to continue the claim. If some directors would, and others would not seek to continue the claim, the case is one for the application of section 263(3)(b). It has been submitted that if the courts are to follow the approach adopted in Iesini, granting of permission will consequently be rare.[3] [4]

b.Ratification

Ratification remains relevant to the new statutory derivative claim. Permission in respect of derivative claim will be refused where the act or omission has been authorised or ratified by the company.[63] In Franbar Holdings, it was confirmed that the 2006 Act does not alter the common law position that certain wrongs are unratifiable.[5]This is premised on the fact that section 239(7) of the 2006 Act states that[6] any rule of law as to acts that are incapable of being ratified by the company remained unaltered by the 2006 Act. Also,under section 239 of the 2006 Act,[65] ratification by a company of the conduct of a director that amounts to negligence, default, breach of duty or breach of trust in relation to the company,must exclude the vote of the miscreant director(s) or any connected person.Under the new statutory regime, the court is vested with the power to adjourn a proceeding to permit the shareholders to decide whether to ratify or not an act or omission.

c.Good faith

The court considers whether the shareholder bringing a derivative claim is acting in good faith. The fact that a shareholder has a financial interest will not cause the application to be refused. Insofar as the claim will promote the success of the company, the court is likely to grant the application. In Stainer v Lee,[7]it was indicated that a shareholder‟s claim that an action brought is in the best interests of the company may be strengthened if he can point to the support of other members whose opinions he has canvassed, especially if they have also given

[2] Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch) at page 10 [60] [2009] EWHC 2526 (Ch) para. 85. [61] [2009] EWHC 2526 (Ch) para. 86.

[3] See A. Keay and J. Loughrey, „Derivative Proceedings in a Brave New World for Company Management and Shareholders‟ (2010) Journal of Business Law 151.

[4] Act, s. 263(2)(b) and (c).

[5] Franbar Holdings [2008] EWHC 1534 (Ch); [2008] B.C.C. 885 at 897 [65] 2006 Act s. 239.

[6] Act s. 261(4).

[7] Stainer v Lee [2010] EWHC 1539 at para. 49.

A

financial support. Where it manifests that the claimant is pursuing a personal feud, the court is most likely to refuse the application.

d. Alternative remedy

A shareholder having an alternative remedy is not an absolute bar to the court permitting a derivative claim.The court will have regard to all the circumstances of the case before it determines whether a shareholder should be allowed to pursue a derivative claim. In Franbar,[8] and Kleanthous v Paphitis,[9]it was noted that where the shareholder could pursue the claim using unfair prejudice petition but is using derivative claim procedure as an attempt to obtain a cost indemnity from the company, permission will be refused.

e. Independent shareholders

In making a determination as to whether or not to grant permission to a derivative claim, the court is required to have regards to the view of members of the company with no personal interest under section 263(4) of the 2006 Act. Keay and Loughrey have submitted that little has been said regarding the issue of independent shareholders, and that it is unclear to whom the subsection is directed.[10] **1.2.4 Disincentives to derivative proceedings**

a. Costs

Litigation is expensive, and a shareholder planning to bring a derivative proceeding would have to deal with the issue of cost. Costs involved in derivative proceedings area major hurdle particularly given the fact that the permission process may be strongly challenged, and as result costs could be high. David Donaldson QC pointed out in Langley Ward Limited[11]that permission applications were set to "become another time-consuming and expensive staple in the industry of satellite litigation."[12]

Furthermore, because the general rule is that the loser pays the costs of the winning party, the shareholder would have to assess the cost of bring the proceedings and the likelihood of having to pay the other side"s costs in the event of a loss. This tends to limit the potential claimants who may want to bring derivative proceedings before the courts.

A claimant may want to secure After the Event ("ATE") Insurance to cover the costs of the action. ATE insurance policies are taken out in order to help the client cover the costs of litigation once a dispute has already arisen.An insurance company would have to evaluate the merit of the case and the level of costs involved in order to decide whether or not to assume the risk. Given the high uncertainty with the permission process, insurance companies may not want to assume such risk. Assuming a claimant is able to secure ATE insurance, the insurance premium paid is not recoverable from the other party when the claimant wins at trial and is awarded costs.

In the alternative, a claimant may wish to consider a Condition Fee Agreement ("CFA"), popularly known as "no win no fee" or Damages-based Agreement. The question here is whether a firm of solicitors will be willing to take up the derivative claim on a CFA basis. In Hughes v Weiss, [13] the claimant was funded through a CFA.However given the uncertainties of obtaining permission to proceed with a derivative action, as well as the uncertainties of litigation in this area in general, many solicitors are not willing to enter this agreement with claimants.

[8] [2008] EWHC 1534 (Ch) at para. 53-54.

[9] Kleanthous v Paphitis [2011] EWHC 2287 (Ch) at para.78-81.

[10] A. Keay and J. Loughrey, „Derivative Proceedings in a brave new World for company management and shareholders" (2010) Journal of Business Law 151.

[11] Langley Ward Limited v Trevor [2011] EWHC 1893(Ch).

[12] Langley Ward [2011] EWHC 1893 (Ch) at [61] per David Donaldson QC (sitting as a deputy High Court judge).

[13] Hughes v Weiss [2012] EWHC 2363 (Ch).

A

Original Article

The courts have power under the Civil Procedure Rules ("CPR") 1998 Part 19.9 E, to order the company to indemnify the costs of a shareholder in running a derivative action.[14] The court will make such an indemnity order only after permission has been granted to continue a derivative claim. The courts have used their power sparingly in this manner. In Wallersteiner v Moir(No 2),[15]the court held that it would be suitable to award an indemnity where the criteria set out below have been satisfied:

a) the claim is one that would have been reasonable for the board to have pursued;

b) the claimant has no interest in the outcome other than in his capacity as a shareholder of the company; and

c) all benefits from the action will accrue to the company.

Under the new statutory regime, indemnity costs orders have been made in Kiani[16] and Stainer.[17]InStainer v Lee,[18]because there was limited permission to continue the derivative claim, the indemnity costs order was restricted in the same manner. In Kiani,[19]although an indemnity costs order was made, it excluded an indemnity for adverse costs.

b.Lack of Information

The owners of a company are not necessarily the same as the managers of the company. Often the shareholders of a company are different from those in charge of running the company. Consequently, the management of the company may have information that benefits them which the shareholders may not be privy to.

This often creates what is generally referred to as information asymmetric. This may not occur in a private company in which the shareholders and directors are the same.

A claimant in a derivative claim may not be able to get the necessary evidence to support his claim. Shareholders may have difficulty in having access to important information that might enable them to have evidence to support the action.[20] This is because should the claimant be at trial, the board might be embarrassed by the breach and might feel that they were or could be perceived as „asleep on the job" or that they put too much faith in the director.[21]

Also, the board has an influence on the type of information which is available to the shareholders. For instance, not all board discussions are recorded at board meetings. Usually, a board influences what they want to be on record. That being said, where there is a breach, the claimant may not have evidence to pinpoint that the board intended to have the consequences flowing from their breach.

c.The Permission process

A shareholder wishing to bring a derivative action to redress a corporate wrong is faced with significant procedural and substantive difficulties.[22] Under the statutory derivative claim, the claimant has to obtain permission from the court at the first stage before proceeding to the second stage. The permission stage has caused a number of cases to be thrown out because there was not a prima facie case. Research conducted by

[14] Wallersteiner v Moir (No1); sun nom. Moir v Wallersteiner (No 1) [1974] 1 W.L.R. 991;[1974] 3 All E.R. 217; (1974) 118 S.J. 464 CA (Civ Div).

[15] Wallersteiner v Moir (No 2) [1975] QB 373.

[16] Kiani [2010] EWHC 577 (Ch); [2010] B.C.C. 463

[17] [2010] EWHC 1539 (Ch) [2011] B.C.C. 134

[18] Stainer v Lee [2010] EWHC 1539 para. 55

[19] Kiani v Cooper [2010] EWHC 577 (Ch.) para 48-49

[20] A. Polinsky and S. Shavell (2000), Journal of Economic Literature.

[21] A Keay, „An Assessment Of Private Enforcement Actions For Directors" Breach Of Duty" 2014 CJQ 76.

[22] P. Roberts and J. Pole, Shareholders Remedies-Corporate Wrongs and the Derivative Action, (1999) JBL 151.

A

Original Article

Armour and Cheffins found that while numerous lawsuits were launched in the UK, private enforcement of breaches of directors‟ duties was rare in the UK.[23]

The introduction of the two-stage process may be a contributing factor to the low use of derivative actions. Although the Law Commission proposed to reform derivative claims, it did not recommend that there should be a threshold test on the merits.[24] It was of the view that, "inclusion of an express test would increase the risk of a detailed investigation into the merits of the case taking place at the leave stage, and that such a "minitrial" would be time consuming and expensive."[25]It has been suggested that the permission stage should be combined to only one stage to decide whether or not to grant the claimant permission.[26]Keay and Loughrey[87] have also submitted that the first stage should be limited to making sure that a claim is not bogus and should involve the court ensuring that the applicant is a member of the company and the application relates to derivative proceedings, as required by the court in Wishart.[27]

Furthermore, from the review of the cases in this area, it appears that the factors in section 263 of the 2006 Act are being considered at both the first and the second stage. Although considering them at the second stage is understandable because it is interpartes. It has been argued that by suggesting that the factors in section 263 of 2006 Act are relevant at the first stage makes the first stage more substantial than it should be, thus making the permission process costly and as such deters members bringing derivative actions.[28] **d. The reputation of the company**

A shareholder might refrain from bringing derivative action for a breach of duty by a director because of the impact the action might have on the company, particularly, its reputation. A claim against a director of company is likely to send wrong signs to creditors, bankers, customers and other stakeholders.

This may affect the ability of the company to raise funds from potential investors or financial institutions due to bad publicity. In well-established strong capital markets such as the United States, UK and Singapore, the news that a company has been sued could cause its share price to decline and eventually affect its fortune. However, this is not the case with companies which are not listed on the capital market.

A shareholder may not bring a derivative claim against the directors for a breach of duty because such a claim may cast slur on the competence of the directors to run the company well in the minds of other stakeholders. Due to the reputational risks associated with a claim against a company, shareholders may abandon a potential challenge for a breach of duty.

1.3Unfair Prejudice Proceedings

Another private enforcement mechanism available to shareholders is unfair prejudice proceedings under section 994 of the 2006 Act. The provision allows a member of a company to claim for a personal remedy in the case where the company‟s affairs are being, or have been conducted in a manner which unfairly prejudices their position as a member. Traditionally, unfair prejudice petition have operated mainly as a mechanism for minority protection or, at least, for the protection of non-controlling shareholders.

[23] J. Armour, B Cheffins and R Nolan, „Private enforcement of Corporate Law: An Empirical Comparison of the US and UK‟ (2009) 6 Journal of Empirical Legal Studies 687.

[24] Law Commission, Shareholders Remedies: Consultative Paper, 1997, para 6.72.

[25] Law Commission, Shareholders Remedies: Consultative Paper, 1997, para 6.71.

[26] M. Almadani, „Derivative actions: does the Companies Act 2006 offer a way forward?‟ (2009) Company Lawyer 131. [87] A. Keay and J. Loughrey, „Derivative proceedings in a brave new world for company management and shareholders‟ (2010) Journal of Business Law 157.

[27] Wishart, Petitioner [2009] CSIH 65 (IH (Ex Div).

[28] A. Keay and J. Loughrey, „Derivative proceedings in a brave New World for company management and shareholders‟ (2010) Journal of Business Law 157.

A

Original Article

An unfair prejudice petition could be initiated in a circumstance where a wrong has been done which caused loss, but only in order to found a claim for personal relief for the petitioner and for the benefit of the company. However, the recent cases of Clark v Cutland[29]and GamlestadenFastigheter AB v Baltic Partners Ltd[30]have demonstrated that the scope of section 994 petition has been expanded to allow for claims of corporate relief.This view has been supported by Reisberg.[31] Hannigan advocated that Cutland et all are exceptional cases in nature and does not forge a general wider scope for the unfair prejudice petition.[32]

The right to seek relief under unfair prejudice petition is conferred upon only members of the company under section 994. However, anon-member to whom shares in a company have been transferred or transmitted by operation of law has the right to petition.[94] A transferee of shares has standing to petition under section 994 of the 2006 Act in circumstances where the company in question refuses to register the transferee as a shareholder and he or she has no grounds to challenge such refusal. As in Re McCarthy Surfacing Limited[33] and Re Satinet Limited,[34]this is concurrent with that of the transferor if the transferor remains the registered shareholder.

Can shareholders seek a relief under section 994 for breach of directors‟ duties? Directors‟ duties are owed to the company, not the shareholders. That said, there are exceptional circumstances where such duties may be owed to a shareholder. This was confirmed in Peskin v Anderson[35]where the court said there may be situations where a relationship between directors and shareholders could create a fiduciary obligation. Ordinarily shareholders will find it difficult to obtain relief under section 994 for a breach of directors‟ duty. Walton J said in the Atlasview Ltd v Brightview Ltd,[36] that a court was not prevented from ruling that mismanagement constituted unfair prejudice.

In light of Re Tobian Properties Ltd,[37] where fiduciary duties are owed to shareholders, it can be easy to bring an unfair prejudice petition under section 994.

Keay[38] leads the argument that if a shareholder has a good ground for bringing section 994 proceedings in respect of a director‟s breach of duty, there will still be several concerns. Firstly, the shareholder would have the burden to discharge that the wrongful acts which are breaches of duty against the company caused him or her prejudice as a member of the company.

Secondly, despite the wide discretion the court has to make such orders as it thinks fit to remedy any unfair prejudice under section 991(1) of the 2006 Act, often unfair prejudice petition may lead to the court asking the wrongdoing member(s) to purchase the minority shareholding of the petitioner. However, there are exceptional circumstances where the court may order the majority shareholders of the company to sell their shares to the minority petitioner as was the case in Re Company (No 00789 of 1987) ex parte Shooter.[39]

[29] Clark v Cutland [2003] EWCA Civ 810; [2004] 1 W.L.R. 783.

[30] Gamlestaden Fastigheter AB v Baltic Partners Ltd [2007] B.C.C. 272.

[31] A. Reisberg, Derivative Actions and Corporate Governance: Theory and Operation (2007), Ch.8.

[32] Hannigan, "Drawing boundaries between derivative claims and unfairly prejudicial petitions" [2009] J.B.L. 606, 623. [94] See Companies Act 2006, section 994(2).

[33] Re McCarthy Surfacing Limited [2006] EWHC 832 (Ch), para. 23-24.

[34] Re Satinet Limited [2011] EWHC 1518 (Ch) para. 148-149.

[35] Peskin v Anderson [2001] B.C.L.C 372 at 372.

[36] Atlasview Ltd v Brightview Ltd [2004] EWHC 1056 (Ch); [2004] 2 B.C.L.C 191 at [50]

[37] Re Tobian Properties Ltd; Maidment v Attwood; sub nom. Re Annacott Holdings Ltd [2012] EWCA Civ 998 [2013] B.C.C.98.

[38] A. Keay, "An Assessment of Private Enforcement actions for directors‟ breaches of duty" (2014) Civil Justice Quarterly 76, at 82.

[39] Re Company (No 00789 of 1987) ex parte Shooter. [1991] BCLC 267.

A

Original Article

Where the court orders the minority to purchase the majority members‟ shares, it is a question of whether the minority has the financial resources to make the purchase of the shares. A purchase order does not remedy the wrongful acts occasioned by the majority members of the company and as result benefits neither the company nor the other members who may have been unfairly prejudiced by the conduct of the majority member(s).

Finally, the petitioner has to be concerned with the costs involved in bringing such an action. The costs involved in unfair prejudice proceedings can be substantial.[40] Unlike with derivative proceedings where the court may make indemnity costs order to cover the costs (partly or wholly) of the claimant, this is not the case with unfair prejudice proceedings.

1.4Proceedings by liquidators and administrators

Liquidators and administrators are able to bring an action for a company against directors for breach of their duties. In respect of liquidators,sections 165(3) and 167(1)(a) of the Insolvency Act 1986, vest the power in the liquidator to institute or defend proceedings. The grounds based upon which the liquidator brings the action is that the directors are in breach of their duties and/or engaged in wrongful trading (see GHLM Trading Ltd v Maroo).

Over the years a number of liquidators have brought proceedings against directors for breach of their duties. However, administrators have hardly brought proceedings. Liquidators most often argue in the proceedings that the directors have engaged in wrongful trading or are in breach of their duties.

Administrators or liquidators often have to deal with a number of obstacles. First, the liquidator must ensure that there are adequate funds available to enable him bring the action. In the event that the company does not have sufficient funds to enable the liquidator to pursue proceedings, the liquidator would have to consider alternative sources of funding, which may be difficult to find. Second, another obstacle that a liquidator may have to deal with is the issue of availability of evidence for the proceedings. The difficulty for proceedings in liquidation is that the event that constituted the breach of duty on which the proceedings are based might well have occurred a long time before a liquidator is appointed, and persuasive evidence might no longer exist.[41]. Finally, some transactions[42] that the liquidator can investigate and have the court restore may be outside the “relevant time”,[106] and as a result may prevent the liquidator from going back to those periods.

In conclusion, flowing from the examination of these methods of private enforcement as discussed above, it seems that directors are not being sufficiently held accountable for their conduct, so it is my argument that there should be public enforcement of directors‟ duties.

Chapter 2

Directors Breach of Duties and Accountability

2.1Directors Disqualification Regime

The directors‟ disqualification operates to check managerial standards in the UK. A director may be disqualified when any of the specified grounds for disqualification are made out. According to Milman,[43]the director disqualification regime is the way the public sector has been involved in maintaining managerial standards since 1986. That said, one could conclude that at present director disqualification under CDDA 1986 is one way of indirect public enforcement in the UK. We will explore directors disqualification

[40] See Annacott Holdings Ltd, Re [2012] EWCA Civ 998; [2013] Bus. L.R. 753; [2013] B.C.C. 98; [2013] 2 B.C.L.C 567. [103] GHLM Trading Ltd v Maroo [2012] EWHC 61 (Ch); [2012] 2 B.C.L.C. 369.

[41] A. Keay, “An Assessment of Private Enforcement actions for directors‟ breaches of duty” (2014) Civil Justice Quarterly 76, at 81.

[42] Sections 238 and 239 of the Insolvency Act 1986 [106] SeSsection 240 of the Insolvency Act 1986.

[43] D. Milman, „Directors, Governance and Managerial Responsibility: New Developments in UK‟ Company Law Newsletter

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regime and assess in the light of breach of duties, whether it is helping in holding directors accountable. **2.1.1 Grounds for Disqualification**

a. Automatic qualification

A director will be automatically barred from being a director in a company in the event that he has been declared bankrupt. Under section 11 of CDDA 1986,it is an offence for an undischarged bankrupt person to take part of, or directly in the promotion, formation or management of a company unless he has leave of the court. Under this option, the disqualification does not require the State‟s involvement; it operates automatically as a consequence of the bankruptcy.

b. Indictable offence

A person will be disqualified under Section 2 of CDDA 1986upon conviction of an indictable offence. According to Hicks, disqualification on the ground of a person convicted of an indictable offence constitutes the second most common source (after unfitness) for disqualification order.[440845]

Usually, the court may make a disqualification order against a person, whether a director or not, who has been convicted of an indictable offence (whether on indictment or summarily) in connection with the promotion, formation, management, liquidation or striking off of a company or in connection with the receivership of a company's property or with his being an administrative receiver of a company. However, in the event that the court does not make a disqualification order against the person, the Secretary of State or the liquidator or a member of the company or past or present creditor may apply to any court having the jurisdiction to wind up the company to impose the disqualification.[109]

c. Persistent breaches of the requirements of companies' legislation

A director may be disqualified under section 3 of the CDDA 1986 where it appears that there have been persistent breaches of the 2006 Act. Pointers such as failure to file returns, financial accounts or documents which are required to be filed or delivered or any notice of any matter required to be sent to the Registrar of Companies will amount to breaches of the 2006 Act. If a person has been convicted of a summary offence in relation to failure to file a document with or give notice of a fact to the Registrar of Companies, the court may disqualify that person if in the previous five years he has had at least three convictions or default orders against him for failure to comply with the reporting requirements of the 2006 Act and Insolvency Act 1986 ("IA 1986").[46]

d. Fraud

Under Section 4 of the CDDA 1986, a person may be qualified for fraud in the course of a company winding up. The court will make a disqualification against a person if it appears that he is guilty of an offence (whether convicted or not), or in respect of fraudulent trading under section 993 of the 2006 Act or has been guilty while an officer or liquidator of a company. Section 993 of the 2006 Act constructs a criminal offence of carrying on business of a company with the intent to defraud creditors[47] of the company or of any other person or for any other fraudulent purpose.[48]Since fraud is a criminal offence, intention would have to be proven. In practice, fraudulent trading claims are infrequent due to the difficulty of establishing intent. In re Patrick and Lyon

[44] .

[45] A. Hicks, Disqualification of Directors: No hiding Place for the Unfit? (ACCA Research Report 59, 1998), p.35, found that in 1996 about one quarter of those at that time disqualified were in that position as result of a section 2 disqualification. [109] See, the Company Directors Disqualification Act 1986, section 16(2).

[46] See, the Company Directors Disqualification Act 1986, section 5.

[47] See, R. v Smith [1996] 2 B.C.L.C. 109, CA, the section embraces fraud on future as well as present, creditors.

[48] P.L. Davies and S. Worthington, Principles of Modern Company Law, 9th edition, 2012 Sweet & Maxwell, 9-4, p. 227.

A

Original Article

Ltd,[49]Maugham Jsaid that „real moral blame"[50] must be established before fraudulent trading can be successfully proceeded against.

e. Wrongful Trading

Section 10 of CDDA 1986 offers the possibility that a director may be disqualified if he has been found to be guilty of wrongful trading under section 214 of the IA1986. It is required that before the winding up the director knew or ought to have known, that there was no reasonable prospect that the company would escape insolvent liquidation.

In Re Brian D Pierson Contractors Ltd,[51]the court having established wrongful trading under section 214 of theIA1986, imposed a disqualification order against the director.On the other hand, in Re Idessa (UK) Ltd,[52]the Judge Lesley Anderson referred the issue to the authorities for them to elect whether they will pursue disqualification when he found that wrongful trading did occur in the case before him. **f. Unfitness**

A director may be disqualified on the ground of unfitness under section 6 of the CDDA 1986. It should be noted that under this section, it is only directors (it extends to de facto and shadow directors) who may be disqualified. The question is what constitutes unfitness? Section 9 and Schedule 1 to CDDA 1986 provides guidance on what may be considered unfitness. It includes any misfeasance or breach of any fiduciary or general duties of directors owed to the company. This is the most common ground for disqualification. As mentioned earlier, the Secretary of State can accept undertaking from a director under this ground of disqualification. This is the ground which is most relevant to the research question. Directors who breach their duties may be disqualified under the unfitness ground. In light of the statistics in Table 1 below, directors being disqualified as unfit is the most common ground for disqualification.

Table 1[53] Directors' Disqualification 2009-2016

Period	Section 2	Section 6	Section 8	Total
2009/2010	49	1,327	10	1,386
2010/2011	53	1,385	15	1,453
2011/2012	44	1,109	12	1,165
2012/2013	59	971	4	1,034
2013/2014	63	1,216	3	1,282
2014/2015	65	1,145	0	1,210
2015/2016	48	1,157	5	1,210

[49] Re Patrick and Lyon Ltd [1993] Ch 786.

[50] Re Patrick and Lyon Ltd [1993] Ch 786 at 790.

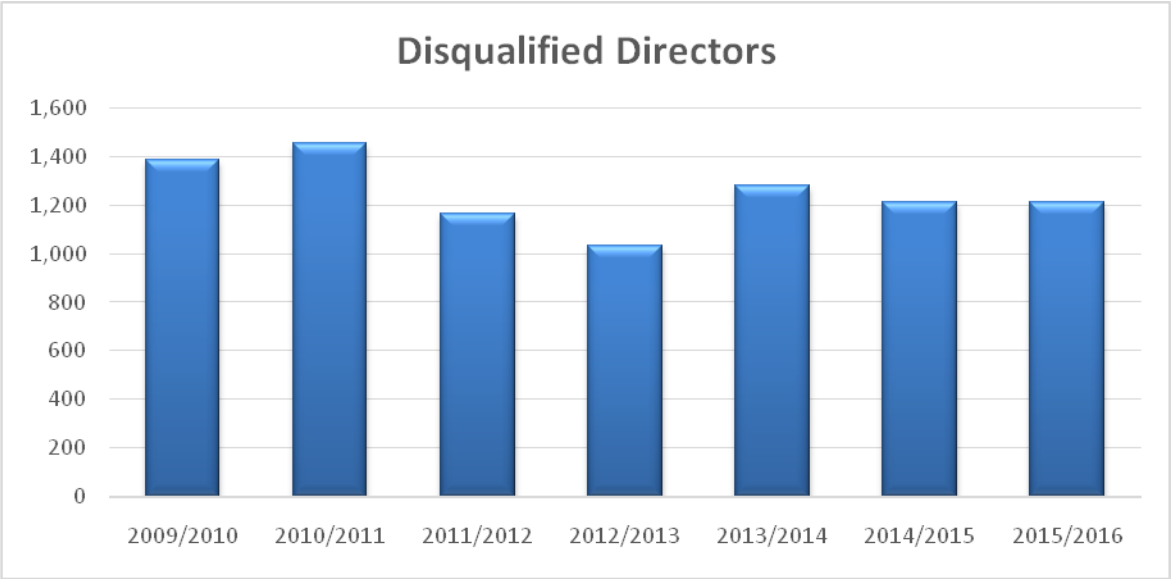
[51] Re Brian D Pierson Contractors Ltd [1999] B.C.C. 26.

[52] Re Idessa (UK) Ltd [2011] EWHC 804 (Ch); [2012] B.C.C. 315.

[53] See https://www.gov.uk/government/statistics/insolvency-service-enforcement-outcomes-monthly-data-tables-october2016.

A

Original Article



The statistics show that between 2009-2010, there were 1,365 disqualification orders made. In the period of 2010-2011the number of directors qualified increased to 1,453. In 2011-2012 the number of directors qualified decreased from 1,453 to 1,165 when compared with the previous year. In 2012-2013 and 2013-2014 the disqualification orders made were 1,034 and 1,282respectively. This represents a decline in the number of directors qualified when compared with the period 2009-2010 and 2010-2011. In 2014-2015 and 2015-16 the disqualification orders made were 1,210 and 1,210 respectively.

The statistics points to the fact that the most common ground for disqualification was unfitness under section 6 of the CDDA 1986, followed by where a person has been convicted of indictable offence pursuant to section 2 of the CDDA 1986.

2.2 To what extent has directors' disqualification held directors in check?

Directors of insolvent companies may be disqualified for breach of their duties. The reason is that the misconduct of directors often comes to bare when the company is insolvent. A number of directors are disqualified each year by UK courts. Also, directors have given undertakings to the Secretary of State for Business, Innovation and Skills not to act as directors for an agreed period of time. A director who is qualified will have his life materially affected because he can be prevented from being a director for a period up to fifteen (15) years.

The existence of a director disqualification regime serves as a deterrent of improper conduct by directors. The mere fact that directors are aware that they may be disqualified from being concerned in the management of a company should he or she be adjudged as disqualified, deters some directors. That being said, it is only those who are aware of the consequences of the disqualification order that may be mindful and more cautious in their conduct. Hicks has submitted that for the non-professional, self-employed or small business person, disqualification may not be a sufficient sanction to induce them to behave better when faced with the possible failure of their business.[54]

The disqualification regime holds directors accountable by offering the public protection to some extent. The performance of the statutory duties by directors have far-reaching consequences beyond themselves. Harris et al submitted that statutory duties of directors perform a higher function than merely serving the interest of the

[54] A. Hicks, "Director Disqualification: can it deliver?" (2001) Journal of Business Law, 433 at 441

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shareholders.[55]When directors manage companies well,issues such as employee redundancy, reduction in tax revenue to Revenue Authorities etc. are minimised. Directors may avoid breaches of duties because they know that their activities will be subject to scrutiny when the company that they are involved in becomes insolvent and that the likely consequence is a disqualification order.

The disqualification regime has the objective of establishing, promoting and disseminating standards of good practice in the management of companies.[56] Most companies have developed management operational standards to demand expected good practices from directors. This is to prevent these companies becoming insolvent, which may prevent some of the directors being subject to disqualification proceedings.

2.3 Problems with the Disqualification Regime

Disqualification orders are made in circumstance where a company becomes insolvent. That being said, it is when a company becomes insolvent and it is a subject of formal insolvency procedures, that disqualification orders may be made. Directors may be breaching their statutory duties to the company and may not be caught because they may not have plunged the company into insolvency. In that case, these directors are not being held accountable for breach of their duties by the disqualification regime. Although under section 8 of the CDDA 1986 the Secretary of State for Department for Business Innovation and Skills may impose a disqualification order when it is in the public interest, flowing from an investigation carried out by it. This power is rarely being used by the Secretary of State.

The qualification regime does not confer on the court power to make compensation orders or financial penalties against directors who breach their duties. That is, directors who have failed to act according to acceptable standards and a loss has been occasioned are not held financially accountable for the loss to the company. With the Small Business and Enterprise and Employment Act 2015 entered into force, the courts can make compensation orders in certain circumstances against disqualified directors.[57] Section 15A of CDDA 1986 now allows the Secretary of State on an application,to ask the court to order a director to pay compensation to his company as a contribution to the company‟s assets, or order the payment of compensation to one or more creditors of the company on condition that the director has been disqualified or undertaking and the conduct of the director leading to the disqualification or undertaking caused loss to one or more creditors of an insolvent company.

Although this change is commendable, it is more favourable to creditors in the event of insolvency. It is emphasised that the compensation order can be made by the court to address misconduct by directors of insolvent companies.

Thus, where the company is solvent, the courts are not permitted to make compensation orders. Also, it did not provide any help to those who lose out in companies where directors are not disqualified.[58]

As stated above, directors may be disqualified from acting as directors on the basis that they are unfit to be involved in the management of a company. The present guideline on what constitutes unfit is narrow.

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[55] J. Harris, A. Hargovan and J. Austin, „Shareholder Primacy Revisited: Does the Public Interest Have any Role in Statutory Duties?‟ (2008) 26 Company and Securities Law Journal 355,366.

[56] he analysis of aims was written before Lord Woolf in *Re Blackspur Group Plc* said in the Court of Appeal ([1998] 1 B.C.L.C. 676 at 680), that "The purpose of the 1986 Act is the protection of the public, by means of prohibitory remedial action, by anticipated deterrent effect on further misconduct and by encouragement of higher standards of honesty and diligence in corporate management…".

[57] Small Business Enterprise and Employment Act 2015, section 110.

[58] ~~See~~ A. Keay and M. Welsh, „Enforcing Breaches of Directors‟ Duties by a Public Body and Antipodean Experiences‟ (2015) 15 2 Journal of Corporate Law Studies at 282

A

Original Article

With the Small Business, Enterprise and Employment Act 2015entered into force, it has amended the factors that must be taken into account when determining whether a person is unfit to act as a director.[59]This changes is likely to widen the scope and increase the disqualification orders in this area. That being good the fitness of a directoris only discovered and dealt with after a company has gone into insolvency and having caused damage to creditors.[60] The disqualification order may not serve as a deterrent, which is desirable. Disqualified directors could set themselves up again in some sort of self-employment. Those who had a formal executive post may be somewhat affected but notwithstanding that they may get a decent job with a small company or enter business as partnership or sole traders. According to Andrew Hicks, disqualification is likely to have a major impact on the more formally qualified professional managers; its implications for the typical small entrepreneurs are more limited.[61] Also, a disqualified director may make an application under section 17 of the CDDA 1986 for the court to make the ban more selective by being allowed to serve as a director of named companies. In that instance, the company has still lost out and the miscreant directors are still able to participate as a director of the named companies.

The disqualification period is in the UK is up to a maximum of fifteen years. This is not punitive enough. In Australia, where they have similar disqualification regime, the disqualification period is unlimited. So where a director breaches his statutory duty, in the UK the court may decide to disqualify the said director for two or more years, with the maximum limit being fifteen years. If directors are aware that they may be disqualified for unlimited years from acting as directors, it will send strong signals to directors to uphold acceptable standards of management of companies.

The enforcement of breaches of directors‟ duties is an important aspect of the accountability of directors. In view of the above analysis, the disqualification regime has resulted in some directors being ineligible. However not all directors are being held accountable for their conduct. The disqualification orders are made in circumstances where the companies have become insolvent. Directors may be breaching their duties when companies are solvent. This gap in the disqualification regime calls for some form of public enforcement as is done in Australia. In Australia, ASIC has enforced directors‟ duties against directors of solvent companies.[62]

CHAPTER 3

Comparative Analysis: Australia's Public Enforcement Model

Australian corporate law provides for both public and private enforcement of directors‟ duties.It has for at least twenty two (22)years hadpublic enforcement for breaches of directors‟ duties. The UK has private enforcement of directors‟ duties, however, it does not have public enforcement of directors‟ duties. The UK and Australia‟s legal system are based on the common law. Secondly, they both have social norms and values which are similar.[63]Directors‟ duties in Australia are quite similar to that of the UK.

The Australia‟s public enforcement of directors‟ duties has attracted attention as some academics are advocating for it to be introduced in the UK.[64] We will examine the Australian public enforcement model and assess whether or not provision should be made in statute for the public enforcement in the UK.

[59] ~~See,~~ See Small Business Enterprise and Employment Act 2015, section 110

[60] ~~See~~ A. Hicks, „Director Disqualification: can it deliver? (2001) Journal of Business Law, 433 at 439

[61] ~~See,~~ A. Hicks, „‟Director Disqualification: can it deliver? (2001) Journal of Business Law 433

[62] ASIC v Healey (2011) 196 FCR 291, [2011] FCA 717.

[63] ibid

[64] A. Keay, „The Public Enforcement of Directors‟ Duties: A Normative Inquiry‟ (2014) 43 Common Law World Review 89.

A

Original Article

3.1 Directors' Duties and Enforcement

Directors‟ duties in Australia are codified in the Corporations Acts 2001 (Cth)The statutory duties of directors are, duty to act with care and diligence;[65] duty to act in good faith in the interests of the company and for proper purposes;[66] duty to avoid improper use of position;[67] duty to avoid improper use of information;[68] duty to disclose material personal interest;[69] and duty to prevent insolvent trading.[70] These statutory duties exist alongside the common law and fiduciary duties.

Some of the duties set forth above have received both civil and criminal consequences when there is a breach of obligations. Consequently, directors who breach their duties are subject to civil penalties and in certain instances, criminal penalties may be imposed.

As in the UK, private enforcement for breach of duties are also available to shareholders of companies in Australia. Shareholders of companies can use the statutory derivative claim, unfair prejudice petition and direct action initiated by the company itself.[71]The many obstacles that shareholders face which prevent them from pursuing claims for breaches of duties exist in Australia as well. That being said, restrictive substantive rules limit the ability of shareholders to sue directors, and also the „loser pay‟ fee rules have the effect of reducing the incidence of shareholder litigation.[72]

A directors‟ disqualification regime exists in Australia which allows a public regulator to disqualify directors from acting as directors in companies. The directors‟ disqualification is one of the civil penalties.[73]

Despite the existence of private enforcement for breach of directors‟ duties, the Australian Securities and Investments Commission (ASIC) plays a key role in enforcing breach of directors‟ duties.

3.2 Why was Public Enforcement introduced in Australia?

Australia was the first English-speaking country to introduce public enforcement (criminal sanctions) of directors‟ duties in 1958. The criminal sanctions were not achieving the desired results so the Australian Senate Standing Committee on Legal and Constitutional Affairs was tasked to review the Australian corporate law.

Following the review of the Australian corporate law in 1987 by the Australian Senate Standing Committee on Legal and Constitutional Affairs (the "Cooney Committee"),[74]the civil penalty regime (as discussed below) was introduced as part of the public enforcement. The civil penalty regime is set out in Part 9.4B of the Corporations Act became effective from 1 February 1993.

The Australian public enforcement model was introduced for a number of reasons; firstly, the Cooney Committee found that public enforcement (criminal sanctions) of directors‟ duties was ineffective. There were concerns that the lack of successful prosecutions leading to imprisonment led to community discontent and to a belief by some

[65] Corporations Act 2001 s. 180

[66] Corporations Act 2001 s. 181

[67] Corporations Act 2001 s.182

[68] Corporations Act 2001 s. 183

[69] Corporations Act 2001 s. 191

[70] Corporations Act 2001 s. 588G

[71] J. Varzaly, „The Enforcement of Directors‟ Duties in Australia: An Empirical Analysis‟ (2015) 16 European Business Organisation Law Review at 313.

[72] J. Armour, B. Black, B. Cheffins, R. Nolan, „Private Enforcement of Corporate Law: an empirical comparison of the United Kingdom and the United States‟ (2009) 6 Journal Empirical Legal Studies at 692.

[73] Chapter 2D Part 2D.6 of the Corporations Act 2001.

[74] Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, Company Directors‟ Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors (1989) (Cooney Report)

A

that the law had fallen into disrepute, as there was no credible accountability mechanism for breaches of the statutory duties.[75] For that reason, the civil penalty regime was introduced to enable ASIC to deal with corporate wrongdoing more effectively than under the previous criminal law regime.

[76]Secondly, public enforcement introduced to promote confidence and integrity in companies in Australia, so as to encourage both domestic and foreign investments in companies.[77]Thirdly, it was introduced because it serves as a deterrent for directors to correctly perform their duties and to encourage them to fulfil them.[78]

Finally, Keay asserts that it is designed to protect company stakeholders who have no standing to bring a cause of action against directors who are in breach.[79]

3.3ASIC and the Types of Orders Available

ASIC is the body responsible for company registration and securities regulation in Australia. It is the regulator responsible for enforcing the Corporations Acts 2001.

ASIC has the power to sue, to enforce directors‟ duties and can seek a range of penalties including pecuniary penalties and officer and director bars.[80]The UK does not have a corporate regulator for enforcing breach of duties.There is no single public body responsible for bringing proceedings against directors when they are in breach of their duties. Enforcement of director‟s duties constitutes a significant component of the overall enforcement activity of ASIC.[81]ASIC is perceived as robust and reasonably well funded.[82]The public enforcement measures available to ASIC are both criminal penalties and the civil penalties.[83]These orders available to ASIC will be discussed below.

3.3.1 Civil Penalties

Under the civil penalty regime, ASIC is allowed to initiate court-based enforcement actions which seek penalties where it is in the public interest to do so.[84]If a civil breach of duty by a director is suspected by ASIC, it can initiate civil penalty proceedings against directors in its own right. The civil penalty may also be enforced by the affected company as well.[85]

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[75] ibid

[76] V. Comino, "Australia‟s "Company law watchdog": the Australian Securities and Investments Commission and the Civil Penalties regime" Journal of Business Law (2014) 228.

[77] R. Tomasic, „Corporations Law Enforcement Strategies in Australia: The Influence of Professional, Corporate and Bureaucratic Cultures‟ (1993) 3 Australian Journal of Corporate Law 192 at 200.

[78] A. Keay, „Public Enforcement of Directors‟ Duties: A Normative Inquiry‟ (2014) 43 2 Common Law World Review 89.

[79] ibid

[80] R.M Jones and M. Welsh, „Toward a Public Enforcement Model for Directors Duty of Oversight‟ (2012) 45 Vanderbilt Journal of Transnational Law 343, 349

[81] J. Hedges, H. Bird, G. Gilligan, A. Godwin, I. Ramsay, „An Empirical Analysis of Public Enforcement of Directors‟ Duties in Australia: Preliminary Findings‟, Working Paper No. 3, 31 December 2015.

[82] Australian Senate Economics References Committee, Performance of the Australian Securities and Investments Commission Final Report http://www.aph.gov.au/Parliamentary_Business Committees/Senate/Economics/ASIC/Final_Report/index> (Accessed 17 October 2015)

[83] R. Tomasic, "The Challenge of Corporate Law Enforcement: Future Directions for Corporations Law in Australia", http://ssrn.com/abstract=1433820.

[84] A. Keay and M. Welsh, „Enforcing Breaches of Directors‟ Duties by a Public Body and Antipodean Experiences‟ (2015) 15 2 Journal of Corporate Law Studies at 261.

[85] Corporations Act 2001 s. 1317J which allows the company to enforce the order; Mesenberg v Cord Industrial Recruiters Pty Ltd (1996) [19] ACSR 483.

A

Original Article

The main civil penalties that ASIC can impose for breaches of directors‟ duties provisions of the Corporation Act 2001 (Cth) are: disqualification orders pursuant to sections 260C-E; pecuniary penalty orders pursuant to Section 1317G; standalone declarations of contravention pursuant to section 1317E (that is, declarations of contravention without any corresponding disqualification or pecuniary order); and compensation orders pursuant to s 1317H.[86] ASIC can levy a pecuniary penalty after a declaration that a director has breached his or her statutory duties. A penalty of up to a maximum of AUD 200,000[87] per breach may be ordered to be paid to the Australia‟s public purse. Pecuniary penalties can be made in circumstances where the breach of duty "materially prejudices the interest of the company or its members, or materially prejudices the corporation‟s ability to pay its creditors; or is serious.[88]

Compensation orders can made against a director who breaches his statutory duty and as a consequence the breach results in a loss to the company. Thus,where a director has failed to perform his duties, he or she may be personally liable to compensate the company or others for any loss or damage suffered.[89]Compensation orders can be made against directors who have breached their directors‟ duties in companies which are solvent. Similarly, compensation orders can also be imposed on directors of insolvent companies.

A director can be disqualified from acting as a director in a company where there is contravention of directors‟ duties. It is possible for a person disqualified to apply to the court for leave to manage a company under section 206G of the Corporations Act 2001.

Disqualification orders can be made for unlimited periods of time unlike in the UK where the maximum disqualification period is fifteen (15) years. Disqualification orders are the most sought order by ASIC, followed by pecuniary penalties and compensation orders.[90]

A term of imprisonment is not an available sanction under a civil penalty regime.

The rules applicable to the civil penalty regime are the civil rules of evidence and procedure.[91] Although the standard of proof is on the balance of probabilities,[92]however, the courts often apply the standard of reasonable satisfaction from Briginshaw v Briginshaw.[93]

3.3.2 Criminal penalties

As stated earlier, some of the directors‟ duties are subject to criminal penalties for breach of them. As a consequence, a criminal penalty can be imposed where a director fails to perform his duty or breaches it. Where criminal conduct is suspected, ASIC refers the matter to the Commonwealth Director of Public of Prosecutions (CDPP) to bring criminal proceedings.[94]

[86] H. Hedges, H. Bird, G. Gilligan, A. Godwin and I. Ramsay, „An Empirical Analysis of Public Enforcement of Directors‟ Duties in Australia: Preliminary Findings‟ Working Paper No. 105/2016/Project T021.

[87] Corporations Act 2001, S. 1317G.

[88] Corporations Act 2001, S.1317E.

[89] Corporations Act 2001, S 1317H.

[90] M. Welsh, „Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia‟ (2014) 42(1) Federal Law Review 217.

[91] Corporations Act 2001, S 1317L.

[92] Corporations Act 2001, S 1332.

[93] ~~See~~ Briginshaw v Briginshaw (1939) 60 CLR 336,368.

[94] A. Keay and M. Welsh, „Enforcing Breaches of Directors‟ Duties by a Public Body and Antipodean Experiences„(2015) 15 Journal of Corporate Law Studies at 258.

A

Original Article

The criminal consequences for breaches of directors‟ duties provisions could be a fine of up to 2,000 penalty units (AUD) or imprisonment for up to five years, or both,[95] a good behaviour bond pursuant to section 20 of the Crimes Act 1914 (Cth), community service orders pursuant to section 20AB of the Crimes Act 1914 (Cth) and reparation orders pursuant to section 21B of the Crimes Act 1914 (Cth).

The predominant criminal penalties are a fine and the term of imprisonment. Thus, a director found guilty of a breach of duty which attracts criminal sanction, a penalty of up to a maximum of AUD360,000 or a term of imprisonment of up to five (5) years or both may be imposed.[96]

The standard of proof in respect of criminal penalty is beyond reasonable doubt and also criminal rules of evidence and procedure must be complied with.

Preliminary findings by Hedges et al suggest that criminal enforcement of directors‟ duties by CDPP was significantly more prevalent than civil enforcement by ASIC.[97] It reveals that when comparing directors‟ duties that attract both civil and criminal liability, criminal enforcement by the CDPP was responsible for about 81% of all matters in which liability was established and about 61% of all defendants found liable.[98]

Despite the criminal enforcement of directors‟ duties being prevalent in Australia, criminal penalties are unlikely to be given serious consideration in the UK. Therefore, the focus is on the civil penalty regime.

3.4Advantages of the Civil Penalties

The civil penalty orders have been easy to obtain in most cases. This is particularly so because it is easier to obtain a civil penalty for a breach.

Furthermore, the civil penalty helps with the deterrent effect that the law seeks to achieve. Tomasic argues that civil penalties have often been favoured and have often had more success, especially when minor breaches were the subject of regulatory attention.[99]

The civil penalty, for example pecuniary penalties, can be calibrated to reflect the seriousness of the harm and the degree of culpability of the director.[100]

Notwithstanding the advantages of the civil penalty, it has been argued that the legal sanctions for breach of duty are not tied to the seriousness of a director‟s degree of culpability but rather the penalty is determined by the losses that a company suffers as a result of the breach.[101]

3.5 Problems with the Civil Penalty Regime

First, ASIC lacks the financial resources to pursue all corporate misconduct. As a result, ASIC may have to cherry-pick cases to pursue. Where it brings an action for breach of duties, there are instances where the litigants have access to financial resources that ASIC found it difficult to respond effectively to.[102]

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[95] Corporations Act 2001, Schedule 3.

[96] Corporations Act 2001 s. 184; See M. Getting, "Do We Really Need Criminal and Civil Penalties for Contraventions of Directors‟ Duties?" (1996) 24 ABLR 375 at 382-385.

[97] H. Hedges, H. Bird, G. Gilligan, A. Godwin and I. Ramsay, „An Empirical Analysis of Public Enforcement of Directors‟ Duties in Australia: Preliminary Findings‟ Working Paper No. 105/2016/Project T021.

[98] ibid

[99] R Tomasic, "The Challenge of Corporate Law Enforcement: Future Directions for Corporations Law in Australia", http:/ssrn.com/abstract=1433820.

[100] R.M. Jones and M Welsh, "Toward a Public Enforcement Model for Directors‟ Duty of Oversight, Vanderbilt Journal of Transnational Law 45, no.2 (2012): 343-403.

[101] ibid

[102] M Moncrieff, "Budget 2006: ASIC gets hands on war chest", The Age, 11 May 2006 at page Business 5.

A

Original Article

Also, the procedural challenges mounted by defendants when ASIC has brought civil penalty proceedings against them have often turned out not to be cheap. For example, in the case of Fortescue Metals Group Ltd v ASIC; Forrest v ASIC,[103] it was reported that ASIC‟s cost was AUD 30 million.[104]

Second, despite ASIC having been successful with the use of the civil penalty in high profile cases, it faces procedural obstacles.The court‟s treatment of civil penalties as quasi-criminal offences has given rise to evidential and procedural difficulties for ASIC, particularly where the defendant is claiming for penalty privilege.[169]Comino posits that a successful claim of the penalty privilege means, for example, that defendants can refuse to disclose its case to ASIC by not filing its affidavits before trial and as a result, ASIC may not know what matters will be raised in defence of the allegations it is making.[105]

Third, although the maximum amount for a pecuniary penalty is AUD 200,000, the courts have imposed a much lower amount on average than the maximum. The median civil penalty imposed on defendants who engaged in a single breach of a directors‟ duties was AUD 25,000.[106]Keay and Welsh have also highlighted that the imposition of low penalties in some recent cases including ASIC v Healy[107] (Centro) pose difficulties.[108]

Fourth, there has been difficulties with the standard of proof required of ASIC when it is making its allegations in civil penalty proceedings. The standard of proof in these cases have often been very close to the criminal standard, which has resulted in inconsistency in the way cases are treated by different courts and judges.[109]

Finally, the civil penalties have been applied more to public companies, rather than private companies, where information is readily available. In a private company, it is quite difficult to know what is going on. ASIC will be able to bring enforcement action against a director or a company when the breach has come to its attention, otherwise such breach will still continue until the director is found out.

A number of commentators have argued that the procedural obstacles in the civil penalty proceedings should be tackled. Comino has argued for Parliament to enact appropriate legislation to settle the procedural obstacles relating to all civil penalty proceedings.[110]

In conclusion Australia‟s civil penalty regime is a public enforcement model that the UK can take a cue from and adopt as part of its company law. The UK already has the disqualification regime, so it can focus on the compensation order and the pecuniary penalty against directors for breach of directors‟ duties.

CHAPTER 4

Public Enforcement V. Private Enforcement

In assessing the effectiveness of private enforcement in the UK in Chapter 1, it was noted that the use of private enforcement by shareholders for breach of directors‟ duties have been ineffective. Thus, in this chapter we will

[103] Forrest v Australian Securities and Investments Commission (2012) 291 A.L.R. 399; [2012] HCA 39.

[104] Durkin, Boxsell and Barrett, „How Regulator Blew $30million on Twiggy‟, The Weekend AFR, 6-7 October 2012, page 37. [169] V. Comino, „James Hardie and the Problem of the Civil Penalties Regime‟ (2014) 37(1) University of NSW Law Journal 197-9.

[105] V. Comino, "Australia‟s "Company law Watchdog": The Australian Securities and Investments Commission and the Civil Penalties Regime" Journal of Business Law (2014) 228, 232.

[106] H. Hedges, H. Bird, G. Gilligan, A. Godwin and I. Ramsay, „An Empirical Analysis of Public Enforcement of Directors‟ Duties in Australia: Preliminary Findings‟ Working Paper No. 105/2016/Project T021.

[107] ASIC v Healey (2011) 196 FCR 291.

[108] A. Keay and M. Welsh, „Enforcing Breaches of Directors‟ Duties by a Public Body and Antipodean Experiences‟ (2015) 15 2 Journal of Corporate Law Studies at 274.

[109] Middleton, ASIC Corporate Investigations and Hearings (*looseleaf)*, para. 8. 1520; and Spender, „Negotiating the Third Way‟ (2008) 26 Company & Securities Law Journal 249, 257.

[110] V. Comino, "The Civil Penalty Problem‟ (2009) 33 Melbourne University Law Review 802, 807.

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explore the arguments that have been advanced for public enforcement as well as arguments against public enforcement of directors‟ duties. Andrew Keay has written more about this than any other commentator and these are his arguments for and against public enforcement.

4.1 Arguments for Public Enforcement of Directors' Duties

a. It will serve as deterrent for directors

Public enforcement of directors‟ duties is likely to deter directors from misusing their positions in a company and it will cause them to exercise due care and skills when carrying out their duties.[111]

The existence of public enforcement of directors‟ duties will send a strong signal to miscreant directors that they will be prosecuted in the event of breaches of their duties. It has also been submitted that public enforcement could deter directors from overlooking the improper actions or lack of care of colleagues and managers.[112] Managing of a company by directors involves taking risks so as to promote the success of the business, particularly regarding enhancing its profitability level. Public enforcement for breaches of directors‟ duties may prevent directors from taking decisions which involve some element of risk for company. It has been argued that a rigorous liability regime would harm shareholder interests by discouraging directors from taking risks and deterring qualified directors from serving as directors.[113]Further, it has been suggested that directors will tend to deviate from the rational acceptance of corporate risk if in authorising the company to undertake a risky investment; the directors must assume some degree of personal risk for any resulting corporate loss.[114]Australia has operated public enforcement of directors‟ duties for at least 22 years and this is not deterring directors from taking risk and neither has it discouraged directors from participating in the operations of companies. According to a study undertaken in Australia, it suggests that enforcement action by ASIC was an important element in encouraging companies to engage in complying with the law, and therefore deterring misconduct.[115]

b. It will offer protection for investors

An argument which is often mooted in favour of public enforcement of directors‟ duties is that it will offer protection for investors in companies.[116] The protection will be offered to all investors regardless of whether or not their shares in companies are publicly or privately held. This view was expressed by a senior Australian judge that the goal of enforcement was to protect shareholders and the investing public.[117] The confidence that the investing public has in the financial market is very important. Where public confidence in the financial market is eroded, this may affect the level of investments in the financial market.

That said, investor protection is vital for financial market to develop.[118] This warrants the need to have public enforcement of directors‟ duties to send a signal to directors that any misconduct will not be condoned, thus helping to maintain confidence in the financial market.

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[111] A. Keay, "The Public Enforcement of Directors‟ Duties: A Normative Inquiry" Common Law World Review 43 (2014) 2, 89.

[112] L. Casey, „Twenty-Eight Words: Enforcing Corporate Fiduciary Duties through Criminal Prosecution of Honest Services of Fraud‟ (2010) 35 Delaware Journal of Corporate Law 1 at 17.

[113] B. Black, B. Cheffins, M. Klausner, „Outside Director Liability‟ (2006) 58 Stanford Law Review 1055 at 1140.

[114] ~~See~~ Re Caremark International Inc. Derivative litigation, 698 A 2d 959, 967 (Del. Ch. 1996).

[115] M.A. Welsh, „New Sanctions an Increased Enforcement Activity in Australia Corporate Law: Impacts and Implications‟ (2012) 41 Common Law World Review 134 at 136.

[116] A. Keay, "The Public Enforcement of Directors‟ Duties: A Normative Inquiry" Common Law World Review 43 (2014) 2, 89.

[117] R. Tomasic, „Corporations Law Enforcement Strategies in Australian: The Influence of Professional, Corporate and Bureaucratic Cultures‟ (1993) 3 Australian Journal of Corporate Law 192 at 200.

[118] H. Jackson, M. Roe, „Public and Private Enforcement of Securities Law: Resource-Based Evidence‟ (2009) 93 Journal of Financial Economics 207.

A

Original Article

The consequence of having public enforcement of directors‟ duties might be to enable companies to attract more external funding, as investors might be encouraged by the possibility of such enforcement if directors act wrongly.[119]It may be plausible for a public body to bring an action for breaches in the public company where shareholdings is often dispersed and may be difficult to bring a cause of action for breaches of duties by directors. Conversely, an empirical study in Australia suggested that private enforcement is more feasible and hence more likely where shareholders are concentrated, due to lower coordination costs.[120]The point is made that in a private company context, shareholdings are concentrated and so there are thus fewer barriers to private enforcement.[121] A private company may be listed someday on the finance market so there is the need to guarantee protection of investors in companies. It is said that the best evidence does not warrant rejecting public (or private) enforcement as vital for investor protection in supporting financial markets.[122]

c. A Public Bodyis more Resourceful

A public body‟s involvement in the enforcement of directors‟ duties has its plausible advantages. Keay submitted that a public body does not have a vested interest in the company so it can be more objective in deciding whether or not there is a good action against the director.[123] A public body can bring actions in the interest of the public even in the absence of prospect for a big payoff for lawyers.[124]A public body may have the interest of enforcing the law to the latter, whereas with private enforcement by a member, a shareholder may bring an action when he or she has issues with the other shareholders or directors of the company.

Furthermore, a public body may have more resources at its disposal to enforce a breach of directors‟ duties than a shareholder will have. For example, the Australian ASIC is perceived to be resourceful, because the level of resources available to ASIC per company has grown over time.[125]Keay[126] suggests that a public authority will have some funding and its officers may well be able to do the job of getting a matter up for trial with less expense. However, with the global financial meltdown, there are budget cuts across most government agencies and departments, therefore the public body may not have enough resources for the purposes of enforcing breaches of directors‟ duties.

d. It will serve the Interest of wider stakeholders

Public enforcement of directors‟ duties will benefit wider stakeholders. An Australian judge Justice Middleton said that the role of a director is significant as their actions may have a profound effect on the community, and not just shareholders, employees and creditors.[127] Flowing from this, public enforcement of these duties will safeguard the interest of these stakeholders.Further, under section 172 of the Companies Act 2006, directors are required to take into account the factors therein when promoting the success of the company.A public body vested

[119] E. Berglof, S. Claessens, „Corporate Governance and Enforcement‟ I.M. Millstein G.N. Bajpai,

[120] J. Varzaly, „The Enforcement of Directors‟ Duties in Australia: An Empirical Analysis‟ (2015) 16 European Business Organisation Law Review at 305.

[121] ibid

[122] H. Jackson, M. Roe, „Public and Private Enforcement of Securities Law: Resource-Based Evidence‟ (2009) 93 Journal of Financial Economics 207.

[123] A. Keay, „The Public Enforcement of Directors‟ Duties: A Normative Inquiry‟ (2014) Common Law World Review 43 2 (89) at Page 9.

[124] R.M. Jones and M. Welsh, „Toward a Public Enforcement Model for Directors‟ Duty of Oversight‟ (2012) Vanderbilt Journal of Transnational Law 45, no.2 343-403.

[125] J. Varzaly, „The Enforcement of Directors‟ Duties in Australia: An Empirical Analysis‟ (2015) 16 European Business Organisation Law Review at 303.

[126] Ibid.

[127] ASIC v Healey (2011) 196 FCR 291, 297 [14].

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with power to enforce directors‟ duties could bring an action against directors where they fail to consider the factors set out under section 172. Shareholders would, in general, not be concerned about taking any action for the kind of breach regarding section 172 of the Companies Act 2006 as it will not usually affect them or their interest in the company.[128] Those stakeholders stated in section172(1) do not have standing before the courts to bring a cause action for breach of the provision.[129] In the event that public enforcement is permitted, this is likely to offer protection for these stakeholders.

Moreover, permitting public enforcement of directors‟ duties will lead to a boost of the UK economy. Investors will have confidence in the economy and as a result this might affect the willingness of overseas investors to deposit capital in UK companies.[130]Investors may be motivated by the fact that a regulator would be able to enforce breaches in appropriate circumstances.[131]

A boost in the economy has the multiplier effect on a number of stakeholders. For example it may lead to an increase in employment for UK resident individuals and increase tax revenue for the government which will be used to improve the lives of residents in the UK.

Public enforcement of directors‟ duties will have an impact on the corporate governance system in the UK. A director is an essential component of corporate governance. Each director is placed at the apex of the structure of direction and management of a company,[132]therefore public enforcement of these duties will improve corporate governance in most companies.

Also, it has been submitted that the amount of protection that a system gives to outside investors has substantial effects on its corporate governance regime.[133] If the ways companies are organised and managed are improved, it will serve broader interests.

e. It will hold directors' accountable

Permitting public enforcement of directors‟ duties will lead to increased compliance and in effect uphold accountability. Accountability is an indispensable part of corporate governance. When a public body is able to hold directors accountable for breaches of their duties, directors will take the necessary steps to ensure that they comply with the law for of fear of being brought to book. It has been suggested that a credible accountability mechanism is a necessary element of a regulatory regime that aims to increase compliance levels.[134]

Having directors‟ duties is a means of demanding accountability from directors. Keay argues that if those duties are not enforced, it makes a mockery of the accounting mechanism.[135] That said, when a public body is allowed to bring an action against directors for breach of duty that serves an accountability mechanism. This may cause directors‟ to voluntarily disclose information regarding their actions to the regulator and also justify their actions for fear of being subsequently found out by the regulator.

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[128] A. Keay, „The Public Enforcement of Directors‟ Duties: A Normative Inquiry‟ (2014) Common Law World Review 43 2 (89) at Page 10.

[129] A. Keay and H. Zhang, „An analysis of Enlightened Shareholder Value in the Light of Ex Post Opportunism and Incomplete Law‟ (2011) 8 European Company and Financial Law Review 445.

[130] www.ons.gov.uk/ons/dcp171778 257476.pdf (Accessed 3 December 2015).

[131] Ibid.

[132] Per Justice Middleton in ASIC v Healey (2001) 196 FCR 291.

[133] A. Reisberg, Derivative Actions and Corporate Governance (Oxford University Press: Oxford, 2007).

[134] R. Jones and M. Welsh, „Toward a Public Enforcement Model for Directors‟ Duty of Oversight‟ (2012) 45 Vanderbilt Journal of Transnational Law 343.

[135] Ibid.

A

Original Article

e. **It will preserve companies**

Permitting public enforcement of directors‟ duties will lead to more companies not failing. Directors knowing that their conduct in managing companies will be subject to public scrutiny will cause them to be responsible in the management of companies, thus preserving most companies from failing. Every year hundreds of companies fail because of breaches of directors duties. If a public body could sanction directors for breach of their duty at any point in the companies‟ life cycle, this will put the directors in check and they will be more responsible in running their companies. There is not a guarantee that a company will not go into insolvent but the rate at which companies fail will be reduced to the barest minimum. Although Australia has had public enforcement for directors‟ duties for over two decades, companies still become insolvent. **4.2 Arguments against Public Enforcement**

a. That company law is private law

Some commentators have argued that breaches of directors‟ duties should be enforced by private enforcement, rather than public enforcement because company law is private law and to a large extent there should be little public intervention. That is to say, the State must not get itself involved in a company‟s affairs because it is regulated by private law. Companies are private even if they are incorporated as public companies, the law, the enforcement of it and relevant remedies should remain private.[136]

It has been argued that because company law is private law, most issues can be resolved by way of a contract.[137] These proponents argue that public regulation should be kept to a complete minimum, as individuals should be at liberty to live how they choose and make whatever agreements they consider appropriate[138] and further suggest that individuals should be allowed to opt out of the application of legal rules.[139]

This has however been said not to be true.[140] For example, the general statutory duties of UK company directors, as set out in sections 171 to 182 of the Companies Act 2006, are mandatory in form and thus cannot be opted out of by individuals or companies.[141]

On the other hand, the Contractarian theorists view has been challenged by those who share the view that companies do have impact on the public and as a result their existence and operation cannot be regarded only as a private matter and to this end public intervention is justifiable.[142]

Although company law is private law, the State interferes in it using directors‟ disqualification regime. Under the Company Directors Disqualification Act 1985 the State is able to disqualify miscreant directors from acting as directors under the grounds discussed in Chapter 2.

In Australia, even though company law is private law, the State acting through ASIC is able to bring enforcement actions against directors for breach of their duties. ASIC is able to bring an action for a breach when it is in the public‟s interest to do. By the same token, a shareholder(s) can institute an action for breach of directors‟ duties.

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[136] A. Keay, „The Public Enforcement of Directors‟ Duties: A Normative Inquiry‟ (2014) Common Law World Review 43 2 (89) at Page 3.

[137] M. Whincop, „Of Fault and Default: Contractarianism as a Theory of Anglo-Australian Corporate Law‟ (1997) 21 Melbourne University Law Review 187.

[138] D. Millon, „New Directions in Corporate Law: Communitarians, Contractarians and Crisis in Corporate Law‟ (1993) 50 Washington and Lee Law Review 1373 at 1382.

[139] S. Bainbridge, „Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship‟ (1997) 82 Cornell Law Review 856 at 860-1.

[140] R. Nolan, „Continuing Evolution of Shareholder Governance‟ Cambridge Law Journal 65 (2006), 92.

[141] M.T. Moore, Comparative Corporate Governance a Functional and International Analysis-Chapter 21 on UK (Cambridge University Press) at page 919; http://dx.doi.org/10.1017/CBO9781139177375.026.

[142] L. Mitchell (ed.), „Progressive Corporate Law (Westview Press: Boulder, 1995).

A

Original Article

In recent times, the New Zealand government has introduced a new legislation to allow for public enforcement of directors‟ duties. The Zealand Financial Markets Authority (FMA) has the power to enforce breaches of directors‟ duties against directors of financial markets participants.[143]

b. Public enforcement will be a constraint on the public coffers

An enforcement of directors‟ duties by a public regulator will mean that public resources will be used to do that. Most countries public coffers face various demands and the UK is not exception, thus there are always limited resources given the demands on them.[144] Consequently, the resources of the State must be allocated judiciously. Thus, allowing taxpayers to fund private actions‟ of shareholders may be unconscionable.

It has been argued that shareholders have the right to bring actions for themselves for breach of directors‟ duties, hence giving a public body the right to take action is replicating the consequences of measures that the shareholders would have put into effect and so the empowering of the public body is redundant.[145]However, shareholders are not likely to take actions for a number of reasons, particularly, restrictive procedural prerequisites to the initiation of some actions and also due to financial constraints. Institutional shareholders and well-to-do shareholders may have the financial resources to mount a legal challenge in court for breach of directors‟ duties. That may be the reason why those who cannot mount a legal challenge may be worthy of protection.[146] Australia like many countries does not have infinite financial resources, yet it uses taxpayer money to fund enforcement of breaches of directors‟ duties.

The impact of the State allowing companies to go into insolvency following from breaches of directors‟ duties is far-reaching. Thus, the current state of the law in the UK allows public enforcement in certain circumstances. For example, a public action can be initiated against a director for engaging in fraudulent trading.[147] In the same way, the Secretary of State for Business Innovation and Skills can wind up companies where it is in the public interest to take such action.[148]

There will always be competing interests on every public coffers. However, that should not stop the public coffers from being used for a purpose that will serve broader interests. Susan Watson and Rebecca Hirsch have said that unless a regulator takes action it is possible that in many cases no one will take action, not because of legal reasons but because of practical ones.[149]

c. It will discourage potential directors

Public enforcement of breaches of directors‟ duties is likely to affect individuals‟ willingness to take up directorship in companies in the UK. Potential directors may be afraid to take up directorship in companies because they may be subject to censorship for breach of duties.

Also, it is argued that if the power for the enforcement of directorial failures is heightened the number of people who are willing to become directors will decline and people will not be attracted to act as directors.[150]Potential directors may be scared of their conduct being subject to public scrutiny and may avoid taking roles in companies.

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[143] S. Quo, „Criminalisation of breaches of directors‟ duties in New Zealand‟ (2014) Company Lawyer 211.

[144] ~~See~~ how generally departments budget are been cut for lack of financial constraints faced by the government http://www.bbc.com/news/uk-politics-34790102 (Accessed 28 December 2015).

[145] B. Cheffins, Company Law: Theory, Structure and Operation (Clarendon Press: Oxford, 1997) 163.

[146] A. Keay, „The Public Enforcement of Directors‟ Duties: A Normative Inquiry‟ (2014) Common Law World Review 43 2 (89) at page 5.

[147] Insolvency Act 1986, section 993. The essence is to protect the interests of creditors of companies.

[148] Insolvency Act 1986, section 124A. This is aimed at promoting creditors and customers of bogus companies.

[149] S. Watson and R. Hirsch, „Empty Heads, Pure Hearts: The Unintended Consequences of the Criminalisation of Directors‟ Duties‟ (2011) 17 New Zealand Business Law Quarterly 97 at 101.

[150] A. Keay, „Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective‟ (2005) 25 Legal Studies 431.

A

Original Article

Cheffins and Black assert that substantial liability risk could have negative corporate governance consequence.[151]They further stated that capable individuals, fearing financial ruin, might decline directorship in companies. Boards could spend too much time on the wrong things; and boardroom decision-making could become counterproductively cautious.[152]Nevertheless, a person serving as a director of a company is regarded as prestigious, and taking up board appointment will enhance the social leverage of the individual as well as the company. To that end, individuals will still accept appointments to directorship office even if the enforcement is tightened in respect of directorial failures.The reason is that individuals are influenced to accept board appointments because of the financial rewards associated with them. For example, an individual who has a regular income from his employment and happens to serve on boards, will have his income augmented by the boards‟ fees and perks. Also, individuals will accept board appointments because of the influence the positions will enable them wield in the society.

Furthermore, the question is, are directors acquainted with their obligation at the time of taking appointments in a company? Directors are not often aware of their responsibilities when entering office, so it is possible that they will have little knowledge of how breaches of duty are enforced and by whom, and will not be deterred from accepting a post in a company.[153] Those who have taken directorship in companies as a profession are likely to be aware of responsibility before taking these roles and may be wary of any consequences of their actions.

The experience in Australia does not lend credence to that fact that public enforcement has the potential of reducing potential directors from taking up directorships in companies. As stated above, Australia has had public enforcement of directors‟ duties for many years now and it does not appear to have any problems in getting people to take up directorships in companies.[154]

d. It will prevent directors from taking risks in business

Managing businesses involvesa number of risks, so directors take risks often with the view of maximising shareholders gains. The primary objective of directors in a company is to maximise profits and minimise costs. Therefore, public enforcement of directors‟ duties may cause directors to avoid taking risks for fear of being brought to book in the event that things do not go well**.** Since they take risks on a daily basis, they have to allocate the companies‟ factors of production very well to maximise profit for the company. It is an established principle in business that the higher the risk the higher the returns.[155] This means that where directors take a higher risk with respect to business decisions, there is likely to be higher return for the company and similarly, where the directors‟ are risk averse, the lower the returns. Nonetheless, permitting public enforcement of directors‟ duties may discourage directors from taking risks in business which may eventually harm shareholders‟ interest.[156]

e. It is the shareholders who have the primary responsibility

An argument which is posited against permitting public enforcement of directors‟ duties is that shareholders are the beneficiary of any relief ordered by the court and hence they should bear the risk of failure rather than the public coffers.[157] Shareholders stand to benefit more when a company is being run successfully. For instance,

[151] B. Cheffins and B. Black, „Outside Director Liability across Countries‟ (2006) 84 Tex. Law Review at 1389.

[152] B. Cheffins and B. Black, „Outside Director Liability across Countries‟ (2006) 84 Tex. Law Review at 1389.

[153] R. Tomasic and B. Bottomley, „Corporate Governance and the Impact of Legal Obligations on Decision Making in Corporate Australia‟ (1991) Australian Journal of Corporate Law 55 at 83.

[154] R. Jones and M. Welsh, „Toward a Public Enforcement Model for Directors‟ Duty Oversight‟ (2012) 45 Vanderbilt Journal of Transnational Law at 371.

[155] N. Smith, „High Risk, High Returns? Not Quite‟ 20 August 2015, www.bloombergview.com (Accessed on 28 December 2015).

[156] B. Black, B. Cheffins and M. Klausner, „Outsider Director Liability‟ (2006) 58 Stanford Law Review 1055, 1140.

[157] A. Keay, „The Public Enforcement of Directors‟ Duties: A Normative Inquiry‟ (2014) Common Law World Review 43 2 (89) at Page 7.

A

when a company makes a profit, the shareholders benefits from the profits after the relevant taxes have been paid. For that reason, shareholders have the responsibility to protect their interests in a company, and not a public body. Furthermore, permitting public enforcement of directors‟ duties may cause shareholders to shirk their responsibility of bringing an action.

However, the case of Australia points to the fact that public enforcement exists alongside the private shareholder action.[158]This has not prevented shareholders from taking actions for breaches of directors‟ duties. Actions by Australian shareholders are not plentiful, but there are more actions being taken by shareholders in Australia for breaches of directors‟ duties than it is in the UK.[159]

Conclusion

This dissertation examined whether there should be public enforcement for breaches of directors‟ duties in the UK. We noted from the assessment of the efficacy of private enforcement of breaches of directors‟ duties that the extent to which private enforcement has been used to enforce breaches of directors‟ duties has been low for a number of reasons discussed therein.

Also, the use of the director disqualification regime to hold directors for their conduct has not been that effective for the reasons outlined in this dissertation.

The present system for enforcing breaches of directors‟ duties is not functioning properly and as a result there have been calls for public enforcement of directors‟ duties. However, the provisions in the 2006 Act exclude public enforcement of directors‟ duties.

Australia adopted public enforcement of directors‟ duties over two decades ago and have chalked a high success rate in a number of cases. That said, both private and public enforcement of directors‟ duties exist in Australia. The public enforcement involves the use of the civil penalties and the criminal penalties by a public body for breaches of directors‟ duties.

The author agrees with Professor Andrew Keay, Michelle Welsh and many other academics and practitioners who have advocated for public enforcement for breaches of directors‟ duties in the UK. The UK needs to consider having public enforcement for breaches of directors‟ duties in its statute books. The model adopted in Australia is an example to follow. The criminal penalty regime is not likely to garner support with the UK Parliament so it should not be adopted, despite the possible advantages that are associated with the use of criminal penalties. What the UK should adopt from the Australian model of public enforcement is the civil penalty regime.

It has been suggested that the introduction of pecuniary penalty orders, in addition to the compensation orders together with the existing disqualification regime, could well make directors take the performance of their duties more seriously and deter them from committing breaches of duty.[160]

Although the Small Business, Enterprise and Employment Act 2015 has been introduced which allows courts to make compensation orders in limited circumstances against directors who are disqualified, the Australian model of public enforcement goes beyond the changes it provides.

As highlighted by Professor Keay,[161] permitting public enforcement for breaches of directors‟ duties will firstly, enable shareholders to be protected in an instance where they cannot fund an action or where they are unlikely to

[158] R. Jones and M. Welsh, „Toward a Public Enforcement Model for Directors‟ Duty Oversight‟ (2012) 45 Vanderbilt Journal of Transnational Law 343, 403.

[159] I. Ramsay and B. Saunders, „Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action‟ 2006 6 Journal of Corporate Law Studies 397 at 418.

[160] ~~See~~ A. Keay and M. Welsh, „Enforcing Breaches of Directors‟ Duties by a Public Body and Antipodean Experiences‟ (2015) 15 2 Journal of Corporate Law Studies 255, at 284.

[161] ~~See~~ A. Keay, „The Public Enforcement of Directors‟ Duties: A Normative Inquiry‟ (2014) 43 2 Common Law World Review 89.

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obtain permission of the court to continue a derivative claim. Secondly, it will offer protection to the public interest.

Where there is public confidence and integrity in the corporate governance system, it will encourage more investments in the UK which will benefit the public. Thirdly, it will deter directors from breaching their duties because it will send signals to them that breach of their duties will not be countenanced. Fourthly, public enforcement will contribute to the efficacy of private enforcement.[162]

Implementation of the civil penalty regime(as adopted in Australia) in the UK will complement the weakness of private enforcement of breach of directors‟ duties. It will not exclude private enforcement as both private and public enforcement will exist alongside one another. The Companies Act should be amended to provide for the civil penalties.

If the UK is to adopt the civil penalty regime, the author agrees with Professor Keay‟s and Vicky Comino‟sviews that regard should be given to resolving the procedural issues that Australia currently faces in respect of the civil penalty regime before it can be adopted in UK.

Word Count: 14,706

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