

## A Consultative Document

on the Review of Criminal,  
Civil and Administrative Sanctions  
in the Companies Act 1965

by the Corporate Law Reform Committee  
for the Companies Commission of Malaysia



SURUHANJAYA SYARIKAT MALAYSIA  
COMPANIES COMMISSION OF MALAYSIA

# C o n t e n t s

<b>Section A: Foreword</b>	<b>Page</b>
1. Foreword	5
<b>Section B: Executive Summary</b>	
1. Background	13
2. Summary of Proposals	13
<b>Section C: Review of Criminal, Civil and Administrative Sanctions in the Companies Act 1965</b>	
1. Introduction	19
2. General Principles for Review	19
3. Imposition of Criminal Sanctions for Corporate Wrongdoing	31
4. On Whom should Criminal Sanctions be Imposed?	36
5. Civil Regulatory Sanctions - Directors' Disqualification Provisions	40

**COMPANY LAW**  
**CORPORATE LAW REFORM COMMITTEE**  
**A CONSULTATIVE DOCUMENT ON**  
**REVIEW OF CRIMINAL, CIVIL AND ADMINISTRATIVE SANCTIONS**  
**IN THE COMPANIES ACT 1965**

DECEMBER 2007

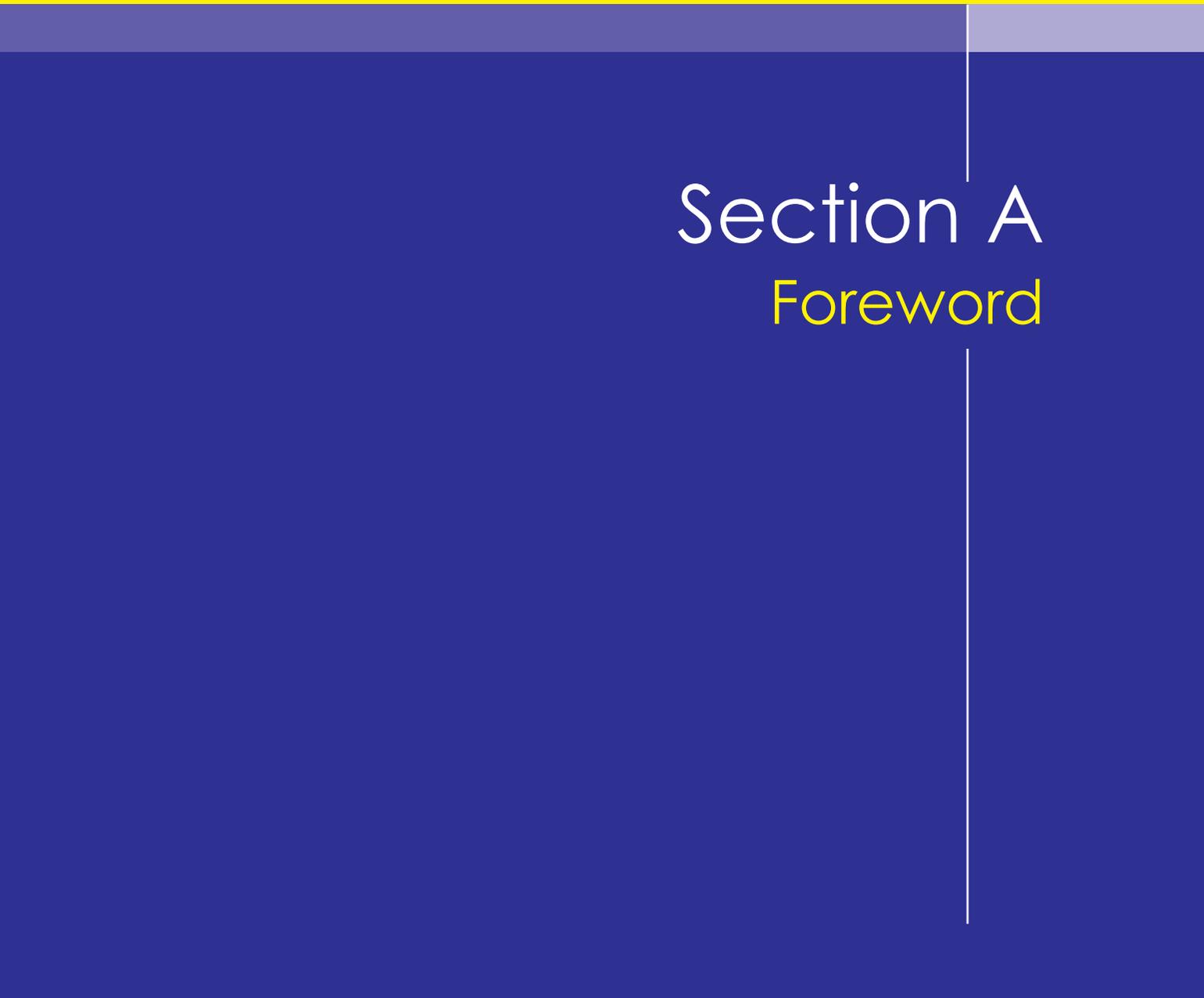
The Corporate Law Reform Committee invites comments, by **2 January 2008** on the issues set out in this consultative document.

You are invited to send comments, together with any supporting evidence on any part of this consultation. We would be grateful if you could refer to the recommendation number(s) and/or paragraph number(s) in your feedback, preferably by email, to:

Nor Azimah Abdul Aziz  
Secretary,  
Corporate Law Reform Committee  
Companies Commission of Malaysia  
17th Floor, Putra Place  
100 Jalan Putra  
50622 Kuala Lumpur  
e-mail : [azimah@ssm.com.my](mailto:azimah@ssm.com.my)  
Fax : 603-40476334

Additional copies of this document may be made without seeking permission from the Companies Commission of Malaysia or downloaded from its website at [www.ssm.com.my](http://www.ssm.com.my).

**Confidentiality:** Your responses may be made public by the CLRC. If you do not want all or part of your response or name made public, please state this clearly in the response. Any confidentiality disclaimer that may be generated by your organisation's IT system or included as a general statement in your fax cover sheet will be taken to apply only if you request that the information remain confidential.



Section A  
Foreword



## SECTION A - FOREWORD

This Consultative Document focuses on the review of the sanctions and enforcement provisions found under the Companies Act 1965. The objective of this review is to create a comprehensive framework by providing for sanctions which are appropriate to support the business environment.

In this Consultative Document, the present position under the Companies Act 1965 and those of the other jurisdictions have been laid out for discussion. Particular attention was paid to jurisdictions such as the UK and Australia as the legal frameworks closely resembles ours.

It is imperative that the corporate framework provides appropriate measures to ensure compliance with the provisions of the Act as any transgression will have an effect on the economy and the community at large.

We hope to receive views and comments on the recommendations stated in this Consultative Document. Please reply to Nor Azimah Abdul Aziz at the Companies Commission of Malaysia (SSM) by 2 January 2008.

Thank you.

Yours truly,

**Dato' K.C. Vohrah**

Chairman  
Corporate Law Reform Committee

**Datuk Dr Abdul Samad Alias**

Chairman  
Working Group E

# MEMBERS OF THE CORPORATE LAW REFORM COMMITTEE (CLRC)

1. Y. Bhg. Dato' K.C. Vohrah (Chairman)  
*Consultant*
2. Y. Bhg. Datuk Dr. Abdul Samad Hj Alias  
*Chartered Accountant*
3. Y. Bhg. Dato' Loh Siew Cheang  
*Advocate & Solicitor*
4. Y. Bhg. Datuk Simon Shim Kong Yip (w.e.f 1 October 2005)  
*Advocate & Solicitor*
5. Abdul Karim Abdul Jalil (w.e.f 1 November 2005)  
*Chief Executive Officer, Companies Commission of Malaysia*
6. Datuk Dr. Nik Ramlah Nik Mahmood  
*Representative of the Securities Commission*
7. Selvarany Rasiah  
*Representative of Bursa Malaysia Securities Berhad*
8. Charon Wardini Mokhzani  
*Deputy Chief Executive, CIMB Investment Bank Berhad*
9. Philip Koh Tong Ngee  
*Advocate & Solicitor*
10. Peter Lee Siew Choong  
*Advocate & Solicitor*

11. Cheong Kee Fong  
*Advocate & Solicitor*
12. Lim Tian Huat  
*Chartered Accountant*
13. Eric Kang Shew Meng  
*Company Secretary Practitioner*
14. Prof. Dr. Khaw Lake Tee  
*Universiti Malaya*
15. Prof. Dr. Aishah Bidin  
*Universiti Kebangsaan Malaysia*
16. See Mee Chun (w.e.f 17 October 2005)  
*Representative of the Attorney General's Chambers*
17. Aslam Zainudin (w.e.f. 13 July 2004)  
*Representative of the Prime Minister's Department*
18. Ahmad Azhari bin Abd Hamid (w.e.f. 15 August 2006)  
*Representative of the Prime Minister's Department*

## MEMBERS OF WORKING GROUP E

1. Y. Bhg. Datuk Dr Abdul Samad Hj. Alias (Chairman)  
*Chartered Accountant*
2. Datuk Dr Nik Ramlah Nik Mahmood  
*Representative of the Securities Commission*
3. Charon Wardini Mokhzani  
*Deputy Chief Executive, CIMB Investment Bank Berhad*
4. Peter Lee Siew Choong  
*Advocate & Solicitor*
5. Lim Tian Huat  
*Chartered Accountant*
6. Cheong Kee Fong  
*Advocate & Solicitor*
7. Eric Kang Shew Meng  
*Company Secretary Practitioner*
8. Prof. Aishah Bidin  
*Universiti Kebangsaan Malaysia*
9. Philip Koh Tong Ngee  
*Advocate & Solicitor*

# MEMBERS OF THE SECRETARIAT (CLRC)

## Consultant

Assoc. Prof. Dr. Aiman Nariman Mohd Sulaiman  
*Ahmad Ibrahim Kulliyah of Laws*  
*International Islamic University Malaysia*

## Secretariat

Nor Azimah Abdul Aziz  
*Secretary*

Norhaslinda Salleh  
*Section Head*  
*Corporate Development and Policy Division*

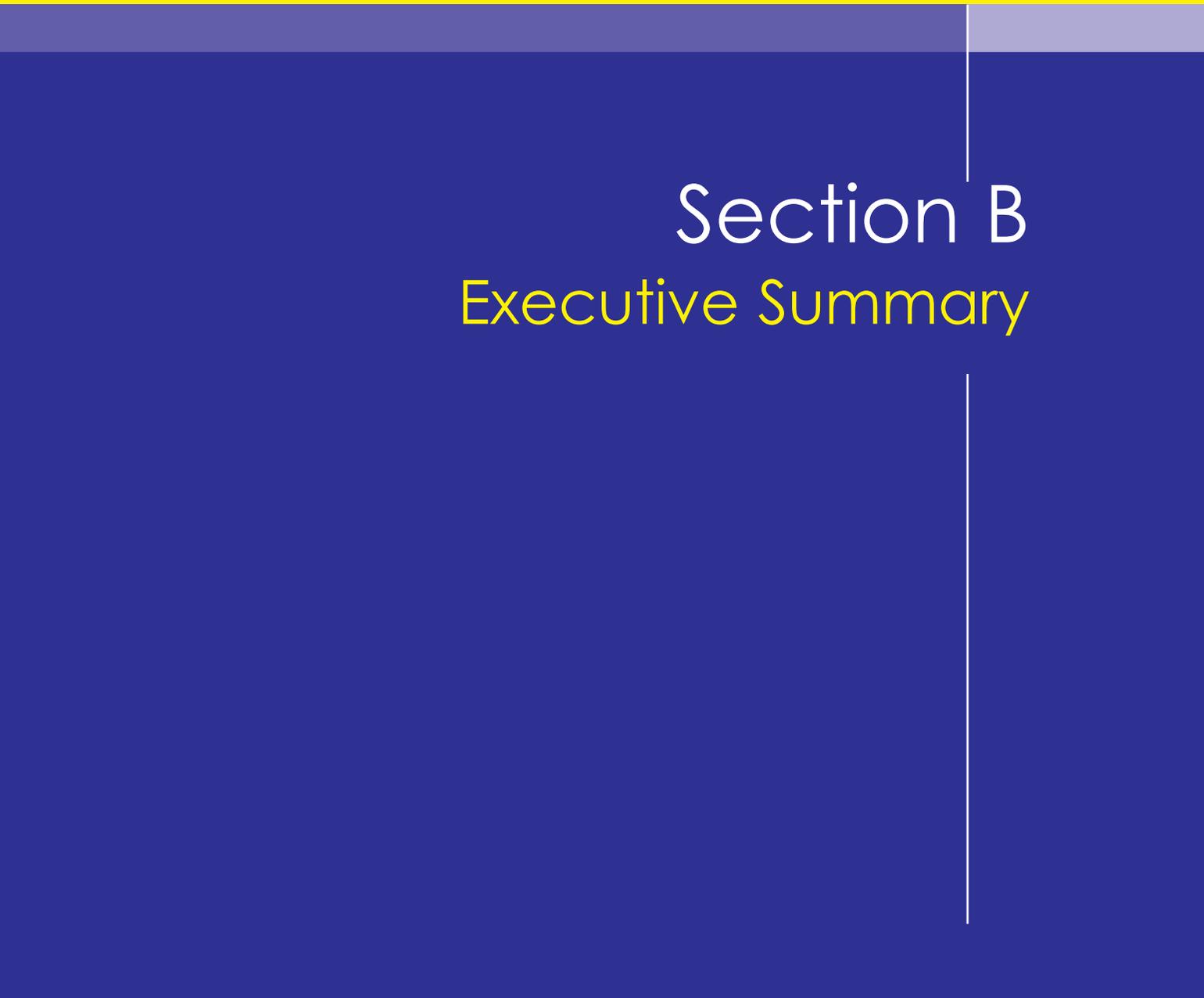
Norhaiza Jemon  
*Corporate Development and Policy Division*

Sapiah Ambo  
*Corporate Development and Policy Division*

Marina Nathan  
*Corporate Development and Policy Division*

The Secretariat can be contacted at:-  
+ 603 4047 6062 / 6063 / 6064  
[clrc@ssm.com.my](mailto:clrc@ssm.com.my)

This Page Is Intentionally Left Blank



Section B  
Executive Summary



## SECTION B - EXECUTIVE SUMMARY

### 1. Background

1.1 This Consultative Document focuses on the review undertaken by Working Group E of the CLRC on the following issues on sanctions under the Companies Act 1965:

- the general principles;
- imposing criminal sanctions when there is any corporate wrongdoing;
- the parties the sanctions are to be imposed on; and
- under the civil regulatory sanctions - the provisions on directors' disqualification.

### 2. Summary Of Proposals

2.1 In reviewing the general principles of sanctions and enforcement, the CLRC reviewed the sanctions framework of the Companies Act 1965. The CLRC also conducted cross jurisdictional studies on countries such as Australia on the 'responsive regulation' theory and the 'pyramid of enforcement' theory proposed by the Australian Treasury in its review of the sanctions regime in Australia.

2.2 The CLRC also looked at the use of criminal sanctions, civil actions by the Regulator and the use of administrative sanctions and also the imposition of criminal sanctions for corporate wrongdoing and proposed the following:

- (a) a contravention of the statutory provision on directors' duties should be enforced by a range of sanctions comprising criminal sanctions enforceable by initiating criminal proceedings and/or civil penalty proceedings.
- (b) criminal sanctions for the contravention of directors' duties should be imposed where the contravention is accompanied by fraud or dishonesty. Where there is no such fraud or dishonesty, the contravention should not be criminalised.

- (c) where there is no fraud or dishonesty in relation to a contravention of the legislative provisions on directors' duties, the regulator should be empowered to bring civil penalty proceedings.
- (d) the regulator should be given a general power to initiate civil proceeding on behalf of the company if it appears that it is in the interest of the public to do so.
- (e) criminal sanctions should still be generally used to ensure compliance with the obligation to disclose but not all failures to comply with any procedural requirements should give rise to criminal sanctions.

2.3 When considering on whom the criminal sanctions should be imposed on, the CLRC benchmarked the provisions of the Companies Act 1965 with other jurisdictions such as the UK. The CLRC after much deliberation is proposing that:

- (a) in cases where a contravention involves fraud or deliberate wrongdoing or dishonesty, the criminal sanctions should be imposed on officers involved in the contravention and not the company.
- (b) the general penalty provision under section 369 of the Companies Act 1965 should be revised to reflect the view of whether or not there should be criminal sanction for a contravention should be decided on a 'section-by-section' basis.
- (c) in the case of non-compliance with procedural requirements, the criminal liability on the company should be removed where there are meaningful and alternative sanctions available on individuals who are involved in the contravention.
- (d) the definition of 'officer in default' should be revised to state as follows:  
'An officer is "in default" for the purposes of the provision if he authorises or permits or participates in the contravention.'

- 2.4 On its review of the civil regulatory sanctions under the Companies Act 1965, it was noted that for provisions on directors' disqualification, there were two (2) types of disqualification provided for i.e. the automatic disqualification provisions under sections 125 and 130 and the disqualification provision by an order of court under section 130A.
- 2.5 Under its review of automatic disqualification provisions, the CLRC is of the view that the automatic disqualification where the director is convicted for an offence involving fraud or dishonesty and for being an undischarged bankrupt should be retained. The CLRC's full recommendations are as follows:
- (a) section 130 of the Companies Act 1965 should be retained but clarified to state that a person who is disqualified under the section ceases to hold office as a director of a corporation and ceases to be entitled to be directly or indirectly concerned or take part in the management in Malaysia of a corporation for so long as he shall be disqualified.
  - (b) that the current position in relation to automatic disqualification should be retained i.e., that there should be automatic disqualification for the conviction of an offence involving fraud or dishonesty, for being an undischarged bankrupt and where there has been a conviction in relation to offences in connection with the promotion, formation or management of a company or where section 132 is concerned.
  - (c) a director who has contravened the legislative provisions relating to director's duties may be disqualified upon an application by the regulator.
  - (d) the Companies Act 1965 should enable a disqualification order to be made if there is persistent default or contravention of the Act.

- 2.6 The final area of review was on the disqualification of directors of insolvent companies under section 130A of the Companies Act 1965. It is the recommendation of the CLRC that there is a need to clarify section 130A whereby the provision should be amended to state that a person may be disqualified if within the last five (5) years, the person has been a director of two (2) or more companies which have been wound up in insolvency and that the conduct of the director in relation to the management, business or property of the company is wholly or partially responsible for the companies' insolvent state.

# Section C

Review of Criminal,  
Civil and Administrative  
Sanctions in the  
Companies Act 1965



# SECTION C - REVIEW OF CRIMINAL, CIVIL AND ADMINISTRATIVE SANCTIONS IN THE COMPANIES ACT 1965

## 1. Introduction

1.1 Enforcement is an essential feature of corporate law and an important component of regulation. It ensures and encourages compliance and provides remedies for persons aggrieved by non-compliance. In this paper, sanction refers to the range of enforcement actions that may be taken when there is a contravention of the Companies Act 1965.<sup>1</sup>

## 2. General Principles For Review

2.1 The Companies Act 1965 contains a range of sanctions for any contravention of its legislative provisions. The sanctions framework in the Companies Act 1965 consists of a statutory penalty regime which includes criminal sanctions in the form of fines and/or imprisonment; civil regulatory sanctions in the form of disqualification and winding up proceedings initiated by the regulator i.e., the Registrar of Companies<sup>2</sup>; and administrative sanctions. These sanctions are publicly enforced by the regulator. The Companies Act 1965 also provides for civil remedies which are privately enforced by the company<sup>3</sup> or by its members.<sup>4</sup> In addition, section 368A allows the Registrar or 'persons whose interests have been, or would be affected by such

<sup>1</sup> The CLRC referred mainly to the UK and Australian legislations due to the fact that the present enforcement framework of the Companies Act 1965 was modelled after the company legislation of these two (2) jurisdictions. The company law enforcement framework in other common law jurisdictions such as Singapore, Hong Kong and New Zealand do not differ substantially from the UK model. The enforcement models of these jurisdictions rely substantially on the public enforcement of company legislation through criminal proceedings by the regulators. Australia is referred to as a comparison to the UK framework since its enforcement framework is substantially different from the UK model. Apart from criminal proceedings, ASIC in Australia is also authorised to bring civil proceedings in relation to any contravention of the company legislation.

<sup>2</sup> The UK CLR identified two (2) civil regulatory sanctions under the Companies Act i.e. (i) the application to wind up a company; and (ii) the disqualification proceedings.

<sup>3</sup> For example, an injunction under sections 132C(2) and 132E(4).

<sup>4</sup> For example, section 181 and 181A of the Companies Act 1965. Section 181 provides for remedies that can be enforced by members as well as by debenture holders where oppression, prejudice etc. is established. Section 181A on the other hand, provides members of the company with the means to institute a statutory derivative action against those who have wronged the company. Section 218 also provides an avenue for the members to apply for the winding up of a company.

conduct' to apply for an injunction to prevent any contravention of the legislative provisions in the Companies Act 1965. Thus, the enforcement framework of the Companies Act 1965 combines the public and private enforcement of its legislative provisions. By contrast, common law provides for a private enforcement framework where wrongs against the company are enforced by the company. However, it is possible for a contravention of corporate law to be both privately enforced under the common law and publicly enforced under the Companies Act 1965 as in the case where there is a contravention of directors' duties.

- 2.2 Under the statutory penalty regime of the Companies Act 1965, the categorisation of sanctions as a criminal sanction depends on whether the contravention with respect to which sanctions are imposed is categorised as an offence, usually punishable by a fine or a custodial sentence or both and whether the contravention is publicly enforced by the regulator. The conduct for which a criminal sanction may be imposed includes those carried out with dishonest or fraudulent intent or with the intention to cause harm (for example, conduct that amounts to an offence of fraudulent trading) as well as for non-compliance with conduct that amounts to non-compliance of the procedural requirements of the Companies Act 1965 such as the failure to comply with the filing or lodgement requirements. There is also a category of sanctions that are enforced by the regulator but does not incur the criminal liability of a fine or imprisonment. This may be categorised as civil regulatory sanctions where a disqualification order is made against a director or where the regulator applies to wind up a company.
- 2.3 A contravention may also be dealt with by administrative sanctions. The administrative sanctions are often in the form of warning letters and/or an offer to compound any contravention where the regulator makes a written offer for a sum

of money to be paid to the regulator within a specified time frame. The administrative sanctions may be taken without having to initiate any court proceedings.

- 2.4 Criminal sanctions are valuable enforcement tools as they serve as a deterrent mechanism due to the social stigma and reputational damage when a penalty is imposed on persons who contravene the law. Criminal sanctions are generally aimed at deterrence and punishment of wrongdoings and are often relied on when there is an element of public interest involved. In determining whether or not to bring criminal proceedings, careful consideration is given to financial and economic costs and constraints and the likelihood of a successful prosecution. Criminal sanctions are also effective when there is little incentive for private/ civil actions. For example, a civil action will not usually be initiated unless the wrongdoing affects an individual's interest so gravely that he or she initiates a civil action. Lack of resources of those who are adversely affected by the wrongdoing can also be a disincentive.
- 2.5 However, where the liability for breach could be imprisonment, criminal sanctions may not be appropriate for a breach or non-compliance with company law requirements that are only procedural in nature. Furthermore, generally, criminal sanctions also require proof of the knowledge or intent for the contravention of the law.<sup>5</sup> Criminal sanctions also require a higher standard of proof of guilt which is beyond a reasonable doubt. The procedures of criminal proceedings and the higher standard of proof which makes it more difficult to obtain a conviction may affect the enforcement of economic crimes and may result in the perception that there is no enforcement for contravention of corporate law.

<sup>5</sup> This may not be so in the case of strict liability offences.



- 2.6 Civil remedies have been used to address wrongdoings that have a direct bearing on an individual's interest where the individual himself brings a civil action. The lower standard of proof i.e., on the balance of probabilities in a civil proceeding as compared to proof of beyond a reasonable doubt in a criminal proceeding also makes a civil proceeding more attractive as an enforcement tool utilised by the regulator. However, there are views that civil remedies should be privately enforced and that public funding should not be utilised to settle the internal problems of a company. Nonetheless, there are some contraventions that, although not serious enough to deserve or justify criminal prosecution and its penalty, do involve the element of public interest thus, requiring the involvement of the regulator.
- 2.7 Administrative sanctions enable the regulator to exercise its discretion to take action and utilise the limited regulatory resources efficiently. Administrative sanctions may also be more suitable for minor regulatory breaches where there is no dishonest intent or where there is less likelihood of criminal proceedings initiated by the regulator. However, administrative sanctions may lack the deterrent effect of loss of reputation or stigma that is associated with a criminal sanction and unlike civil remedies does not provide a remedy to persons aggrieved by the contravention.
- 2.8 The advantages and disadvantages of each type of sanction indicates that there should be a combination of sanctions to address different kinds of breaches. The UK Company Law Review (UK CLR) in its review stated that a range of sanctions of differing severity, 'either as an alternative or as an increasing penalty in the case of persistent or repeated failure 'should be provided for contravention of corporate law'.<sup>6</sup> In general, criminal sanctions should still form part of the sanctions regime but should only be imposed after taking into consideration the following issues:

<sup>6</sup> UK Steering Committee on Company Law Review: 'Modern Company Law: Completing the Structure', chapter 13.

- (i) whether the criminal sanction is justified;
- (ii) whether the offence is sufficiently certain;
- (iii) is the penalty proportionate;
- (iv) are there differing degrees of culpability that require different levels of penalty; and
- (v) whether the penalty is imposed on the right person.

The UK CLR was of the view that the statutory penalty regime should be retained and that criminal sanctions for regulatory offences should not be removed as they are highly efficient and enable a high compliance level. However, the UK CLR did consider whether criminal sanctions should be removed from being imposed on companies (instead of the officer in default) specifically in relation to procedural requirements.<sup>7</sup> The review also proposed continued reliance on administrative sanctions as these constitute a highly efficient use of prosecutorial discretion and resources.<sup>8</sup> The UK CLR also acknowledged the relevance of civil remedies but did not favour the involvement of the regulator “in initiating proceedings to vindicate purely private rights” and that “... any such rights should be enforceable only by or on behalf of the persons who benefit from them”.<sup>9</sup>

- 2.9 The Australian Treasury, in its review of the sanctions regime in Australia stated that the ideal model to be adopted should be one where the interplay between the deterrence model of regulation and the accommodative model is at a maximum.<sup>10</sup> The deterrence model is premised on the assumption that individuals and

<sup>7</sup> Ibid, at para 13.29. At para 13.92, the UK CLR cited the following regulatory offences where the company should not be penalised but where the directors or officer alone should be made criminally liable: breaches of filing requirements, breaches of the requirements to allow inspections of registers that is required to be kept, minutes of general meetings, charging instrument or register of charges and breaches of the requirements to allow inspections of the statutory declaration and auditor's report.

<sup>8</sup> Ibid at page 300, paras 13.15 to 13.17.

<sup>9</sup> Ibid, at page 317.

<sup>10</sup> Australian Treasury: 'Review of Sanctions in Corporate Law', March 2007, para 1.10 at page 4.



corporations are motivated entirely by profit. They will carefully assess opportunities and risks, and will breach the law if the costs of being caught in terms of fines and the probability of being caught are small in relation to the expected profits to be made through non-compliance. Hence, harsh sanctions and penalties are necessary to ensure compliance. On the other hand, the accommodative model is premised on the assumption that individuals and corporations are ordinarily inclined to comply with the law, partly because they believe in the rule of law and partly because of long-term self-interest. The regulator adopting this model will normally seek compliance through co-operation rather than coercion. A purely punitive policy may be perceived as too unreasonable and may create disincentives for well-qualified persons from serving as corporate officers and/or directors. Persons of good faith who are desirous to comply may also be saddled with compliance costs. On the other hand, to assume that all individuals are honest would be too naïve as there will be people taking advantage of a policy based on this assumption and will intentionally breach the law to obtain profits or benefits. In place of a regulation theory that subscribes for the adoption of either an accommodative model or deterrence model, there should be 'responsive regulation'.

- 2.10 The 'responsive regulation' theory proposed that a regulator should have a range of enforcement tools and enforce them incrementally. The 'responsive regulation' theory is reflected in a 'pyramid of enforcement' as introduced by Ayres and Braithwaite<sup>11</sup> (Figure 1) where the severity of 'sanctions' that may be imposed increases or escalates from one that relies on persuasion before proceeding to more severe punishments.<sup>12</sup>

<sup>11</sup> J Braithwaite and I Ayers, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press (1992).

<sup>12</sup> While there are other enforcement pyramids that have been suggested by others for example, The Australian Cooney Committee Report, B Fisse and J Braithwaite, in *Corporations, Crime and Accountability* (Canterbury University [press, 1993]), all of them state that the severity of the sanction should be incremental in nature.



Figure 1-Source: J Braithwaite and I Ayers, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press (1992)

2.11 The 'pyramid of enforcement' provides a general guideline for public enforcement. A good example of how the pyramid of enforcement has been modified in relation to the enforcement of corporate law can be seen in the Australian Treasury's review. The review showed how the pyramid had been adapted and applied in relation to the enforcement tools available to and applied by the Australian Securities and Investment Commission (ASIC).<sup>13</sup> (Figure 2)

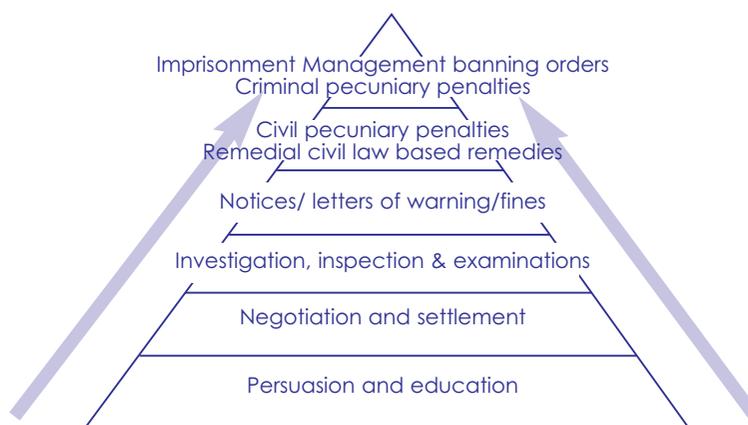


Figure 2- Source: Australian Treasury: 'Review of Sanctions in Corporate Law'

<sup>13</sup> Australian Treasury: 'Review of Sanctions in Corporate Law', March 2007, para 1.24 at page 7.

- 2.12 Based on the above, the CLRC's approach in relation to sanctions is as stated below:
- (a) While the Companies Act 1965 already contains a range of sanctions, the review will consider whether the application of a particular type of sanction to a particular conduct is appropriate. The sanctions regime in the Companies Act should be one that deters undesirable conduct and practices but at the same time promotes responsible risk taking. This requires a sanctions regime that takes into consideration the type of sanctions that may be imposed and the appropriateness of such sanctions in relation to the contravention.
  - (b) The sanctions regime should comprise a range of enforcement tools ranging from administrative sanctions and civil remedies to the more severe criminal sanctions or disqualification order or winding up.

#### **A. THE USE OF CRIMINAL SANCTIONS**

- 2.13 The CLRC is of the view that criminal sanctions should be reserved for the most serious cases of contravention or non-compliance particularly involving fraud or deliberate wrongdoing or dishonesty. Not all provisions in the Companies Act 1965 should be enforced with criminal sanctions. The focus of the use of criminal sanctions should be on the seriousness of the wrongdoing i.e. whether such wrongdoing had caused serious harm to other people or seriously contravened the fundamental aspects of commercial life which could bring harm to society. Examples of such wrongdoings would include section 304 (the fraudulent trading provision) and section 368 (fraud by officers) of the Companies Act 1965 which provide for criminal sanctions, as fraud is involved. These provisions together with their criminal sanctions should be retained. Other examples of wrongdoings that attract criminal sanctions and which should also be retained are sections 364 and 364A of the Companies Act 1965 which deal with the offence of making false or misleading statements or reports.

2.14 This also means that the application of the general penalty provision under section 369 needs to be reviewed. Currently, the section is a default provision which states that a contravention of the Companies Act 1965 is an offence, hence giving rise to criminal sanctions. The CLRC proposes that the types of contravention that may be categorised as enforceable with criminal sanctions must be identified on a 'section-by-section' basis. An example of the application of this approach can be seen under the provisions relating to the duties of directors. Where there is fraud or deliberate wrongdoing or dishonesty in relation to the breach of directors' duties, the regulator may initiate a criminal action with its criminal sanction. However, where there is no fraud or deliberate wrongdoing or dishonesty, no criminal sanctions should be provided for. In cases involving non-compliance with the procedural requirements of the Companies Act 1965, it should be stated where appropriate in the relevant statutory provision that the contravention is not an offence and these contraventions, in general, may be enforced by administrative sanctions.

## **B. CIVIL ACTIONS BY THE REGULATOR**

2.15 While contraventions of the Companies Act 1965 may be publicly and privately enforced, in general, the regulator has no authority to initiate civil actions for contraventions of the Act. However, the recent amendment to the Companies Act in 2007 which introduced section 181A(4)(d) allows the Registrar to commence a derivative action in the case of a declared company under Part IX of the Act. This section indicates a shift in the enforcement model conferred on corporate regulators although the scope of powers conferred on the Registrar is quite limited.<sup>14</sup>

<sup>14</sup> In contrast, securities market regulators in the US, the UK, Australia and Malaysia have been conferred with the authority to use civil proceedings to enforce any contravention of the securities laws.

- 2.16 In contrast, corporate regulators in the UK and Australia have wider powers to initiate civil actions on behalf of a company. Nonetheless, while both the UK and Australia acknowledged the need for a combination of sanctions, they differ on the extent of the role played by the regulator in commencing a civil action on behalf of the company. The sanctions regime for corporate law in the UK comprises primarily of a statutory penalty regime enforced by the regulator and private enforcement of civil remedies which may be initiated by the company or its members. The sanctions regime in Australia comprises of criminal and civil penalties enforced by the regulator as well as civil remedies which may be privately enforced by the company or its members.
- 2.17 The range of enforcement actions in Australia that may be taken was introduced as a response to the 'responsive regulation' theory. This was due to the following reasons:
- (i) criminal sanctions were perceived as too draconian since these often include custodial sentences which may not be appropriate,
  - (ii) courts were reluctant to impose imprisonment as a penalty and instead imposed modest fines that gave the appearance that the law was weak, and
  - (iii) the criminal standard of proof made it very difficult for the contravention to be publicly enforced.<sup>15</sup>

As a result, a new category of sanctions was introduced known as 'civil penalties' in addition to the criminal sanctions, civil remedies and administrative sanctions. Under the Corporations Act 2001, criminal sanctions are imposed only when the contravention is accompanied by dishonest

<sup>15</sup> Senate Standing Committee on Legal and Constitutional Affairs, *Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*, (1989), AGPS, Canberra.

intent or recklessness. A civil penalty provision is enforced by ASIC where a civil standard of proof is applicable. The civil penalty provision was first introduced in relation to the duties of directors but has since been expanded to cover the failure to comply with the statutory requirement to keep financial records and reports, prohibition against insolvent trading, financial benefits to related parties, share capital transactions, duties imposed on those involved in the management of managed investment schemes and market misconduct provisions which include the continuous disclosure obligation, market manipulation, insider trading, false trading, market rigging and dissemination of information about illegal transactions.<sup>16</sup> The remedies available for the contravention of the above are:

- (i) a pecuniary order (i.e. payment of a sum of money to ASIC),
- (ii) a compensation order for the corporation, or
- (iii) a disqualification order.<sup>17</sup>

2.18 In addition to the civil penalties under the Australian Corporations Act 2001, ASIC may also initiate a public interest litigation under section 50 of the Australian Securities and Investments Commission Act 2001, if it appears to ASIC that it is in the interest of the public for a company to sue a director to recover compensation from the director who has breached his duty. A similar provision can be found in the UK Companies Act 1985 which provides for under section 438 that the Secretary of State may bring civil proceedings on a company's behalf if it appears to him that it would be in the interest of the public to do so. However, the UK CLR recommended the deletion of this provision<sup>18</sup> and thus, the UK Companies Act 2006 does not contain an equivalent provision any more.

<sup>16</sup> George Gilligan, Helen Bird and Ina Ramsay, *Regulating Directors' Duties: How Effective are the Civil Penalty Sanctions in the Australian Corporations Law?*, Centre for Corporate Law and Securities Regulation 1999.

<sup>17</sup> A company may also seek a compensation order but not a pecuniary penalty order or a disqualification order.

<sup>18</sup> UK Steering Committee on Company Law Review: *Modern Company Law: Completing the Structure*, Chapter 13, at page 317.

members or the company to initiate a civil action where there is contravention of corporate law should be retained. However, the regulator should also be empowered to initiate civil proceedings if it appears that it is in the interest of the public to do so. This power is to be exercisable in addition to the existing power to initiate criminal proceedings which would be applicable where there is dishonest intent. The introduction of civil proceedings that may be initiated by the Registrar will result in better enforcement as the applicable rules of evidence and procedure applicable are those governed under civil proceedings. In addition to this power, the amount of compensation recovered should first be utilised to reimburse the regulator for all costs of investigations or proceedings incurred in relation to the contravention and second, to compensate aggrieved persons who have suffered losses or damage as a result of the contravention.<sup>19</sup> These new powers will reflect the view that there should be a range of enforcement tools that are incremental in nature and will also ensure that the sanctions imposed are appropriate and proportionate in relation to the contravention.

- 2.20 The CLRC also recommends the retention of the authority given to the regulator to commence the winding up of a company and to initiate disqualification proceedings but would suggest some modifications to the current disqualification provisions in the Companies Act 1965 as discussed below.

### **C. THE USE OF ADMINISTRATIVE SANCTIONS**

- 2.21 The CLRC is of the opinion that the use of administrative sanctions is an effective and efficient use of regulatory resources. On this point, the regulator should have in place a range of administrative sanctions that may be utilised that commensurate with the

<sup>19</sup> See sections 200 and 358 of the Capital Market and Services Act 2007.



severity of the contravention. However, the CLRC cautions that the use of administrative sanctions should be best applied for small and relatively insignificant regulatory contraventions. This is to avoid sending the wrong message to the public that more serious offences are capable of being settled through such a process.

### **3. IMPOSITION OF CRIMINAL SANCTIONS FOR CORPORATE WRONGDOING**

3.1 As previously noted, criminal sanctions are an important component of a sanctions regime and have value in terms of both its deterrent and punitive functions. However, criminal sanctions may not be appropriate or effective for all types of contravention. The following discussion highlights the Working Group's views in relation to whether certain corporate wrongdoings should be criminalised/decriminalised.

#### **A. DUTIES OF DIRECTORS**

3.2 Section 132 of the Companies Act relates to the duties of directors. The CLRC in its Consultative Document titled *'Engagement with Shareholders'* (CD 3) reviewed the section and recommended the codification of directors' duties. The recent amendments to the Companies Act has already reflected these recommendations.<sup>20</sup> This part of the review now looks at the appropriateness of retaining criminal sanctions for the contravention of the statutory provision on directors' duties.

3.3 In Australia, a range of enforcement actions may be taken by the regulator where there is a contravention of the statutory provisions on directors' duties and the regulator can decide to apply for criminal sanctions or civil penalties. The principle is

<sup>20</sup> The Companies (Amendment) Act 2007.

that criminal liability/sanction should only be imposed for conduct with dishonest intent and where there is no such intent in the contravention; a civil penalty should be imposed. These civil penalty provisions also reflect the enforcement policy of ASIC to undertake public enforcement of directors' duties where private enforcement may not be effective or may not be initiated. Nonetheless, the company is also allowed to apply to court to initiate a civil action against the wrongdoers or intervene where ASIC applies for a disqualification order.

- 3.4 On the other hand, jurisdictions like Malaysia and the UK have traditionally relied on civil proceedings by private parties to seek redress for the contravention of directors' duties. However, in Malaysia, the contravention of the legislative provisions on directors' duties under the Companies Act 1965 is also an offence and gives rise to criminal sanctions. The UK CLR stated that they did not want to adopt the Australian model that imposes criminal penalties on directors for breach of duty as this has the effect of public authorities being involved in the internal matters of a company.<sup>21</sup> Thus the UK Companies Act 2006 does not impose any criminal liability for breach of the statutory provision on director's duties, instead the UK Companies Act 2006 states that a breach of directors' duties should be privately enforced with civil remedies. The UK Companies Act 2006 also does not contain any legislative provision that enables the regulator to bring any civil penalty proceedings for breach of the legislative provisions on directors' duties.<sup>22</sup>
- 3.5 Taking into consideration the general principles adopted for this review, the CLRC recommends that the contravention of the statutory provision on directors' duties should be enforced by a range of sanctions comprising criminal sanctions enforceable by the regulator initiating criminal proceedings and/or civil penalty

<sup>21</sup> UK Steering Committee on Company Law Review: *'Modern Company Law: Completing the Structure'*, chapter 13, at 317.

<sup>22</sup> Section 178 of the UK Companies Act 2006.



proceedings. Criminal sanctions for the contravention of directors' duties should be imposed where the contravention is accompanied by fraud or dishonesty. Where there is no fraud or dishonesty, the contravention should not be criminalised. Instead, the regulator should be authorised to initiate civil proceedings as recommended in para 2.19. At the same time, private redress for breach of directors' duties should still be available to the company or its members.

**B. OFFENCES ARISING FROM NON-COMPLIANCE WITH DISCLOSURE/PROCEDURAL REQUIREMENTS**

- 3.6 The CLRC noted that the majority of offences arising from the contravention of the Companies Act are offences that deal with non-compliance of procedural requirements of the Companies Act 1965, for example, in relation to filing obligations or lodgement requirements as well as the duty to keep and maintain various registers under the Companies Act 1965. The majority of these offences are dealt with by the regulator by way of a fine or an offer to compound. Normally prosecution is used as a last resort.
- 3.7 The UK CLR noted that criminal sanctions are effective in securing high compliance of the disclosure obligations. Such compliance is a matter of public interest as failure to supply accurate information may not only affect private individuals but may also distort the market. Directors or officers may be unwilling to disclose where not effectively obliged to do so; in the absence of such disclosure poor management may continue in place with shareholders being unable to protect the company from it.<sup>23</sup> An example of an obligation to disclose that should be enforced by criminal

<sup>23</sup> UK Steering Committee on Company Law Review - 'Modern Company Law: Completing the Structure', paragraphs 13.25 - 13.29 at pages 305 and 306.

sanction is the directors' obligation to disclose their interests in contracts as provided for under section 131 of the Companies Act 1965. Other examples include the failure to keep accounting records under section 167 of the Companies Act 1965 and section 364A of the Companies Act 1965 which deals with the liability for making false reports. These are offences which give rise to criminal sanctions in order to uphold the importance of accurate and truthful reporting. Apart from being cost effective, the criminalising of such disclosure and procedural requirements underlines the importance of compliance by directors and advisors. As such, the CLRC recommends that criminal sanctions should still be generally used to ensure compliance with the obligations to disclose.

- 3.8 For other offences arising from the non-compliance of the disclosure/procedural requirements, the main consideration is whether the relevant legislative provisions may be as effectively enforced by using other remedies, apart from relying on criminal sanctions. For example, the UK CLR has identified breaches of the filing requirement and failure to allow inspection of registers that a company must keep and maintain as provisions for which criminal sanctions may not be required to be imposed on the company in view of the existence of civil remedies or civil regulatory sanctions.<sup>24</sup> In Australia, certain non-compliance of procedural requirements such as the failure of the company to include certain matters in the register of members is not criminalised. In this situation, ASIC may issue a penalty notice to the company requiring the company to pay a certain sum within a prescribed time. However, where a company fails to have a register of members, the court may impose a penalty on the company or impose a penalty or an imprisonment order for three(3) months or both on any person involved in the contravention.<sup>25</sup> The CLRC is of the view that not all failures to comply with procedural requirements should give rise to

<sup>24</sup> Ibid. at pages 328-329.

<sup>25</sup> See sections 168 and 169 of the Australian Corporations Act 2001.



criminal sanctions. There are therefore contraventions that should not be criminalised as such contravention may not justify the stigma associated with criminal sanctions.

## RECOMMENDATIONS

3.9 The CLRC recommends that:

- (a) a contravention of the statutory provisions on directors' duties should be enforced by a range of sanctions comprising criminal sanctions enforceable by initiating criminal proceedings and/or civil penalty proceedings.
- (b) criminal sanctions for the contravention of directors' duties should be imposed where the contravention is accompanied by fraud or dishonesty. Where there is no such fraud or dishonesty, the contravention should not be criminalised.
- (c) where there is no fraud or dishonesty in relation to a contravention of the legislative provisions on directors' duties, the regulator should be empowered to bring civil penalty proceedings.
- (d) the regulator should be given a general power to initiate civil proceeding on behalf of the company if it appears that it is in the interest of the public to do so.
- (e) criminal sanctions should still be generally used to ensure compliance with the obligation to disclose but not all failures to comply with any procedural requirements should give rise to criminal sanctions.

## Questions for Consultation

### Question 1

**Do you agree that a contravention of the statutory provisions on directors' duties should be enforced by criminal sanctions enforceable by initiating criminal proceedings and/or civil penalty proceedings?**

## Question 2

**Do you agree that criminal sanctions for the contravention of directors' duties should be imposed only where the contravention is accompanied by fraud or dishonesty?**

## Question 3

**Do you agree that where there is no fraud or dishonesty in relation to a contravention of the legislative provisions on directors' duties, the regulator should be empowered to bring civil penalty proceedings?**

## Question 4

**Do you agree that the regulator should be empowered to bring public interest litigation? If yes, in what situations should the public interest litigation be allowed? Should the regulator be allowed to initiate public interest litigation only where there is a breach of directors' duties or should there be other instances where the regulator is allowed to do so?**

## 4. ON WHOM SHOULD CRIMINAL SANCTIONS BE IMPOSED?

4.1 An effective sanctions regime requires consideration of who should be responsible for the conduct that has brought about a contravention of the law. Sanctions will not have their intended impact unless they can be effectively enforced against the appropriate person. Where corporate defendants are concerned, an effective sanctions regime requires consideration of whether punishing the company, for example in the form of fines as is currently the case under the Companies Act 1965, may effectively deter future contravention and will not ultimately harm the shareholders, employees or customers instead of the person who has brought about the contravention of the law.

- 4.2 The UK CLR recommended that in general, there should be a presumption against criminal liability unless the act in question was capable of seriously damaging the company and where making the individual personally liable would have a sufficient deterrent effect.<sup>26</sup> In the case of offences arising out of non-compliance with the disclosure/ procedural requirements, criminal liability on the company should be removed where there are meaningful and alternative sanctions available against individuals who are involved in the contravention. The CLRC is in favour of this approach. In cases where the offence involves fraud or deliberate wrongdoing or dishonesty, the criminal sanction should be imposed on officers and not the company. Subjecting the company to criminal liability may aggravate the loss suffered by the company whereas the wrongdoing is the conduct of an individual.<sup>27</sup> However, as there could be difficulties in drafting a general provision along this line, the CLRC proposes that this be done on a 'section-by-section' basis.
- 4.3 The CLRC noted that in general where sanctions are to be imposed on a person, the sanctions will be imposed on the 'officer in default'.<sup>28</sup> Section 370(3) of the Companies Act 1965 defines "officer who is in default" as:
- "...any officer of the company or corporation who knowingly and wilfully
- (a) is guilty of the offence; or
- (b) authorizes or permits the commission of the offence."

<sup>26</sup> UK CLR, *Modern Company Law: Final Report* (2001) at page 315.

<sup>27</sup> This approach is seen in relation to section 67 of the Companies Act 1965 where the company is not guilty of an offence, instead the officer who is in default shall be guilty of an offence under the Act.

<sup>28</sup> The UK Companies Act 2006 defines 'officer in default' as follows:

"1121 Liability of officer in default

(1) This section has effect for the purposes of any provision of the Companies Acts to the effect that, in the event of contravention of an enactment in relation to a company, an offence is committed by every officer of the company who is in default.

(2) For this purpose "officer" includes-

(a) any director, manager or secretary, and

(b) any person who is to be treated as an officer of the company for the purposes of the provision in question.

(3) An officer is "in default" for the purposes of the provision if he authorises or permits, participates in, or fails to take all reasonable steps to prevent, the contravention."

This section requires that the mental element must exist before any sanctions are imposed on the officer/person concerned. The CLRC has recommended that in general, criminal sanctions should only be imposed for the most serious cases of contravention or non-compliance particularly contraventions involving fraud or deliberate wrongdoing or dishonesty, or where it is necessary to ensure compliance with the obligation to disclose. In addition, not all contraventions should give rise to criminal sanctions. Thus, the CLRC recommends that the 'officer in default' should be ascertained by identifying who is the person ordinarily responsible for the specific obligation and whether he authorises or permits it or actively participates in the contravention.

- 4.4 It is also noted that the UK Companies Act 2006 widens the responsibility of an officer so that he is also in default if, apart from authorising, permitting or participating in the contravention, he fails to take reasonable steps to prevent the contravention. This approach considers that an omission due to negligence can be criminalised. The CLRC would like to obtain views on whether the definition of 'officer in default' should be extended to include a person who is negligent i.e., by failing to take reasonable steps to prevent the contravention.

## RECOMMENDATION

- 4.5 The CLRC recommends that:
- (a) In cases where a contravention involves fraud or deliberate wrongdoing or dishonesty, the criminal sanctions should be imposed on officers involved in the contravention and not the company.
  - (b) The general penalty provision under section 369 of the Companies Act 1965 should be revised to reflect the view that whether or not there should be criminal sanction for a contravention should be decided on a 'section-by-section' basis.

- (c) In the case of non-compliance with procedural requirements, the criminal liability on the company should be removed where there are meaningful and alternative sanctions available on individuals who are involved in the contravention.
- (d) The definition of 'officer in default' should be revised to state as follows:  
'An officer is "in default" for the purposes of the provision if he authorises or permits or participates in the contravention.'

## Questions for Consultation

### Question 5

**Do you agree that in cases where a contravention involved fraud or deliberate wrongdoing or dishonesty, a criminal sanction should be imposed on officers involved in the contravention and not the company?**

### Question 6

**Do you agree that the general penalty provision under section 369 of the Companies Act 1965 should be revised to reflect the view that whether or not there should be criminal sanction for a contravention should be decided on a section-by-section basis?**

### Question 7

**Do you agree that in the case of a contravention of procedural requirements, the criminal liability on the company should be removed where there are meaningful and alternative sanctions available on individuals who are involved in the contravention?**

### Question 8

Do you agree that the term 'officer who is in default' should be re-phrased to mean 'An officer is "in default" for the purposes of the provision if he authorises or permits or participates in the contravention'?

### Question 9

Do you agree that the definition of 'officer in default' should be extended to include a person who is negligent i.e., by failing to take reasonable steps to prevent the contravention?

## 5. CIVIL REGULATORY SANCTIONS-DIRECTORS' DISQUALIFICATION PROVISIONS

5.1 Under the Companies Act 1965, there are two (2) types of disqualification:

- automatic disqualification under sections 125 and 130; and
- disqualification by an order of court under section 130A.

### A. AUTOMATIC DISQUALIFICATION

5.2 The automatic disqualification of an undischarged bankrupt was introduced in the UK company legislation based on the recommendation of the Greene Committee. This was intended to prevent bankrupts from being able to use the separate legal liability and limited liability doctrine as a guise to incur debts and then failing to pay for such debts. This is reflected in section 125 of the Companies Act 1965. In addition, there is an automatic disqualification under section 130 that states that a person who is found to have been convicted of certain conduct identified under section 130, and is a director or a promoter or takes part or is involved in the management of a company within a period of five (5) years from the date of conviction or if he is imprisoned, five (5) years after his release from prison, without the leave of the court shall be guilty of an offence.

- 5.3 The effect of sections 125 and 130 is that the person, who comes within the category of persons identified under these sections, is obliged to apply for leave of court if he wants to be a director or be involved in the management of a company. Failure to obtain leave of court is a criminal offence. The accepted view is that a person who is disqualified because of section 130 automatically ceases to be a director. The CLRC noted that the Australian Corporations Act 2001<sup>29</sup> states that the person ceases to be a director of the company. The New Zealand Companies Act 1993 provides that a person shall not take part or be involved in the management of a company during the specified period unless the leave of court is obtained.<sup>30</sup> The CLRC is of the view that the existing section 130 should be clarified to state that a person who is disqualified under the sections ceases to hold office as a director or to be directly or indirectly concerned or to take part in the management in Malaysia of a corporation.
- 5.4 Nevertheless, there are views that the automatic disqualification provisions are draconian as the sections do not distinguish between fraud and dishonesty on one hand and trivial contraventions of the Companies Act on the other. The Singapore Companies Act for example provides that there is automatic disqualification upon a conviction for an offence involving fraud or dishonesty and for being an undischarged bankrupt. However, a person who is convicted of an offence in

<sup>29</sup> Section 206A of the Australian Corporations Act 2001.

<sup>30</sup> Section 382 of the New Zealand Companies Act 1993.



connection with the formation, promotion or management of a company may be disqualified by an order of the court.<sup>31</sup> This approach enables the regulator to exercise its discretion to consider the seriousness of the conduct that brought about the conviction and to decide whether or not to apply to disqualify the person.

- 5.5 There are, nonetheless, reservations about changing an automatic disqualification provision to a disqualification by an order of the court. Under the current law, the onus is on the person to refrain from taking part or being involved in the management of a company and to apply for leave from the court and to show that he should not be disqualified if he wishes to take part or be involved in the management of a company during the period of his automatic disqualification. In terms of costs of enforcement, automatic disqualification reduces the regulator's cost of enforcement.
- 5.6 The CLRC is of the view that the automatic disqualification for the conviction of an offence involving fraud or dishonesty and for being an undischarged bankrupt should be retained. It is noted that where automatic disqualification in relation to offences in connection with the promotion, formation or management of a company or section 132 of the Companies Act 1965 is concerned, the automatic disqualification only applies where there has been a *conviction* which means that the corporate mismanagement is sufficiently serious to justify criminal proceedings and a conviction. Thus, the current position in relation to an automatic disqualification should be retained. However, in view of the recommendation that

<sup>31</sup> The disqualification provisions in Singapore are found in the Companies Act (Cap 50). Section 154 provides for two (2) types of disqualification.  
(a) Firstly the automatic disqualification where the person has been convicted of fraud or dishonesty punishable with imprisonment for three (3) years or more.  
(b) Secondly is the disqualification by order of the court  
a. where a person has been convicted of an offence in connection with the formation or management of a corporation or for any offence under section 157 or 339 of the Companies Act.  
b. for persistent default in filing documents required to be filed under the Companies Act.  
See also section 383(1)(a) of the New Zealand Companies Act 1993.

the regulator should be given the authority to commence civil penalty proceedings in cases involving a breach of directors' duties, it is also recommended that the regulator should be given the discretionary power of disqualification in the case of a director who has been held liable for breach of directors' duties even if there is no conviction.

- 5.7 The CLRC is also aware that the majority of cases of non-compliance with the Companies Act 1965 involved the failure to comply with the lodgement or filing of documents which are required to be lodged, filed or submitted to the regulator. Often, there is persistent default in relation to the filing and lodgement obligations. To further enhance the power of the regulator, it is recommended that the Companies Act should enable a disqualification order to be made if there is persistent default or contravention of the Companies Act.<sup>32</sup> Under the UK Company Directors Disqualification Act 1986, the section authorising disqualification for persistent default was introduced as part of the emphasis given to the obligations to disclose that must be complied with by a company for being allowed to utilise the limited liability concept. This was because the directors who have failed to maintain proper records would usually be unable to ascertain the company's financial position which is part of the responsibility of the directors when managing the company's affairs. The failure to file information as required by law would also affect the information available to creditors. It is thus recommended that the Companies Act 1965 should include a provision allowing the regulator to apply to court to disqualify a person for persistent contravention of the Companies Act 1965 in relation to the filing of any return, account or document that is required to be filed with, delivered or sent to the Registrar.

<sup>32</sup> Singapore, New Zealand and Australia have similar provisions where a person may be disqualified by an order of the court for persistent contravention of the company legislations.

## RECOMMENDATIONS

5.8 The CLRC recommends that:

- (a) section 130 of the Companies Act 1965 should be retained but clarified to state that a person who is disqualified under the section ceases to hold office as a director of a corporation and ceases to be entitled to be directly or indirectly concerned or take part in the management in Malaysia of a corporation for so long as he shall be disqualified.
- (b) that the current position in relation to automatic disqualification should be retained i.e., that there should be automatic disqualification for the conviction of an offence involving fraud or dishonesty, for being an undischarged bankrupt and where there has been a conviction in relation to offences in connection with the promotion, formation or management of a company or section 132 is concerned.
- (c) a director who has contravened the legislative provisions relating to director's duties may be disqualified upon an application by the regulator.
- (d) the Companies Act 1965 should enable a disqualification order to be made if there is persistent default or contravention of the Act.

### Questions for Consultation

#### Question 10

**Do you agree that section 130 of the Companies Act 1965 should be clarified to state that a person who is disqualified under the section ceases to hold office as a director of a corporation and ceases to be entitled to be directly or indirectly concerned or take part in the management of a corporation in Malaysia of a corporation for so long as he shall be so disqualified?**

**Question 11**

Do you agree that a director who has contravened the legislative provisions relating to director's duties should be disqualified upon an application by the regulator?

**Question 12**

Do you agree that a person may be disqualified as a director or to not take part or not be involved in the management of a company for persistent default or contravention of the Companies Act 1965?

**Question 13**

Do you agree that there should be an automatic disqualification for:

- (a) conviction of an offence involving fraud or dishonesty;
- (b) for being an undischarged bankrupt;
- (c) where there has been a conviction in relation to offences in connection with the promotion, formation or management of a company or section 132?

**B. DISQUALIFICATION OF DIRECTORS OF INSOLVENT COMPANIES UNDER THE COMPANIES ACT 1965**

5.9 Section 130A of the Companies Act 1965 requires that the person to be disqualified under the section must have been involved in a company that went into insolvent liquidation and was also a director of other companies that went into liquidation within five (5) years of the first-mentioned company's insolvent liquidation and that his conduct renders him unfit to be involved in the future management of other companies.

5.10 The concept underlying this section originates from the Cork Committee's concern about the easy manner in which a person who incorporates and allows a company to go into insolvency was able to set up another company and repeat the whole process whilst leaving debts unpaid.<sup>33</sup> However, the CLRC noted that section 130A of the Companies Act 1965 does not require that all the companies must be in insolvent liquidation. The existing provision is considered to be inappropriate since a person should not be disqualified if the company of which he is a director is not wound up in insolvency. The CLRC noted that the Australian Corporations Act 2001 provides the court with authority to make a disqualification order against a person who was involved within the last seven (7) years in two (2) or more companies that have failed financially where the Court is satisfied that the manner in which the corporation was managed was wholly or partly responsible for the corporations' failure and that the disqualification is justified. The disqualification order may be made upon an application by ASIC. In determining whether or not the disqualification is justified, the Court may have regard to the person's conduct in relation to the management, business or property of the corporation and any other matters that the court considers appropriate.<sup>34</sup> The CLRC is of the view that section 130A of the Companies Act 1965 should be amended to state that the disqualification order should be imposed where the person is a director of two (2) or more companies which have been wound up in insolvency and that the manner in which these corporations were managed, including the director's conduct, was wholly or partly responsible for the corporations' insolvent liquidation.

<sup>33</sup> See *Report of the Review Committee on Insolvency Law and Practice (1982)* Cmnd 8558 (Cork Committee).

<sup>34</sup> Section 206D of the Corporations Act 2001.



5.11 There are also views that to enable effective enforcement and monitoring of disqualified persons, there must be publicity of the persons against whom a disqualification order is made. The CLRC noted that the regulator (ASIC in Australia, the Registrar in the UK) in other jurisdictions is required to keep a register of persons who have been disqualified from managing companies whilst the Registrar in New Zealand is required to give notice in the *Gazette* of the person against whom the disqualification order is made. However, while this publicity may be useful as part of the 'naming and shaming' strategy suggested by the UK CLR, there are potential liabilities in tort that must be considered by the regulators. There are also concerns that this power may not be efficiently administered to the detriment of the individual. The CLRC would like to seek views on this issue.

## RECOMMENDATION

5.12 The CLRC recommends that section 130A of the Companies Act 1965 be clarified to state that a person may be disqualified if within the last five (5) years, the person has been a director of two (2) or more companies when they are wound up in insolvency and that the manner in which the company is managed, including the director's conduct in relation to the management, business or property of the company, was wholly or partially responsible for the companies' insolvent liquidation.

## Questions for Consultation

### Question 14

Do you agree that section 130A of the Companies Act 1965 should be amended to state that a person may be disqualified if within the last five (5) years, the person has been a director of two (2) or more companies when they are wound up in insolvency and that the manner in which the company is managed, including the director's conduct in relation to the management, business or property of the company, was wholly or partially responsible for the companies' insolvent liquidation?

### Question 15

Do you agree that the Companies Act should be amended to require the regulator to keep a register of persons who have been disqualified from managing companies?

