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DIRECTORS' LIABILITY FOR CORPORATE FAULTS AND DEFAULTS – AN INTERNATIONAL COMPARISON

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DIRECTORS' LIABILITY FOR CORPORATE FAULTS AND DEFAULTS – AN INTERNATIONAL COMPARISON

DR HELEN ANDERSON *

ABSTRACT

Australia's new Rudd Government has indicated to business leaders that it intends to review various aspects of corporate law, including the imposition of personal liability on directors for corporate fault. Their concern is that the present corporate law regime is causing directors to be overly cautious in making decisions, to the detriment of the efficient operation of companies and the wellbeing of our economy. At the same time, the government acknowledges the importance of imposing appropriate sanctions where a company or its officers fail to meet required standards. These are universal concerns. To inform this debate, this article will look at the way in which key aspects of corporate law are dealt with in other jurisdictions, and outline some reasons for convergence and divergence.

KEY WORDS

Directors' personal liability; corporate fault; international comparison; convergence and divergence.

A. INTRODUCTION

Directors' liability is a contentious area, and much has been written on the subject of whether directors should be personally liable for corporate faults and defaults. The new Australian government's stated aim is to review the matter, to determine whether liability is imposed appropriately and effectively. [1] This is an issue of concern and interest to governments, business people and scholars internationally.

The aim of this article is to show ways in which other countries deal with some of the corporate law problems which Australia faces. This article does not seek to analyse these laws to conclude that they are superior or inferior to the Australian ones. Rather

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[1] Dr Ken Henry, *Keynote Address to ASIC Summer School*, Melbourne, 19 February 2008, available at http://www.treasury.gov.au/documents/1346/HTML/docshell.asp?URL=Ministers_Speech_to_ASIC_Summer_School.htm. Dr Henry is the Secretary to the Treasury, and gave this speech on behalf of The Hon Nick Sherry, Minister for Superannuation and Corporate Law.

it serves to make and illustrate two simple, but often overlooked, points - first, that there is more than one way in which a regulatory objective can be achieved, and second, that some economies appear to function perfectly well without any law at all on a particular matter.

What is most striking about an examination of various types of directors' liability across jurisdictions is the degree of diversity. One might assume in this era of globalisation that there would be greater uniformity. Perhaps it is not surprising that emerging economies such as China and Korea do not have the same body of law as the Commonwealth jurisdictions. But it is remarkable to find that Canada has stringent laws imposing liability on directors for unpaid wages of employees but not for trading insolvently, whereas the United Kingdom is the direct opposite.[2] The United States lacks both and Australia has both. Nonetheless, it is true to say that there are areas of the law where there is a considerable degree of similarity.

This article is divided into sections. Section B provides some examples of similarity of laws, although even in such cases, there is no generally accepted template for their format or even adoption across all the jurisdictions surveyed. Three areas of liability have been chosen to illustrate the point - capital raising, unremitted employee tax deductions and protection of the environment.

Section C then looks at some instances of diversity of laws. It begins with insolvent trading, where there are considerable differences between countries. Next it looks at the protection of employees' entitlements, where many countries have not legislated at all. Finally, it concludes with the tortious liability of directors qua directors, where the law is unsettled and contentious even within jurisdictions.

Inevitably, the question arises – why have some jurisdictions found it necessary to impose liability in certain situations and in certain ways, where other jurisdictions apparently function well with different laws or no law at all? Section D speculates as to what these reasons might be. While it is beyond the scope of this article to try to answer this definitively, the article reflects upon some possible reasons for similarity and diversity. It makes an observation, worthy of further research, that similarity of laws is associated with the protection of powerful corporate stakeholders – shareholders and revenue authorities, as well as the conspicuous environment lobby – whereas there is a correlation between diversity of laws and vulnerable stakeholder cohorts – unsecured trade creditors, employees and tort creditors. Some reasons for this will be suggested. Section E concludes.

B. SIMILARLITY IN DIRECTORS' LIABILITY LAWS BETWEEN JURISDICTIONS

1. Capital raising

Australia[3] has long had laws dealing with capital raising and imposing liability on directors for misleading statements in relation to the offering of securities.[4] To

[2] This liability is called wrongful trading in the United Kingdom.
[3] Karen Wheelwright, 'Australia' in H Anderson (ed), *Directors' Liability for Corporate Fault* (forthcoming 2008).

prevent the inclusion of misleading information in the offer and issue of securities by public companies, the *Corporations Act* contains extensive provisions for the public disclosure of information. The offer must be made via a disclosure document,[5] in the form of a prospectus, an offer information statement or a profile statement,[6] and must not include a misleading or deceptive statement[7] or omit to include specified information.[8] Section 729 contains a table outlining the parties who may be liable to those who suffered loss. This table includes directors, whether or not they committed or were involved in the contravention, although defences are available.[9] In addition, the purchaser of the security may return it for a refund, and if this is not forthcoming from the company, the directors are personally liable for this amount.[10] There are also criminal penalties applicable.[11]

By contrast, in **Canada,**[12] another federal jurisdiction, there is no federal securities law statute.[13] There are, however, provincial and territorial securities laws in Canada which impose particular obligations on directors of publicly traded corporations. Using Ontario as an example, under the Ontario *Securities Act 1990*, a purchaser of securities has a right to seek damages from directors where the plaintiff can establish there was a misrepresentation.[14] Unlike other jurisdictions, this right exists, whether or not the purchaser relied on the misrepresentation.[15] Directors are jointly and severally liable. [16]Defences are available, including due diligence,[17] knowledge by the plaintiff of the misrepresentation which did not therefore cause loss,[18] reasonable

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[4] See for example, s 107 of the Australian *Securities Industry Code*, which came into effect in July 1981.

[5] *Corporations Act 2001* (Cth) s 710: 'A prospectus for a body's securities must contain all the information that investors and their professional advisers would reasonably require to make an informed assessment of the matters set out in the table below'. In relation to an offer to issue shares, the matters to be disclosed under that section include 'the rights and liabilities attaching to the securities offered; the assets and liabilities, financial position and performance, profits and losses and prospects of the body that is to issue (or issued) the shares, debentures or interests'.

[6] Under s 709(4), an offer information statement, instead of a prospectus, can be used for capital raisings of $10 million or less. Profile statements are governed by s 709(2).

[7] *Corporations Act 2001* (Cth) s 728(1).

[8] This is information required by the Australian *Corporations Act 2001* (Cth) ss 710, 711, 712, 713, 714 and 715, depending on the type of disclosure document.

[9] These defences include s 731 - due diligence, which is proved by forming a belief on reasonable grounds after making reasonable enquiries; s 732 - lack of knowledge, which is available only in relation to offer information statements and profile statements; and s 733 - reasonable reliance upon information from someone other than an employee or agent, where the director caused all due enquiries to me made. This final defence is available for all disclosure documents.

[10] *Corporations Act 2001* (Cth) s 737(3).

[11] *Corporations Act 2001* (Cth) s 1311 and Schedule 3.

[12] Janis Sarra, 'Canada' in Helen Anderson (ed), *Directors' Liability for Corporate Fault* (forthcoming 2008).

[13] There are 13 jurisdictions in Canada, as well as a federal jurisdiction.

[14] *Securities Act*, RSO 1990, c. S-5, s 130(1). Under s 1(1) of this Act, 'misrepresentation' means (a) an untrue statement of material fact, or (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made'.

[15] *Securities Act,* RSO 1990, c. S-5, s 130(1).

[16] *Securities Act,* RSO 1990, c. S-5, s 130(8).

[17] *Securities Act,* RSO 1990, c. S-5, ss 130(3) to (5).

[18] *Securities Act,* RSO 1990, c. S-5, ss 130(2) and (7).

grounds for believing an expert's opinion,[19] or lack of consent or withdrawal of consent to the filing of the prospectus. [20]

In addition, four provinces in Canada have now enacted a statutory civil liability regime for misrepresentation or failure to disclose to secondary market participants. [21] These provisions give secondary market investors a right of action against issuers and key related persons in relation to public misrepresentations or material omissions as required by securities law. Secondary market participants claiming under these provisions need only to show that they acquired or disposed of the company's securities during the period between the time the misrepresentation or omission occurred and the time that it was corrected.[22]

In **New Zealand**,[23] capital raising is regulated by its *Securities Act* 1978. A registered prospectus is required for securities offerings to the public,[24] failing which the offer is rendered void and the amounts subscribed must be repaid.[25] Joint and several liability may be imposed on directors where these repayments are not made,[26] although a defence is available to the director upon proof of lack of personal default or negligence.[27] Civil liability, in the form of compensation orders[28] or pecuniary penalties,[29] is provided for in relation to untrue statements in advertisements and registered prospectuses. Subscribers may apply for compensation orders if they subscribed 'on the faith of an advertisement or registered prospectus that includes an untrue statement, for the loss or damage that the persons have sustained by reason of the untrue statement'.[30] Defences are available under s 56.[31] Directors may also be criminally liable pursuant to s 58(1) of the *Securities Act 1978*.

China [32] has also had a long standing problem with false statements, misleading disclosure and market manipulation,[33] and has recently made significant improvements to the legislation dealing with these matters. Listed companies are prohibited from including false or misleading information or omitting material

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[19] *Securities Act,* RSO 1990, c. S-5, s 130(3)(c).
[20] *Securities Act,* RSO 1990, c. S-5, s 130(3)(a) and (b) respectively.
[21] These are Ontario (*Securities Act*, RSO 1990, c. S.5), Alberta (*Securities Act*, Part 17.01), Manitoba (*Securities Act*, Part XVIII) and Saskatchewan (*Securities Act* Part XVIII.1).
[22] Other features of the new legislation include a reverse burden of proof in relation to misrepresentations in 'core' documents and proportional liability in certain circumstances.
[23] Chris Noonan and Susan Watson, 'New Zealand' in Helen Anderson (ed), *Directors' Liability for Corporate Fault* (forthcoming 2008).
[24] *Securities Act 1978* (NZ) s 37.
[25] *Securities Act 1978* (NZ) s.37(5).
[26] *Securities Act 1978* (NZ) s.37(6).
[27] See, for example, *Alexander v De Lacy* (1992) 6 NZCLC 68,020; *Reuhman v Paape* (2002) 9 NZCLC 262,988 (CA); *Robinson v Tait* (2001) 9 NZCLC 262,651 (CA).
[28] *Securities Act 1978* (NZ) s 55G.
[29] *Securities Act 1978* (NZ) s 55C.
[30] *Securities Act 1978* (NZ) s 55G(1).
[31] These include the absence or withdrawal of consent to be a director or to the distribution or registration of the advertisement or prospectus, or reasonable grounds to believe that statements made on the authority of an expert or in a public officials document were true.
[32] Chenxia Shi and Bin Hu, 'China' in H Anderson (ed), *Directors' Liability for Corporate Fault* (forthcoming 2008).
[33] See further Z Chen, 'Capital Markets and Legal Development: The China Case' (2003) 14 *China Economic Review* 451.

information in disclosure documents.[34] Recent amendments have strengthened civil, administrative, and criminal liabilities against persons who contravene statutory provisions dealing with false statements.[35]

While the emphasis has been on punishment rather than compensation of parties affected by the conduct,[36] investors' actions against directors who have been administratively sanctioned or found liable in a criminal proceeding are allowed by the Supreme People's Court Rules.[37] The liability imposed on directors, which is joint with the company, is based on personal fault,[38] including where they participate in making false statements, or know or ought to know about the false statement but do not act to prevent its publication.[39]

South Africa[40] has both criminal and civil provisions dealing with disclosure when shares are offered to the public.[41] A director is liable to compensate persons who relied on the prospectus and acquired shares.[42] Liability is strict,[43] but a series of defences apply.[44] Where the company fails to refund moneys to investors where the minimum subscription has not been received[45] or where a condition that shares would be listed has not been fulfilled, [46] civil and criminal liability is imposed on directors. However, in these cases, there is a defence to both civil and criminal liability where the director can prove an absence of misconduct or negligence.[47]

Hong Kong's[48] Companies Ordinance [49] obliges companies seeking to raise capital from the public to register and issue a prospectus. Requirements are set out in s 38. According to s 41A(1)(a), 'a statement included in a prospectus shall be deemed to be untrue if it is misleading in the form and context in which it is included' . Under s 40, directors 'shall be liable to pay compensation to all persons who subscribe for any

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[34] *Securities Law 2005* (China) Chapter 3.
[35] *Securities Law 2005* (China) art 69; *Company Law 2005* art 150 and 153; and *Criminal Law (6th Amendment*) art 5.
[36] *Securities Law 2005* (China) art 191 and 193.
[37] *Supreme People's Court Rules* (China) art 26, 27 and 28.
[38] *Supreme People's Court Rules* (China) art 21, 22, 23, 24 and 25.
[39] Liability is also extended to situations where directors should assume responsibility for the false statement and its effects. See *Supreme People's Court Rules* (China) art 28 and *Securities Law1998* art 63; also see Z Cui and M Ma, 'Directors' Liability to Shareholders in Cases Concerning False Statements' (2003) 2 *China Legal Studies* 96.
[40] Kathleen van der Linde, 'South Africa' in Helen Anderson (ed), *Directors' Liability for Corporate Fault* (forthcoming 2008).
[41] *Companies Act 1973* (RSA) Chapter VI.
[42] *Companies Act 1973* (RSA) s 160(2).
[43] *Companies Act 1973* (RSA) s 160(1)(a)–(b).
[44] These are that the director reasonably believed in the accuracy of the information in the prospectus (s 160(3)(a)–(c) civil, s 162(3)(a)–(c) criminal); that the director did not consent to the issue of the prospectus and, upon learning that the prospectus was issued without their consent, gave reasonable public notice of this fact, or that, after they consented to the issue of the prospectus, upon becoming aware that it contained an untrue statement, they withdrew their consent and gave reasonable public notice of the withdrawal and the reason therefor - s 160(3)(c)(ii)–(iii) civil liability; s 162(4)(b)–(c) criminal liability.
[45] *Companies Act 1973* (RSA) s 165.
[46] *Companies Act 1973* (RSA) s 169.
[47] *Companies Act 1973* (RSA) s 165(5)(b); s 169(5)(b).
[48] Say H Goo, C K Low and Paul von Nessen, 'Hong Kong' in Helen Anderson (ed), *Directors' Liability for Corporate Fault* (forthcoming 2008).
[49] *Companies Ordinance* (HK) (Cap 32).

shares or debentures on the faith of the prospectus for the loss or damage they may have sustained by reason of any untrue statement included therein', subject to defences set out s 40(2).[50] Criminal penalties also apply, subject to defences. [51] In addition, s 108 of the *Securities and Futures Ordinance* provides for civil liability where 'a person makes any fraudulent misrepresentation, reckless misrepresentation or negligent misrepresentation by which another person is induced to invest in securities or other forms of regulated investments.'

The **United States of America**[52] enacted the *Securities Act 1933* as a result of the market crash of 1929, which state laws had proved unable to prevent. The legislation's two main goals were to ensure more transparency in financial statements so investors can make informed decisions about investments, and to establish laws against misrepresentation and fraudulent activities in the securities markets. Section 11(a)(2) of the Act provides for the liability of directors to acquirers of securities for untrue statements or material omissions in registration statements. Defences are available under s 11(b) including resignation from the role, lack of knowledge about the registration statement, and reasonable belief in the opinion of experts.

In **Malaysia**,[53] capital raising and disclosure of information is now regulated by the *Capital Markets and Services Act 2007*.[54] Prospectuses must be registered[55] and contain all the information reasonably required.[56] Pursuant to s 246, it is an offence for a person to 'authorise or cause the issue of prospectus'[57] which contains any statement or information that is false or misleading or which omits material information, punishable by fine or imprisonment. Civil compensation is available but only where the investors' loss has been caused by reliance on the prospectus. [58] Defences include due diligence,[59] reasonable reliance on another person such as an expert[60] and lack of consent,[61] although the latter is arguably superfluous, as the words of the section themselves connote an active participation by 'authorising or causing the issue of the prospectus'. Some conduct also attracts criminal liability.[62]

In the **United Kingdom**,[63] capital raising is governed by the *Financial Services and Markets Act 2000*. As in other jurisdictions, the duty of disclosure requires the prospectus or listing particulars to

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[50] These include withdrawal of consent, reasonable grounds for belief that the statement was true, reliance on experts whose competence they had no grounds to doubt, and reliance on public documents.
[51] *Securities and Futures Ordinance* (HK) s 40A and sch 12. (Cap 571).
[52] Erik Gerding, 'United States' in Helen Anderson (ed), *Directors' Liability for Corporate Fault* (forthcoming 2008).
[53] Janine Pascoe, 'Malaysia' in Helen Anderson (ed), *Directors' Liability for Corporate Fault* (forthcoming 2008).
[54] Capital raising was previously regulated by the *Securities Commission Act 1983*. That Act was repealed and its provisions inserted into the *Capital Markets and Services Act 2007*.
[55] *Capital Markets and Services Act 2007* (Malaysia) ss 232 and 233.
[56] *Capital Markets and Services Act 2007* (Malaysia) s 236.
[57] *Capital Markets and Services Act 2007* (Malaysia) s 246.
[58] *Capital Markets and Services Act 2007* (Malaysia) ss 248 and 357.
[59] *Capital Markets and Services Act 2007* (Malaysia) s 250.
[60] *Capital Markets and Services Act 2007* (Malaysia) s 251.
[61] *Capital Markets and Services Act 2007* (Malaysia) s 254.
[62] *Capital Markets and Services Act 2007* (Malaysia) s 243.
[63] John Lowry, United Kingdom, in Helen Anderson (ed), *Directors' Liability for Corporate Fault* (forthcoming 2008).

> contain all such information as investors and their professional advisors would reasonably require, and reasonably expect to find there for the purposes of making an informed assessment of (a) the assets and liabilities, financial position, profits and losses and the prospects of the company; and (b) the rights attaching to the securities.'[64]

The Act provides a compensation remedy to persons who have suffered loss as a result of any untrue or misleading statement in the relevant document or the omission from the particulars of any matter required to be included.[65] Defences are available under Schedule 10 of the Act.

In **Korea**,[66] there has been a process of legislative consolidation, and the capital raising provisions are now located in the *Capital Market and Financial Investment Act*, which was passed in August 2007. This Act provides that where there are false or misleading statements or omissions about material information in prospectuses used to offer securities to the public, directors may be liable to purchasers for damages incurred as a result.[67] A due diligence defense applies. Directors may also be subject to criminal liabilities for failing to comply with the duty to disclose.[68]

In **France**,[69] directors can be held liable under civil, criminal and administrative provisions in relation to the issue of securities. The markets are protected by an independent agency, the Autorité des Marchés Financiers (AMF). While the *Code de commerce* deals with disclosures for listed companies,[70] the *Code monetaire et financier* provides for liability for:

> whoever carries out or attempts to carry out, directly or through an intermediary, a manoeuvre intended to impede the normal operation of a regulated market by misleading others [or]…publicly disseminates, via whatever channel or means, any false or deceptive information concerning the prospects or the situation of an issuer whose securities are traded on a regulated market, or the likely performance of a financial instrument admitted to trading on a regulated market, which might affect the price thereof.[71]

2. Liability for unremitted employee tax instalments

Australia[72] has seen some significant increases in the liability for directors for their own actions over the past fifteen years. One of the most noteworthy is the imposition of personal liability for taxation instalments which the company has failed to remit.

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[64] *Financial Services and Markets Act 2000* (UK) s 80.
[65] *Financial Services and Markets Act* 2000 (UK) s 90.
[66] Ok-Rial Song, 'Korea' in Helen Anderson (ed), *Directors' Liability for Corporate Fault* (forthcoming 2008).
[67] *Capital Market and Financial Investment Act* (Korea) s 125.
[68] *Capital Market and Financial Investment Act* (Korea) s 444.
[69] Cristina Mauro, 'France' in H Anderson (ed), *Directors' Liability for Corporate Fault* (forthcoming 2008).
[70] *Code de commerce* (France) art 242-6-2 imposes criminal liability on directors who give false information relating to the financial position of the company, with the aim of hiding the truth. For the English language version of French legislation, see http://195.83.177.9/code/index.phtml?lang=uk.
[71] *Code monetaire et financier* (France) art L465-2.
[72] Wheelwright, above n 3.

Briefly,[73] since 1993, Australian company directors have been potentially liable for the unremitted instalments of tax which they deduct from workers' salaries, amongst other things, in the event that their company does not pay them in a timely manner.[74] The ATO gives the directors written notice of a 'penalty', equal to the amount of the unremitted tax owed by the company.[75] The director then has 14 days to cause the company to comply with its tax obligations or to undertake one of a number of other specified actions,[76] failing which, the director will become personally liable to pay the amount of the penalty. While a number of defences exist, they are difficult to establish.[77] In addition, even if the director causes the company to pay the unremitted instalments to the ATO in the lead-up to insolvency, the director will be personally liable to the Commissioner of Taxation for the debt, if the liquidator successfully claws back this preferential payment from the ATO.[78]

While the introduction of these laws in 1993 caused some concern amongst commentators,[79] Australia is now in line with many other parts of the world. For example, in **Canada**,[80] directors may be jointly and severally liable with the corporation for the company's failure to deduct and remit employees' instalments of income tax.[81] They can avail themselves of a due diligence defence [82] where they have exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances. Directors' liability ceases two years after they cease to hold a directorship.[83]

In **South Africa**, the *Income Tax Act 1962* provides for strict liability on the part of directors in respect of unremitted employee tax instalments. It provides that '[w]here an employer is a company, every shareholder and director who controls or is regularly involved in the management of the company's overall financial affairs shall be personally liable for the employees' tax, additional tax, penalty or interest for which

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[73] The provisions are discussed in more detail in other publications, See for example Stephen Barkoczy and Mei-ling Barkoczy, 'Directors' Liability and the New Regime for Collecting Unremitted Tax Instalments', (1996) 6 *Revenue Law Journal* 147; Christopher Symes, 'Reminiscing the Taxation Priorities in Insolvency' [2005] *Journal of the Australian Tax Teachers Association* 23; Patricia Blazey, 'Non Payment of Pay As You Go Withholding Tax and the Implications for Company Directors' [2006] *Journal of the Australasian Tax Teachers Association* 29; Helen Anderson, 'Directors' Liability for Unpaid Employee Entitlements – Suggestions for Reform Based on their Liabilities for Unremitted Taxes' (2008) *Sydney Law Review* (forthcoming).

[74] *Income Tax Assessment Act* 1936 (Cth), Part 6 of Division 9 (sections 222AOB – 222AQD).

[75] *Income Tax Assessment Act* 1936 (Cth), s 222AOE.

[76] Under s 222AOB(1), these include entering into a repayment agreement pursuant to s 222ALA, placing the company into administration or winding the company up.

[77] Eg *Fitzgerald v Deputy Commissioner of Taxation* 95 ATC 4587, 4590. See further Barkoczy, above n 73.

[78] *Corporations Act 2001* (Cth) s 588FGA. This is subject to a number of defences under s 588FGB.

[79] See above n 73.

[80] Sarra, above n 12.

[81] *Income Tax Act*, RSC, 1985, as amended, s. 227.1 '(1) Where a corporation has failed to deduct or withhold an amount as required .... has failed to remit such an amount or has failed to pay an amount of tax ..., the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.' Under ss 2, liability is subject to the corporation's inability to pay, as evidenced by unsatisfied execution of a registered liability, its liquidation or assignment or bankruptcy order.

[82] *Income Tax Act*, RSC, 1985, as amended , s. 227.1(3).

[83] *Income Tax Act*, RSC, 1985, as amended, s. 227.1(4).

the company is liable.'[84] There is no director liability for other unpaid taxes, with the exception of value added tax. No defences are available.

In **New Zealand**,[85] joint and several liability can be imposed on directors for the income tax of a company. Section HD15(1) of the *Income Tax Act 2007* deals with arrangements entered into by companies which have the effect that the company cannot meet its tax obligations. For the section to apply the purpose of the arrangement must have been to have this effect, and 'if a director of the company at the time of the arrangement made reasonable inquiries, they could have anticipated at the time that the income tax liability would, or would likely, be required to be met.'[86] Liability is subject to some exclusions[87] and defences.[88] In addition, s 141F of the *Tax Administration Act 1994* also allows that where any shortfall penalty is imposed on a company, a director may be held liable for a portion, where he or she fails to fulfil specified responsibilities under taxation law.

Some countries require an element of fault on the part of the director. For example, in the **United States**,[89] s 6672(a) of the *Internal Revenue Code 1954* provides that

> [a]ny person required to collect, truthfully account for, and pay over any tax … who willfully fails to collect such tax, or truthfully account for and pay over such tax, … shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax … not accounted for and paid over. [90]

The *Internal Revenue Code 1954* requires that employers withhold federal income taxes and social security taxes from their employees' wages.[91] Because the employer holds these taxes as 'special fund[s] in trust for the United States',[92] the withheld amounts are commonly referred to as 'trust fund taxes'.[93] While an employer remains liable for its failure to remit trust fund taxes, the Internal Revenue Code also imposes personal liability, in an amount equal to an employer's deficient taxes, upon those officers or employees responsible for collecting, accounting for, and remitting payroll taxes, who willfully fail to do so.[94]

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[84] *Income Tax Act 1962* (RSA) Sch. IV para. 16(2C).
[85] Noonan and Watson, above n 23.
[86] *Income Tax Act 2007* (NZ) s HD15(1)(c)(ii).
[87] *Income Tax Act 2007* (NZ) s HD 15 (2).
[88] *Income Tax Act 2007* (NZ) s HD15 (3) provides that '[a]ll persons who are directors of the company at the time the arrangement is entered into are treated as agents of the company in relation to the tax obligation, and the liability is joint and several. But a director has no liability if—
(a) they do not derive a benefit from the arrangement, and at the first reasonable opportunity after becoming aware of the arrangement, or the aspects of the arrangement that cause this section to apply to it, they record formally their dissent in relation to the arrangement with the company and with the Commissioner; or
(b) they were not at the relevant time involved in the executive management of the company and had no knowledge of the arrangement, or the aspects of the arrangement that cause this section to apply to it.
[89] Gerding, above n 52.
[90] For example, *United States v. Sotelo*, 436 US 268 (1978).
[91] 26 USC §§ 3402(a), 3102(a).
[92] 26 USC § 7501(a).
[93] *Slodov v United States* 436 US 238, 243 (1978).
[94] See 26 USC § 6672(a); 26 USC § 6671(b); see also *O'Connor v. United States*, 956 F.2d 48, 50 (4th Cir. 1992) (outlining elements of § 6672 liability).

In **France**, any director, whether formally appointed or de facto, of any corporation, can be jointly liable with the corporation for the payment of any tax, if, by fraudulent tactics or serious and repeated violations of tax law, he made the collection of taxes impossible.[95] A number of generous defences apply.[96] In **Malaysia**,[97] transactions which have the direct or indirect effect of avoiding or evading tax may be ignored by the Director-General of Inland Revenue, pursuant to s 140 (1) of the *Income Tax Act*.

By contrast, in **Korea**,[98] there is no liability on directors, although interestingly, shareholders who receive a distribution of the company's residual assets when the company is wound up may be liable as secondary tax debtors for unremitted taxes,[99] as may the shareholders in family-owned companies.[100] Likewise, China's new Enterprise Income Taxation Law [101] passed in 2007 does not impose any liability on directors for unpaid corporate tax debts.

Similarly, in the **United Kingdom**,[102] there is no liability on the part of directors for unremitted taxes. The only liability which might be attracted in such cases is for misfeasance and disqualification on the grounds of 'unfitness' under the *Company Directors Disqualification Act* 1986.

3. Environmental Protection

In **Australia,** [103]there is extensive environment protection legislation.[104]Some impose liability on directors for the faults and defaults of their companies. Directors may face criminal prosecutions under state legislation.[105] The 'positional/managerial' model of deemed liability is the most common,[106] where persons within a company holding certain positions are liable for the company's breach of the law. Other models of liability include positional, managerial, responsible officer, participatory and accessorial.[107] Defences are available under the statutes.[108] They differ markedly

[95] *Livre des procédures fiscales* (France) art L 267.
[96] These include that even if formally appointed, the director was not assuming in fact the direction of the corporation; that he had delegated his powers in the tax field to another person; or that the tax was not due at the time he was managing the corporation.
[97] Pascoe, above n 53.
[98] Song, above n 66.
[99] *National Tax Collection Act* (Korea) art 34.
[100] *Corporate Tax Code* (Korea) art 2, item 10.
[101] The *Enterprise Income Taxation Law* of the People's Republic of China was promulgated by the NPC on 16 March 2007 and came in effect on 1 January 2008.
[102] Lowry, above n 63.
[103] Wheelwright, above n 3.
[104] Examples of federal legislation include *Protection of the Sea (Civil Liability) Act 1981*, *Protection of the Sea (Prevention of Pollution from Ships) Act 1983*, *Environment and Heritage Legislation Amendment Act (No 1) 2003*, *World Heritage Properties Conservation Act 1983*, *Environment Protection (Sea Dumping) Act 1981, Environment Protection and Biodiversity Conservation Act 1999, Hazardous Waste (Regulation of Exports and Imports) Act 1989.*
[105] These are set out in Appendix 6 of the Corporations and Markets Advisory Committee 'Personal Liability for Corporate Fault 'Discussion Paper, May 2005, available at http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/$file/Personal_Liability_DP_May05.pdf, accessed 27th May, 2008.
[106] Ibid 33.
[107] Above n 106.
[108] Above n 105.

depending on the particular piece of legislation, although most commonly include due diligence and the individual not being in a position to influence the contravention.

Canada [109] is also typified by a multitude of statutes governing environmental protection, with more than 30 statutes imposing liability on directors for breach. Personal liability is generally imposed on those persons who have charge, management or control of the corporation's activities or property, which occurs if they take an active role in the business or if they had a duty or opportunity to take preventive or corrective action but failed to do so.[110] Directors who authorize, permit or acquiesce in their corporation's offence will be liable for the same offence pursuant to many environmental statutes in Canada.[111] The applicable penalties are fines, with imprisonment reserved for serious misconduct.[112] Liability is strict, with a due diligence defence.[113] This includes a requirement to establish proper and effective preventative and reporting systems.[114] Former directors may also be liable, acknowledging the fact that environmental damage may take some time to become evident. [115]

China [116] has in recent years increased its regulation of the environment[117] and has embraced international cooperation in environmental protection.[118] However, there have been a number of impediments to actual protection of the environment, including the growth of China's industry, gaps in the legislation and lack of enforcement. While there is a central body[119] responsible for environmental protection, local enforcement remains with local governments. While the persons directly responsible for a serious environmental pollution accident are subject to administrative sanction,[120] the law does not provide for directors to be jointly liable in civil actions to pay compensation to parties affected. However, China's Criminal Law imposes criminal sanctions including fines and imprisonment[121] on persons directly responsible for violations of environmental law regarding pollution and waste control,[122] forestry law,[123] and mineral resources law.[124]

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[109] Sarra, above n 12.
[110] See Janis Sarra and Ronald Davis, *Director and Officer Liability in Corporate Insolvency* (Toronto: Butterworths, 2002).
[111] See for example, *Environmental Protection Act*, SC 1999, c 33.
[112] Examples of statutes that include imprisonment as a potential sanction include *Environmental Protection Act* SC 1999; the Ontario *Environmental Protection Act*, RSO 1990, c. E-19; the Alberta *Environmental Protection and Enhancement Act*, RSA 2000, c. E-12; and the *Water Act*, RSBC 1996 c. 483.
[113] *R v Bata Industries Ltd* [1992] O.J. No. 236 (Ont. Prov. Crt.).
[114] Ibid.
[115] See for example, *Environmental Management Act*, S.B.C. 2003, c. 53, s. 47(1).
[116] Shi and Hu, above n 32.
[117] The National People's Congress has since 1949 passed nine laws on environmental protection and 15 laws on the protection of natural resources. See Environmental Protection in China (1996-2005), a white paper released by the State Council in June 2006, available at: www.china.org.cn.
[118] China has acceded to more than 50 international conventions on environmental protection. See *Environmental Protection in China* (1996-2005), a white paper released by the State Council in June 2006. Available at: www.china.org.cn.
[119] The State Environmental Protection Administration (SEPA).
[120] *Environmental Protection Law 1989* (China) art 38.
[121] *Criminal Law 1999* (China) arts 338 – 346.
[122] *Criminal Law 1999* (China) arts 338 and 339.
[123] *Criminal Law 1999* (China) art 344 .
[124] *Criminal Law 1999* (China) art 343.

In **South Africa**,[125] the *National Environmental Management Act* 1998 imposes criminal and civil liability on directors in an unusual way. Section 34(1) provides that

> [w]henever any person is convicted of an offence under any provision listed in Schedule 3 and it appears that such person has by that offence caused loss or damage to any organ of state or other person, including the cost incurred or likely to be incurred by an organ of state in rehabilitating the environment or preventing damage to the environment, the court may … inquire summarily and without pleadings into the amount of the loss or damage so caused.

Directors are named in ss 8 as parties who may be so convicted. Subsection 7 states that directors are guilty 'if the offence in question resulted from the failure of the director to take all reasonable steps that were necessary under the circumstances to prevent the commission of the offence'. The burden of disproving this lies with the director.

In the **United Kingdom**,[126] protection of the environment is governed mainly by the *Environmental Protection Act 1990*.[127] Action may be taken against directors, as well as the company, for breaches of the law on the initiative of the HM Inspectorate of Pollution or the local authority Environmental Health Officer. [128] Criminal penalties include both fines and imprisonment, as well as disqualification from acting as a director.[129]

In **Hong Kong**,[130] there is a range of ordinances imposing criminal liability for damage to the environment,[131] or failure to protect the natural[132] and cultural environment.[133] In addition, future impact on the environment is governed by the *Environmental Impact Assessment Ordinance*,[134] where developers must indicate

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[125] Van der Linde, above n 40.
[126] Lowry, above n 63.
[127] Note also the *Environment Act 1995* (UK), the *Control of Substances Hazardous to Health Regulations 1999* (UK) and the *Control of Major Accident Hazards Regulations 1999* (UK).
[128] This may be done pursuant to the United Kingdom *Environmental Protection Act 1990*, ss 157(1), which provides that '[w]here an offence under any provision of this Act committed by a body corporate is proved to have been committed with the consent or connivance of, or to have been attributable to any neglect on the part of, any director, manager, secretary or other similar officer of the body corporate or a person who was purporting to act in any such capacity, he as well as the body corporate shall be guilty of that offence and shall be liable to be proceeded against and punished accordingly.
[129] Section 2 of the *Company Directors Disqualification Act 1986* (UK) provides that the court may, in its discretion, issue a disqualification order against a person 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 with the receivership or management of a company's property. The offence does not have to relate to the actual management of the company provided it was committed in 'connection' with its management.
[130] Goo et al, above n 48.
[131] For example, the Hong Kong *Air Pollution Control Ordinance* (Cap 311), *Water Pollution Control Ordinance* (Cap 358), *Dumping at Sea Ordinance* (Cap 466) *Merchant Shipping (Prevention and Control of Pollution) Ordinance* (Cap 413) and the specific problem of oil pollution, *Merchant Shipping (Liability and Compensation for Oil Pollution) Ordinance* (Cap 414), *Noise Control Ordinance* (Cap 400); *Civil Aviation (Aircraft Noise) Ordinance* (Cap 312), *Waste Disposal Ordinance* (Cap 354).
[132] *Animals and Plants (Protection of Endangered Species) Ordinance* (Cap 187), *Marine Fish Culture Ordinance* (Cap 353), *Wild Animals Protection Ordinance* (Cap 170), *Whaling Industry (Regulation) Ordinance* (Cap 496) and *Forests and Countryside Ordinance* (Cap 96).
[133] *Antiquities and Monuments Ordinance* (Cap 53).
[134] *Environmental Impact Assessment Ordinance* (Cap 499).

what the likely impact of their plans upon the environment might be. Criminal liability is provided for under s 29(1). [135]

Malaysia[136] also has environmental laws, such as the *Environmental Quality Act 1974*, which impose criminal liability upon directors for breaches committed by their companies. Section 43 of the Act deems directors to be liable for the environmental offences of their company unless one of the defences apply.[137] However, prosecution is rare.[138]

In **Korea**,[139] environmental law is now heavily regulated.[140] Companies may be criminally liable for breaches. While there are no provisions imposing civil liability on companies, directors may be liable for the amount of any criminal penalty imposed on their company if that penalty is attributable to a breach of the directors' fiduciary duty, provided that negligence or intention to commit the violation is proved. Directors are not liable in the absence of personal fault, even where the relevant statute imposes strict liability on the company.

The **United States** [141]has the *Comprehensive Environmental Response, Compensation and Liability Act* ('CERCLA').[142] This federal statute, passed in 1980 following a major environmental disaster,[143] imposes extensive and complicated liability on directors in relation to land contaminated with hazardous waste. Liability attaches to owners and operators, including individual persons, of sites from where such material is released into the environment. However, courts have taken different approaches to the definition of 'operators'. The most common approach has been to hold directors, liable as 'operators' for violations in which they directly participate.[144] However,

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[135] Section 29(1) of the Hong Kong *Environmental Impact Assessment Ordinance* provides that '[w]here a person convicted of an offence under this Ordinance is a body corporate and it is proved that the offence was committed with the consent or connivance of, or was attributable to any neglect or omission on the part of, a director, manager, secretary or other person concerned in the management of the body corporate, the director, manager, secretary or other person also commits the offence'.

[136] Pascoe, above n 53.

[137] These include lack of knowledge and consent, and that the directors exercised due diligence to prevent the commission of the offence.

[138] A possible cause of this is corruption: A H Ansari, 'Enforcement of Environmental Laws in Developing Countries: An Expository Study with Special Reference to Malaysia' [2007] 4 MLJ liv.

[139] Song, above n 66.

[140] More than 20 laws regulate environmental issues, in areas such as noise, air, soil, water, sewage, and the preservation of nature. See for example *Basic Environmental Policy Law*, *Air Environment Preservation Law*, *Water Environment Preservation Law*, *Natural Environment Preservation Law*, *Soil Environment Preservation Law*. See further Min Shin et al, 'Korean Environmental Law Developments', available at http://www.bakernet.com/NR/rdonlyres/1298A282-673A-4E4E-9D2B-C3552030E375/40219/Korea.pdf, accessed 27th May, 2008. For a short history of the development of Korean environmental law, see Hong Sik Cho 'An Overview of Korean Environmental Law' (1999) 29(3) *Environmental Law* 501.

[141] Gerding, above n 52.

[142] 42 USC §§ 9601-9675 (2008).

[143] The Love Canal disaster – see further M. Brown, 'Laying Waste: The Poisoning of America by Toxic Chemicals' (New York, Pantheon Books, 1979).

[144] Bryan Moore 'The Corporate Officer as CERCLA Operator: Applying the Holding in *United States v. Bestfoods* to the Determination of Officer Liability' (1999) 12 *Tulane Environmental Law Journal* 519, 526-28; L J Oswald and Cindy A Schipani, 'CERCLA and the "Erosion" of Traditional Corporate Law Doctrine' (1992) 86 *Northwestern University Law Review* 259 (1992); Cindy A Schipani, 'Integrating Corporate Law Principles with CERCLA Liability for Environmental Hazards' (1993) 18 *Delaware Journal of Corporate Law* 1, 5; Gerding, above n 52.

some courts have held directors liable for contraventions of the law where they had the 'capacity to control' those operations, even if they did not know of, or directly participate in, those contraventions.[145]

In **France**,[146] directors may be criminally liable under the *Code de l'environnement* for a range of crimes. These include lesser strict liability offences, as well as more serious crimes under the *Code de l'environnement* which require negligence or intention. An example of the latter is water pollution.[147]

4. Conclusion

The discussion above has highlighted similarities in the legislation relating to capital raising, unremitted tax instalments and protection of the environment. The severity of the laws, as well as their international adoption, appears to form part of a continuum – the most severe, in terms of strictness of liability on directors, is capital raising, and it is also the most similar across nations. There is a general obligation on companies to produce a prospectus in relation to capital offerings to the public, and directors are liable for errors in, and omissions from, such documents. Defences are usually available, but are generally limited to due diligence, reliance on the advice of an expert or lack of consent to the issuing of the prospectus. Nonetheless, there are some local variations to both the format of the personal and criminal liability provisions, as well as the defences available. This illustrates the point that there are multiple ways for laws to be drafted to meet a common legislative objective.

This pattern continues for unremitted taxes. Most, but not all, of the countries surveyed have laws making directors liable for the unremitted tax instalments taken from employees' wages. Again, there are defences. However, some jurisdictions require some element of intention on the part of the directors, making such laws somewhat harder to make out than those relating to capital raising. The diversity between countries is more marked too, and some countries such as the United Kingdom do not legislate on this matter at all.

In relation to the protection of the environment, most of the countries surveyed impose criminal liability on directors for their companies' actions; however, not all impose civil liability, and the mechanism for finding directors liable differs between strict liability based on position but subject to defences and liability based on actual involvement or fault.

C. DIVERSITY IN DIRECTORS' LIABILITY LAWS BETWEEN JURISDICTIONS

Section C goes further along the continuum introduced in Section B. Insolvent trading, protection of employee entitlements and protection of tort claimants will be

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[145] This is also known as the 'authority to control' test. *See* Moore, above n 144, 533-40. He distinguishes cases in which courts based director and officer liability determination on whether the individual had 'actual control' over hazardous substances from those that used an 'authority to control' test. Ibid 529-40.

[146] Mauro, above n 69.

[147] *Code de l'environnement* (France) art 216-16.

examined. Again, it appears that laws which treat directors more leniently are also the ones which are more varied across jurisdictions.

1. Insolvent trading

In **Australia**,[148] the *Corporations Act 2001* (Cth) imposes both personal liability and in some cases, criminal penalties on directors who allow their company to trade whilst insolvent.[149] Section 588G(1) imposes liability on directors for the company's debt, where

> (a) a person is a director of a company at the time when the company incurs a debt; and
> (b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and
> (c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be …
>
> (2) By failing to prevent the company from incurring the debt, the person contravenes this section if:
> (a) the person is aware at that time that there are such grounds for so suspecting; or
> (b) a reasonable person in a like position in a company in the company's circumstances would be so aware.

Defences are available under s 588H. Several aspects of the legislation have created problems.[150] The requirement of liquidation means that directors can escape liability by placing the company into voluntary administration. If the liquidator chooses not to take action, creditors face a number of procedural hurdles before they themselves can sue.[151] In addition to civil liability, the director commits a criminal offence if the director's failure to prevent the company incurring the debt was dishonest.[152] Courts have a range a options in relation to contraventions of s 588G. In addition to holding the directors liable for the debts of the company from the commencement of insolvent trading, they may impose on directors pecuniary penalties,[153] banning orders[154] and compensation orders.[155]

The **United Kingdom**[156] does not have insolvent trading as such. Its legislation affords a dual approach, targeting both fraudulent trading as well as wrongful trading. The former is imposed by section 213 of the *Insolvency Act 1986* (UK) which provides that:

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[148] Wheelwright, above n 3.
[149] This is in addition to directors' duties to the company under Part 2D.1 Div 1 of the *Corporations Act 2001* (Cth).
[150] An example is the definition of insolvency, and whether the commercial reality of a company being able to borrow more money affects its solvency: *Powell v Fryer* [2000] SASC 97, *Southern Cross Interiors Pty Ltd (in liq) v Deputy Commissioner of Taxation* (2001) 53 NSWLR 213, 224, *Lewis v Doran* [2004] NSWSC 608, [111] – [112]; cf *Emanuel Management Pty Ltd v Fosters Brewing Group* [2003] QSC 205. See further Helen Anderson, *Corporate Directors' Liability to Creditors* (Thomson Monograph Series, 2006), 148–152.
[151] *Corporations Act 2001* (Cth) ss 588R – 588U.
[152] *Corporations Act 2001* (Cth) s 588G(3).
[153] *Corporations Act 2001* (Cth) s 1317G.
[154] *Corporations Act 2001* (Cth) s 206C.
[155] *Corporations Act 2001* (Cth) s 1317H and s 588J (compensation orders). An order may be sought by the regulator, or by the company's liquidator. Note that the compensation is payable to the company and not to individual creditors.
[156] Lowry, above n 63.

> (1) If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, the following has effect.
> (2) The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company's assets as the court thinks proper.

The meaning of fraud for the purposes of section 213 has been defined as requiring 'real dishonesty involving, according to current notions of fair trading among commercial men at the present day, real moral blame'.[157] In *Re William C Leitch Brothers Ltd*,[158] Maugham J stipulated that this occurs 'when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts ... '.[159] This includes turning a blind eye, where there is a suspicion of the relevant facts together with a deliberate decision to avoid confirming their existence.[160] Criminal liability also applies.[161] The difficulties in making out the requirements of 'actual dishonesty' and 'real moral blame' led to the enactment of the wrongful trading provisions, following recommendations by the Jenkins Committee[162] and the Cork Committee.[163]

Wrongful trading, which is governed by section 214 of the *Insolvency Act 1986* (UK), is considerably more involved than fraudulent trading. There is the same requirement that the company be wound up in insolvent liquidation, and the court may order that a person who was a director at that time 'is to be liable to make such contribution (if any) to the company's assets as the court thinks proper.' Directors may not escape liability by being a 'sleeping' director, [164]or through ignorance, either of the facts of the company's insolvency or of the basic financial and accounting knowledge necessary to fulfil their obligations.[165]

But unlike fraudulent trading, the wrongful trading section requires that the director 'knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation,' unless the court is satisfied that the director 'took every step with a view to minimising the potential loss to the company's creditors as (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation) he ought to have taken.' The relevant standard is of a 'reasonably diligent person having both—

> (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and
> (b) the general knowledge, skill and experience that that director has.

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[157] *Re Patrick and Lyon Ltd* [1933] Ch 786, Maugham J.
[158] [1932] 2 Ch 71. Cf *Re Augustus Barnett & Son Ltd* [1986] PCC 167.
[159] Ibid 76. See also *Welham v DPP* [1961] AC 103; *Bernasconi v. Nicholas Bennett & Co* [2000] BCC 921; *Aktieselskabet Dansk Skibsfinansiering v Brother* [2001] 2 BCLC 324; and *R v. Grantham* [1984] QB 675.
[160] *Morris v. State Bank of India* [2005] 2 BCLC 328.
[161] *Companies Act 2006* s 993.
[162] United Kingdom, *Report of the Company Law Committee,* Cmnd 1749 (1962), para 503(b).
[163] United Kingdom, *Report of the Review Committee Insolvency Law and Practice*, Cmnd 8558 (1981), chap 44.
[164] *Re Brian D Pierson (Contractors) Ltd* [2001] 1 BCLC 275.
[165] *Re DKG Contractors Ltd* [1990] BCC 497.

Malaysia,[166] like the United Kingdom, imposes liability for both wrongful and fraudulent trading. Breach of the wrongful trading provision, s 303(3) of the *Companies Act 1965*, is both a civil wrong and a crime attracting serious fines and possible imprisonment.[167] It states:

> If in the course of the winding up of a company or in any proceedings against a company it appears that an officer of the company who was knowingly a party to the contracting of a debt had, at the time the debt was contracted, no reasonable or probable ground of expectation, after taking into consideration the other liabilities, if any, of the company at the time, of the company being able to pay the debt, the officer shall be guilty of an offence against this Act.

Directors' liability is provided for by s 304(2), which says that:

> Where a person has been convicted of an offence under subsection 303(3) in relation to the contracting of such a debt ... the Court, on the application of the liquidator or any creditor or contributory of the company, may, if it thinks proper so to do, declare that the person shall be personally responsible without any limitation of liability for the payment of the whole or any part of that debt.

Possible recovery under the section is limited by the need to prove knowing participation in the incurrence of the debt and that the director himself had no reasonable or probably ground to expect that the company could pay it. In addition, by making criminal liability a pre-requisite for civil liability, the criminal burden of proof is imposed onto the recovery by the liquidator or creditor. There are also criminal sanctions for those who 'knowingly' carry on the business of the company with the intent to defraud creditors.[168] Here, civil recovery is not linked to a criminal conviction, but the requirement to prove an intent to defraud is a significant hurdle. [169]

Like the United Kingdom, **Hong Kong**[170] allows for directors' liability for fraudulent trading, but it has not adopted the more recent wrongful trading provisions of its former colonial governors. Section 275(1) of the *Companies Ordinance 1997* (HK) provides that:

> [i]f in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the court, on the application of the Official Receiver, or the liquidator or any creditor or contributory of the company, may, if it thinks proper so to do, declare that any persons who were knowingly parties to the carrying on of the business in manner aforesaid shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct.

The British definition of fraud applies in Hong Kong, so that if it is proved that the directors knew or ought to have known that there was no reasonable prospect of the company avoiding insolvent liquidation, they will be liable.[171] This is a question of fact and is resolved by asking whether the director's decision to continue to trade

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[166] Pascoe, above n 53.
[167] Malaysia *Companies Act 1965* s 303 (3) – breach attracts a penalty of imprisonment for one year or a fine of 5,000 Ringgit.
[168] Malaysia *Companies Act 1965* s 304 (1) and (5).
[169] There is one reported case: *H. Rosen Engineering B.V. v. Siow Yoon Keong* [1997] 1 CLJ 137.
[170] Goo et al, above n 48.
[171] Re *W C Leitch Ltd* [1932] 2 Ch 71, discussed above n 158.

involved unnecessary risks to the repayment of creditors.[172] Criminal liability is also imposed under s 275(3).

New Zealand[173] also has laws against fraudulent trading.[174] Liability is provided for under in s 380(2).[175] Due to the purpose requirement in this section, it is not targeted at directors whose only motivation is to save the company, regardless of whether that aim was unrealistic.[176] Reckless trading is also dealt with by s 135,[177] which imposes a duty, objectively assessed, on directors to supervise the company's business.[178] An overlapping duty is imposed by s 136, which provides that 'A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.'

South Africa[179] takes a different approach, by including both fraudulent and reckless trading in the one section. Section 424 of the *Companies Act 1973* imposes personal liability on directors, by providing that:

> When it appears, ... that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct.

Intention is a key issue. In order to qualify as 'reckless' the business must be carried on with a minimum of gross negligence, while the minimum requirement for fraudulent trading is intent in the form of *dolus eventualis*.[180] Trading whilst insolvent is not sufficient on its own to constitute recklessness or fraud; nonetheless, courts will

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[172] See eg *Secretary of State for Trade and Industry v Gash & Others* [1997] 1 BCLC 341; *Re Amaron Ltd* [2001] 1 BCLC 562; *Re Park House Properties Ltd* [1997] 2 BCLC 530; *Re McNulty's Interchange Ltd* [1989] BCLC 709 and *Re Synthetic Technology Ltd. Secretary of State for Trade and Industry v Joiner* [1993] BCLC 549.

[173] Noonan and Watson, above n 23.

[174] *Companies Act 1993* (NZ) - Section 380(1) makes it an offence for directors to carry on business with an intent to defraud creditors or any other person or for a fraudulent purpose. In addition, s 33 of *the Companies Amendment Act 2006* (NZ) makes it an offence for directors who with intent to defraud a creditor or creditors do anything which causes material loss to any creditor.

[175] *Companies Act 1993* (NZ) s 380(2): 'Every director of a company who,(a) By false pretences or other fraud induces a person to give credit to the company; or (b) With intent to defraud creditors of the company,—
(i) Gives, transfers, or causes a charge to be given on, property of the company to any person; or
(ii) Causes property to be given or transferred to any person; or (iii) Caused or was a party to execution being levied against property of the company— commits an offence and is liable on conviction to the penalties set out in section 373(4) of this Act.'

[176] *Re Nimbus Trawling Co Ltd; Keegan v Page Vivian Motors Ltd* [1986] 2 NZLR 308 (CA).

[177] 'A director of a company must not— (a) Agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or (b) Cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.'

[178] *Mason v Lewis* [2006] 3 NZLR 225 (CA).

[179] Van der Linde, above n 40.

[180] Dolus eventualis (indirect intention) exists when the possibility of a particular consequence or circumstance is foreseen, and there is a reckless disregard as to whether it ensues or not. The person knows that the action - or the consequences of the action - are wrong.

draw an inference of recklessness where a company continues to incur debts when a reasonable person in business would have realized that there was no reasonable prospect that the creditors would receive payment when due.[181] The director can be held liable for 'any or all' of the debts of the company[182] and there is no need to prove a causal connection between the reckless or fraudulent carrying on of the business, and the debt or debts for which liability is sought to be imposed.[183] Criminal liability may also be imposed.[184]

In **France**,[185] the *Code de Commerce* contains arguably very harsh provisions on directors in the event of a company's insolvency. Article L 651-2 of the *Code de commerce* imposes liability for any director, amongst others, where the insolvency of the company is partly or entirely due to a directors' fault in management. It provides:

> Where the rescission of a safeguard or of a reorganization plan or the liquidation of a legal entity reveals an excess of liabilities over assets, the court may, in instances where management fault has contributed to the excess of liabilities over assets, decide that the debts of the legal entity will be borne, in whole or in part, by all or some of the de jure or de facto managers, who have contributed to the management fault. If there are several managers, the court may, by way of a reasoned ruling, declare them jointly and severally liable. The right of action shall be barred after three years from the date of issuance of the order pronouncing the liquidation proceedings or the rescission of the plan. Sums paid by the managers in compliance with the first paragraph shall form part of the debtor's assets. These sums shall be distributed to all creditors on a pro rata basis.

In addition, Article L 653-2 *Code de commerce* allows the court to disqualify the director from holding that office in any other company for a maximum term of 15 years. Further criminal liability can be found in Article L 654-2 *Code de commerce*[186] where the director commits certain crimes during the company's bankruptcy. These include embezzlement, concealing the company's property or increasing the insolvency of the company. If these same acts took place before the insolvency started, they will constitute a misuse of company assets[187] and the director will be liable for breach of his fiduciary duties.

In **China**,[188] there is no insolvent trading liability as such. However, there are a number of provisions relating to insolvency which act to protect creditors. China's Enterprise Bankruptcy Law, [189] which came into effect on 1st June, 2007, lifts the corporate veil, imposing liability on directors of insolvent companies where the liquidation was caused by breaches of fiduciary duties.[190] Disqualification orders may be sought against directors, and the company's administrator can claw back

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[181] See *Ozinsky NO v Lloyd and Others 1995* (2) SA 915 (A); *Philotex (Pty) Ltd v Snyman; Braitex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA); *Terblanche NO v Damji* 2003 (5) SA 489 (C).
[182] *Companies Act 1973* (RSA) s 424(1).
[183] *Saincic v Industro–Clean (Pty) Ltd* [2006] JOL 17559 (SCA); Van der Linde, above n 40.
[184] *Companies Act 1973* (RSA) s 424(3).
[185] Mauro, above n 69.
[186] The law establishes a maximum term of 5 years imprisonment and a 30,000 euro fine.
[187] Abus de biens sociaux, *Code de commerce* (France) art L 242-6-3°.
[188] Shi and Hu, above n 32.
[189] The Law replaced the *State Enterprise Bankruptcy Law (Trial Implementation) 1986*. See further E J Chua, 'The Reform of PRC Corporate Bankruptcy Law: Slowly but Surely' (2002) 16(8) *China Law & Practice* 19.
[190] *Enterprise Bankruptcy Law* (China) art 125.

assets which were diverted to avoid the reach of creditors.[191] Similarly, the administrator may recover assets embezzled by directors and managers, and these directors may be ordered to pay compensation to creditors whose interests have been harmed. [192] In addition, a range of criminal penalties applies.[193]

As in China, there is no specific liability for insolvent trading in **Korea**.[194] Liability to a third party would only be imposed on directors where loss was incurred as a result of the directors' neglect of his or her duties to the company if such neglect results from wrongful intent or gross negligence.[195] This would include the behaviour of directors during periods of financial difficulty, if such behaviour interfered with the company's ability to pay its debts.

2. Employee entitlements

When companies collapse, employees can miss out payment of their entitlements, including unpaid wages, holiday pay, redundancy payments, pay in lieu of long-service leave and superannuation contributions.

In **Australia**, [196]employees, although unsecured creditors, enjoy a small measure of priority in the distribution made by the liquidator in the winding up.[197] However, this priority is not sufficient to ensure their proper compensation. As a result of a public outcry in the wake of a series of prominent corporate failures, Australia introduced two measures for the protection of employees.

The first is Part 5.8A of the *Corporations Act*,[198] which enables the liquidator to recover compensation from a 'person'[199] who has entered into an agreement or transaction with the intention of preventing the recovery of entitlements by employees of a company, or of significantly reducing the amounts of entitlements that can be recovered.[200] Criminal penalties also apply.[201] While the provision may appear harsh, the requirement to prove a subjective intention on the part of the person significantly diminishes its effectiveness. In addition, while employees themselves may take action against a director in respect of their loss, they require the liquidator's permission and can only do so six months or more after the company has commenced winding up.[202]

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[191] *Enterprise Bankruptcy Law* (China) arts 33 and 34.
[192] *Enterprise Bankruptcy Law* (China) art 36.
[193] *Criminal Law* (China, 1999 amendment) art 2 provides that where an employee of a State-owned company or enterprise is gravely derelict in the exercise of his or her duties or is abusing his or her powers, causing bankruptcy or heavy losses to the company or enterprise which results in heavy losses of the state' interests, he or she shall be sentenced to fixed-term imprisonment of not more than three years or criminal detention, or to fixed-term imprisonment of not less than three years but not more than seven years in very serious cases.
[194] Song, above n 66.
[195] *Commercial Code* (Korea) § 401.
[196] Wheelwright, above n 3.
[197] *Corporations Act 2001* (Cth) s 556.
[198] This was inserted into the Corporations Act by the *Corporations Law Amendment (Employee Entitlements) Act 2000* (Cth).
[199] This term is not defined, but includes a director.
[200] *Corporations Act* 2001 (Cth) s 596AB(1).
[201] These are a fine of up to $110,000 or imprisonment for 10 years, or both. Section 1311 and Schedule 3 of the *Corporations Act 2001* (Cth).
[202] *Corporations Act 2001* (Cth) s 596AG.

The second is a taxpayer-funded scheme called GEERS, which pays a portion of the entitlements of employees which have been lost upon their employers' liquidation.[203] While this scheme is beneficial to employees, it arguably undermines the incentive for directors to make adequate provision for employee entitlements prior to the company's insolvency.

Canada, [204]by way of contrast, has considerably more generous provisions. Federal, provincial and territorial statutes specify that directors may be held personally liable for employee entitlements[205] for a prescribed period.[206] The provisions become relevant where the corporation has failed to pay, usually in the lead up to insolvency.[207] Section 119(1) of the *Canada Business Corporations Act 1985*(CBCA) is an example:

> Directors of a corporation are jointly and severally, or solidarily, liable to employees of the corporation for all debts not exceeding six months wages payable to each such employee for services performed for the corporation while they are such directors respectively.

Pursuant to s 119(3) the director must be sued within two years after ceasing to be a director.[208] A due diligence defence applies under the CBCA.[209] Directors who pay employee entitlements under these provisions are then subrogated to the rights of the employees in terms of priority of recovery from the company's liquidated assets.[210]

New Zealand's[211] provision of liability with respect to certain unpaid employee entitlements is governed by s 234(2) of the *Employment Relations Act 2000*. The section provides

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[203] See further http://www.workplace.gov.au/workplace/Programmes/EmployeeEntitlements/GEERSV2/, accessed 6th May, 2008. There are limits on what employees may recover.
[204] Sarra, above n 12.
[205] However, severance pay is not included: *Barratte v Crabtree Estate* [1993] 1 S.R 1027. It is considered to be a payment arising from breach of contract, and not from services rendered. However, where a collective agreement guarantees the payment of severance pay on dismissal based on a formula of service, it may be included in the claim against the directors eg *Schwartz v. Scott* (1985) 32 BLR 1 (Que. C.A.).
[206] See for example the *Canada Business Corporations Act*, RSC 1985, c. C-44. Related compensation can include vacation pay and guaranteed bonuses; *Mills-Hughes at al v. Raynor et al* (1988), 63 O.R. (2d) 343 and 730(n) (Ont. C.A.).
[207] The *Canada Business Corporations Act* s 119 (2) provides that '[a] director is not liable under subsection (1) unless
(a) the corporation has been sued for the debt within six months after it has become due and execution has been returned unsatisfied in whole or in part; (b) the corporation has commenced liquidation and dissolution proceedings or has been dissolved and a claim for the debt has been proved within six months after the earlier of the date of commencement of the liquidation and dissolution proceedings and the date of dissolution; or (c) the corporation has made an assignment or a bankruptcy order has been made against it under the Bankruptcy and Insolvency Act and a claim for the debt has been proved within six months after the date of the assignment or bankruptcy order.'
[208] *Canada Business Corporations Act* RSC 1985, c. C-44 s 119(3).
[209] *Canada Business Corporations Act* RSC 1985, c. C-44 s 123.
[210] *Canada Business Corporations Act* RSC 1985, c. C-44 s 119(5).
[211] Noonan and Watson, above n 23.

> Where… the Labour Inspector establishes on the balance of probabilities that the amount claimed in the action by way of minimum wages or holiday pay[212] or both is, if judgment is given for that amount, unlikely to be paid in full, whether because—
> (a) the company is in receivership or liquidation; or
> (b) there are reasonable grounds for believing that the company does not have sufficient assets to pay that amount in full,—
> the Authority may authorise the Labour Inspector to bring an action for the recovery of that amount against any officer, director, or agent of the company who has directed or authorised the default in payment of the minimum wages or holiday pay or both.

Liability is joint and several,[213] and is initiated by a Labour Inspector commencing proceedings in the Employment Relations Authority against the company for the payment of the relevant amounts. It is then within the discretion of the Employment Relations Authority to authorise the Labour Inspector to bring the recovery action against the director.

In **South Africa**, employers are required to withhold and pay over contributions in respect of their employees, pursuant to the *Unemployment Insurance Contributions Act 2002.* Directors are personally liable for any amount withheld and not paid over,[214] in addition to penalties. There are no defences available.

In **Hong Kong**,[215] directors are not liable for unpaid employee entitlements upon corporate insolvency. Where employees are owed wages and other specified entitlements,[216] the *Protection of Wages on Insolvency Ordinance* may make ex gratia payments to applicants. A fund has been established under s 6 of that Ordinance, which is made up of business registration fees[217] and other specified monies. Similarly in the **United Kingdom**,[218] there is a National Insurance Fund established under the *Employment Rights Act 1996*. This pays amounts of unpaid wages, accrued entitlements, pay in lieu of notice, and redundancy pay.

3. Tort

This article will conclude with a brief examination of tort law. It is presented as a contrast to the varied statutory provisions examined above. Interestingly, in the absence of individual national legislation, some of the Commonwealth countries discussed above have developed law which is an amalgam of their various decisions. However, the weakness of this development is that there is general dissatisfaction with the state of the law, as well as confusion as to the appropriate test to apply in any given situation. South Africa, by way of contrast, avoids all of the judicial gymnastics of the Commonwealth countries by imposing liability on directors regardless of the fact that their actions were undertaken in their capacities as directors.

Within the Commonwealth countries, there are four different tests which are used by courts to determine the personal liability of directors in tort. Australia has relatively

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[212] These are provided for under the under the *Minimum Wages Act 1983* (NZ) or the *Holidays Act 2003* (NZ).
[213] *Employment Relations Act 2000* (NZ) s 234(3).
[214] *Unemployment Insurance Contributions Act 2002* (NZ) s 7(4A).
[215] Goo et al, above n 48.
[216] These are wages, wages in lieu of notice and severance pay.
[217] These are paid under s 21 of the Hong Kong *Business Registration Ordinance* (Cap 310).
[218] Lowry, above n 63.

few cases which look at the issue, and these draw heavily on precedents from other Commonwealth jurisdictions. The 'direct or procure' test is the most common, and has been used in Britain, Canada, New Zealand and Australia since the development of liability of directors for company torts. It is also the easiest test to establish liability and has been used for the torts of negligence, breach of copyright, nuisance, deceit and conversion. The 'make the tort his own' test was first applied in 1978 and has been used in Canada, Britain and Australia, principally in copyright, passing off and patent cases, and is more difficult to make out. The 'assumption of responsibility' test, which was first applied in 1992, has been used in Britain and New Zealand, mainly in negligent misstatement cases. Commentators discussing the law relating to a director's personal liability to creditors in tort generally confine themselves to these three tests. However, a number of recent cases have relied on the decision in *Said v Butt*,[219] in finding that directors are not liable for the tort of procuring a breach of contract which they commit while acting for the company.

Commonwealth courts have been troubled by the dual roles of directors – as people and as the directing mind and will of companies. Le Dain J summed up the dilemma facing courts thus:

> On the one hand, there is the principle that an incorporated company is separate and distinct in law from its shareholders, directors and officers, and it is in the interests of the commercial purposes served by the incorporated enterprise that they should as a general rule enjoy the benefit of the limited liability afforded by incorporation. … On the other hand, there is the principle that everyone should answer for his tortious acts.[220]

Each of the tests will now be briefly examined. The first is the 'direct or procure' test. It originally sought to attribute liability to a director for the tortious actions of a more junior person in the company, where those actions are directed or procured by the director.[221] Later courts, however, have frequently used the expression 'direct or procure' to hold a director liable for his own actions.[222]

The 'make the tort his own' test originated in Canada in *Mentmore Manufacturing Co Ltd v National Merchandising Manufacturing Company Inc*.[223] Le Dain J of the Federal Court of Appeal of Canada found that cases warranting personal liability exhibited 'a knowing, deliberate, wilful quality to the participation', 'that degree and

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[219] [1920] 3 KB 497.

[220] *Mentmore Manufacturing Co Ltd v National Merchandising Manufacturing Company Inc* (1978) 89 DLR (3d) 195, 203.

[221] It is well accepted that employees are liable in tort for their actions as part of their employment. Given that they are more likely to be acting under others' instructions, it seems ironic that this liability is unchallenged, yet the liability of those who give the instructions is contentious. Even employees performing the 'very essence' of their contract can be held personally liable in tort, according to the Supreme Court of Canada in *London Drugs Ltd v Kuehne & Nagle International Ltd*. Iacobucco J there stated: 'There is no general rule in Canada to the effect that an employee acting in the course of his or her employment and performing the "very essence" of his or her contractual obligations with a customer does not owe a duty of care, whether one labels it "independent" or otherwise, to the employer's customer.' [1992] 3 SCR 299, 407-8.

[222] In *Standard Chartered Bank v Pakistan National Shipping Corp (No 2)* [2002] 3 WLR 1547, Lord Rodger described the use of the 'direct or procure' test to ascribe liability for director's own actions as 'strangely complex', at 1557.

[223] (1978) 89 DLR (3d) 195.

kind of personal involvement by which the director or officer makes the tortious act his own'.[224]

The third test, of assumption of responsibility, was outlined in the New Zealand decision in *Trevor Ivory Ltd and Trevor Ivory v Anderson*,[225] a case of negligent misstatement involving a one-man company. Hardie Boys J said:

> Essentially, I think the test is, or at least includes, whether there has been an assumption of responsibility, actual or imputed. That is an appropriate test for the personal liability of both a director and an employee… Assumption of responsibility may well arise or be imputed where the director or employee exercises particular control or control over a particular operation or activity,… This is perhaps more likely to arise within a large company where there are clear allocations of responsibility, than in a small one.[226]

His Honour then commented that the use of a company to carry on the business could be seen as a personal disclaimer, rather than the basis for imputing an assumption of responsibility.[227] In other words, why else would someone incorporate himself, as in *Salomon v Salomon & Co Ltd*,[228] if not to escape from personal responsibility and liability?[229]

The fourth test arose from *Said v Butt*,[230] which concerned an action against the managing director of a theatre company for the tort of wrongfully and maliciously procuring the company to breach its contract with the plaintiff, by refusing him entry after he had purchased a ticket. McCardie J denied the plaintiff's claim that a director could be personally liable for this tort.

In **Australia**, courts have been unable to decide which test to apply.[231] Each of the tests were examined and criticised in *Root Quality Pty Ltd v Root Control Technologies Pty Ltd*.[232] They were also canvassed extensively in 2003 in *Johnson Matthey (Aust) Pty Ltd v Dascorp Pty Ltd*. [233] *Root Quality* concluded that the director

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[224] Ibid 204.
[225] [1992] 2 NZLR 517. This decision built on the earlier decision in *Fairline Shipping Corp v Adamson* [1975] QB 180. See further John Farrar, 'The Personal Liability of Directors for Corporate Torts' (1997) 9 *Bond Law Review* 102, 109.
[226] [1992] 2 NZLR 517, 527.
[227] Ibid 528.
[228] [1897] AC 22.
[229] In *Oakley Inc v Oslu Imports and Exports Pty Ltd* [2000] FCA 700, [35] Finn J said, citing *Mentmore*, *Trevor Ivory* and *Williams,* that 'such are both the controversies surrounding it in the common law world and its implications for small companies … that, in the absence of argument directed to the foundation of the tort - and in particular to whether it properly is to be regarded in the present setting as an intentional tort - I am not prepared to assume liability from the fact that, as the company's alter ego, Mr Tao directed the actions that gave rise to the infringements.'
[230] Ibid.
[231] In *G M (North Melbourne) v Young Kelly* (1986) 7 IPR 149, directors' liability for their tortious actions on behalf of their companies was described as a 'complex and burgeoning field of the law' at 158. In *Root Quality*, Finklestein J called it a 'confusing picture on an issue that has persistently vexed the common law' (2000) 177 ALR 231, [115]. See further Helen Anderson, 'The Theory of the Corporation and Its Relevance to Directors' Tortious Liability to Creditors' (2004) 16 *Australian Journal of Corporate Law* 73; Helen Anderson, 'Directors' personal liability to creditors: theory versus tradition' (2003) 8 *Deakin Law Review* 209.
[232] (2000) 177 ALR 231.
[233] [2003] VSC 291.

must be shown to have directed or procured the tortious conduct of the company.[234] In *King v Milpurrurru*, a stricter test was laid down requiring that the defendant make the tort his own by deliberately and knowingly pursuing the course of conduct that constituted the breach.[235]

Even within each test, courts differ as to the extent of its application and the factors considered relevant for its determination. Under the 'direct or procure' test, Australian courts generally agree that the holding of an office, such as director or even managing director, does not of itself render the office holder liable for the torts of the company, although the actual degree of involvement required is unresolved. Personal liability, however, is not dependent on the director knowing that the conduct is in fact tortious. But there is no agreement as to the extent of involvement required of the director. In *Autocaps (Aust) Pty Ltd v Pro-Kit Pty Ltd*,[236] the director was liable as the person 'in charge of its affairs' and with knowledge of the offending behaviour. *Martin Engineering Co v Nicaro Holdings Pty Ltd*[237] described the director as the 'moving spirit'.[238] In *Australasian Performing Right Association Ltd v Jain*[239] a director was liable for 'countenancing' the breach.

Canada[240] is in a similar position to Australia in relation to the imposition of personal liability on directors, in that there is diversity of judicial opinion on the matter. The Federal Court of Appeal in *Mentmore,* discussed above, has noted that formulating a test of general application is a difficult task, and that courts will have 'regard to the particular circumstances of each case to determine whether as a matter of public policy they call for personal liability'.[241]

While *Mentmore* laid down the 'make the tort his own' test, the Court of Appeal of Ontario applied the rule in *Said v Butt*[242] in *ADGA Systems International Ltd v Valcom Ltd*.[243] Carthy JA found that the rule:

> provides an exception to the general rule that persons are responsible for their own conduct. … The exception also assures that officers and directors, in the process of carrying on business, are capable of directing that a contract of employment be terminated or that a business contract not be performed on the assumed basis that the company's best interest is to pay damages for failure to perform. By carving out the exception for these policy reasons, the

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[234] *Root Quality Pty Ltd v Root Control Technologies Pty Ltd* (2000) 177 ALR 231*; Microsoft Corp v Auschina Polaris Pty Ltd* (1996) 142 ALR 111.
[235] *King v Milpurrurru* (1996) 34 IPR 11.
[236] (1999) 46 IPR 339.
[237] (1991) 100 ALR 358.
[238] 'Moving spirit' is the expression also used by Sundberg J in *Pioneer Electronics Australia Pty Ltd v Lee* [2000] FCA 1926, [46] in finding a director liable for the torts of breach of copyright and passing off. His Honour looked at the various tests of liability, commenting that '[t]he law on the personal liability of a director for corporate torts is in an uncertain state. There seem to be at least four views having judicial support.' at [45]. He noted that the director 'directed and *promoted*' the breaches, at [46] (emphasis added).
[239] (1990) 26 FCR 53.
[240] See further Sarra, above n 12.
[241] *Mentmore Manufacturing Co Ltd. v. National Merchandising Manufacturing Company Inc.,* [1978] F.C.J. No. 521 at [23], [25] and [28].
[242] [1920] 3 KB 497.
[243] (1999) 168 DLR (4th) 351.

> court has emphasised and left intact the general liability of any individual for personal conduct.[244]

The court found that this exception applies where the directors are procuring a breach of a contract to which *their own company* is a party. Carthy JA found on the facts that the directors of a company which intentionally procured the breach of contract of employees of *another* company, in a recruitment exercise, were personally liable for the tort.[245] In addition, despite the *Said v Butt*[246] exception, Carthy JA stressed the consistent line of Canadian authority which holds that 'in all events, officers, directors and employees of corporations are responsible for their tortious conduct even though that conduct was directed in a bona fide manner to the best interests of the company.'[247]

In **New Zealand**,[248] the assumption of responsibility rule from *Trevor Ivory* is now being applied beyond negligent misstatement cases to 'leaky building' cases. [249] The test has been used as an obstacle for property damage claims against directors, although it was distinguished in *Dicks v Hobson Swan Construction Ltd (in liq),*[250] on the basis of the director's actual involvement in the project.

In the **United Kingdom**,[251] a similar debate on the personal liability of a director qua director in tort has arisen. The House of Lords[252] in *Williams v Natural Life Health Food Ltd and Mistlin*[253] upheld the 'assumption of responsibility' test in a case of negligent misstatement. Lord Steyn acknowledged the potential for director liability by noting that 'whether the principal is a company or a natural legal person, someone acting on his behalf may incur personal liability in tort as well as imposing vicarious or attributed liability upon his principal'.[254] Lord Steyn held that neither the defendant's state of mind nor his internal arrangements with his company were relevant to the inquiry, but rather 'whether the director, or anybody on his behalf, conveyed directly or indirectly to the prospective franchisees that the director assumed personal responsibility towards'[255] them.

Approving *Trevor Ivory*,[256] he found that where a director acts in the capacity of director, he will not be liable. His Lordship considered that the finding of a *Hedley*

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[244] Ibid 357.
[245] Similar facts led to the same result in *Multinail Australia Pty Ltd v Pryde (Aust) Pty Ltd* [2002] QSC 105. Chesterman J confined the rule in *Said v Butt* to cases where the director procured a breach of their own company's contract, finding that the 'direct or procure' test was applicable otherwise, at [126].
[246] [1920] 3 KB 497.
[247] (1999) 168 DLR (4th) 351, 358.
[248] See further Noonan and Watson, above n 23.
[249] Ibid; see also S Carpenter, 'Directors' Liability and Leaky Buildings' [2006] NZLJ 117; N Campbell, "Leaking Homes, Leaking Companies" [2002] CSLB 101.
[250] *Dicks v Hobson Swan Construction Ltd (in liq)* (2006) 7 NZCPR 881.
[251] Lowry, above n 63.
[252] Lord Steyn, with Lord Goff, Lord Hoffman, Lord Clyde and Lord Hutton concurring.
[253] [1998] 1 WLR 830. See further Ross Grantham and Charles Rickett, 'Directors' "Tortious" Liability: Contract, Tort or Company Law?' (1999) 62 *Modern Law Review* 133; Andrew Borrowdale, 'Directors' Liability in Tort' [1999] *New Zealand Law Journal* 51.
[254] [1998] 1 WLR 830, 835 (emphasis added).
[255] Ibid.
[256] [1992] 2 NZLR 517.

Byrne & Co Ltd v Heller & Partners Ltd[257] special relationship between plaintiff and company is not the same as one between plaintiff and director. The key issue was whether the director had acted in a way that exceeded his corporate authority as a director, so that any accountability for the tortious act became his alone. He stated:

> in order to establish personal liability under the principle of Hedley Byrne, which requires the existence of a special relationship between plaintiff and tortfeasor, it is not sufficient that there should have been a special relationship with the principal. There must have been an assumption of responsibility such as to create a special relationship with the director or employee himself.[258]

Dealing with criticisms of the assumption of responsibility test, Lord Steyn said:

> Returning to the particular question before the House it is important to make clear that a director of a contracting company may only be held liable where it is established by evidence that he assumed personal liability and that there was the necessary reliance. There is nothing fictional about this species of liability in tort.[259]

However, the law is not settled. In the *Standard Chartered Bank* case, Lord Hoffmann rejected the earlier appellate view in that case, [260] holding that '[n]o one can escape liability for fraud by saying "I wish to make it clear that I am committing this fraud on behalf of someone else and I am not to be personally liable."'[261]

In **Malaysia**, it is rare to find cases where directors have been found personally liable for the tortious actions of their companies. One such decision was that of the Court of Appeal in the case of *Victor Cham v Loh Bee Tuan*.[262] The Court found a director personally liable in deceit in relation to fraudulent misrepresentations contained in a sale and purchase document prepared by his company. The Court applied English authorities[263] in holding that the director had authorised or procured the company to commit the fraudulent misrepresentation. [264]

South Africa is in stark contrast to the jurisdictions discussed above. The law of delict, as tort law is known in South Africa, has no difficulty attributing personal liability to directors. This is despite the fact that directors are simply carrying out their duties on behalf of the company. Therefore, the issue of whether the directors directed or procured the wrongful act of the company does not arise in South African company law.[265]

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[257] [1964] AC 465.
[258] [1998] 1 WLR 830, 835.
[259] [1998] 1 WLR 830, 837.
[260] [2001] 1 Lloyd's Rep 218, 233 (Aldous LJ).
[261] [2003] 1 BCLC 244, 252.
[262] [2006] 5 MLJ 359, [13].
[263] *Rainham Chemical Works Ltd v Belvedere Fish Guano Co Ltd* [1921] All ER 48 and *Performing Rights Society Ltd v Ciryl Theatrical Syndicate Ltd* [1924] 1 KB 1.
[264] See also *Loh Bee Tuan v Shing Yin Construction (Kota Kinabalu) Sdn Bhd* [2002] 2 MLJ 532, [540]. In Victor *Cham*, at [366], the court referred to and approved of the decision of the Privy Council in *Wah Tat Bank Ltd v Chan Cheng Kum* [1975] 2 All ER 257 (a decision on appeal from the Malaysian Supreme Court). In that case, Lord Salmon, (at 272) applied the 'direct or procure' test in imposing personal liability on the director.
[265] See further M Havenga 'Directors' Co–liability for Delicts' (2006) 18 *South African Mercantile Law Journal* 229.

Korea adopts a different method to find directors liable for their own fault. The Korean Commercial Code provides that

> where a director (1) has acted in violation of any laws and regulations, or of the company's articles of incorporation or (2) has neglected to perform his or her duties, such director shall be jointly and severally liable for damages *to the company* resulting from such acts or omissions.[266]

Directors are also liable where the act in question is done in accordance with a resolution of the board, and they have either assented to the resolution, or failed to have their dissenting opinion entered into the company minutes. While liability is to the company, the party affected by the directors' negligence or other fault sues the company, and then the company recoups this amount from the director.

4. Conclusion

This Section has looked at three areas of law where there is considerable dissimilarity in the jurisdictions surveyed. Insolvent trading, which acts to protect unsecured trade creditors, has wide international variations. Many countries have a requirement of fault, sometimes in terms of fraud, negligence, recklessness or breach of duty. Few impose objectively assessed liability subject to limited defences. The format of the various pieces of legislation differs as well. Even relatively stringent legislative regimes such as Australia's is not without its difficulties in terms of recovery for the parties affected by the conduct. Canada, unlike other Commonwealth countries, has no insolvent trading laws at all.

Employee entitlements receive very limited legislative protection in the countries examined. Canada's is the most generous in imposing a strict liability regime, subject to a due diligence defence. The subjective element in Australia's test renders it useless, necessitating a government assistance scheme funded by tax payers. New Zealand's scheme relies on the initiative of a government official, and is limited in the amounts recoverable. The other countries examined above have no laws imposing liability on directors.

The rights of tort claimants in some of the Commonwealth countries were scrutinised. There is no relevant legislation, and it was seen that courts have struggled to enunciate tests of general application. In part this is because of a misunderstanding of the laws of attribution. The director is seen as the directing mind and will of the company, and therefore his actions become the actions of the company itself, rather than his own. Something special needs to be done to make the director personally liable for the tort, such as 'making the tort his own' or an 'assumption of [personal] responsibility'.

Employees of companies committing torts are personally liable for their actions without any question, in addition to the company's vicarious liability. Directors' liability for their own tortious conduct is recognised in jurisdictions such as South

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[266] *Commercial Code* (Korea) s 399 (emphasis added).

Africa and Korea. There is nothing in the doctrine of limited liability[267] or separate legal entity which prevents a director's actions being attributed to the company for the purpose of making the company vicariously liable, *as well as* being a basis for personal liability. Indeed, this point is made abundantly clear in the examination of the legislation in Section B and in this Section. If legislatures want to protect a given cohort of corporate stakeholder, such as subscribers to offers of shares, they can simply impose personal liability on directors. The difficulty faced by tort claimants is that there is no legislative will to protect them. A possible reason for this will be discussed in the next Section.

D. REASONS FOR SIMILARITY AND DIVERSITY

The preceding examination of the similarity and diversity of laws between various jurisdictions inevitably leads to the question of why this should be so. Indeed, it is equally valid to question why they should be similar, as it is to exclaim at their differences.

Nonetheless, it seems appropriate, after an extensive examination of these laws and jurisdictions, to speculate on why these laws are the way they are. It should be noted much of the comparative corporate law literature on convergence and divergence concentrates on the broader governance debate, rather than the narrower focus on directors' liability for their companies' faults and defaults. Nonetheless, the same forces appear to be applicable to the present enquiry. Broadly speaking, these can be summarised as political, economic, practical, and evolutionary (or path dependent).

Political influences both towards and against similarity are numerous. They include pressure from interest groups and institutions,[268] such as business associations, trade unions, employer groups, consumer organisations, and local and international environmental lobbies. While there may be pressure to reform the law to acknowledge the needs of the group's particular constituents, often vested interests can actively work to protect themselves against legislative reform.[269] Responses to corporate scandals can result in knee-jerk legislative reform tailored to the particular situation, [270] as can a major environmental disaster.[271] The political persuasion of the incumbent government will also affect its stance on corporate law reform,[272] as will

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[267] This doctrine relates to the liability of shareholders to contribute to the debts of the company upon its liquidation.

[268] Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2000) 89 *Georgetown Law Journal* 439, 453.

[269] Hansmann and Kraakman, above n 268, 459.

[270] Jennifer Hill, 'The Persistent Debate about Convergence in Comparative Corporate Governance' (2005) 27 *Sydney Law Review* 743, 750: '[P]ost-Enron regulatory developments are a potent reminder that corporate events of this magnitude can generate new divergence in laws'. Hill cites here the introduction in the United States of the Sarbanes Oxley legislation, and in Australia, of CLERP 9. 'The architecture of these laws often directly tracks the contours of local scandals.' Ibid 751. See further Jennifer Hill, 'Regulatory Responses to Global Corporate Scandals' (2005) 3 *Wisconsin International Law Journal* 367.

[271] For example, the CERCLA laws in the United States, discussed at Section B 3 above, which were enacted in response to the environmental damage caused at Love Canal.

[272] This can include calls to reduce the compliance burden on business, which can result in less legislative intervention in corporate business.

the extent to which law is made by the courts, as opposed to the legislature.[273] Some countries have more sophisticated theoretical frameworks and existing mechanisms, such as Law Reform Commissions and dedicated parliamentary committees, for the process of law reform than others.

Other relevant political factors include whether the country is run by a democratically elected government or not,[274] levels of judicial and legislative accountability, and the overall transparency of the political process. The law as it is applied can also differ from the 'law on the books', due to lack of political will to enforce it.[275] This is sometimes the result in a country into which law has been transplanted, perhaps by former colonial governors.[276]

There can also be implicit or explicit political pressures to adopt certain laws from outside the country, for example, in order to be accepted into a trade group or other alliance. The European Union is a good instance of this phenomenon.[277] Membership can in some instances be contingent on adoption of harmonised laws, although these are not always successful in the absence of supporting institutions and culture.[278]

There are also a multitude of economic influences which primarily drive similarity of laws. Access to the international market for capital can be a major motivating force for harmonisation of laws, and the capital raising laws across the various jurisdictions outlined above provide evidence of this. There is also a 'force of example'[279] argument, whereby jurisdictions adopt the laws of successful economies, in an attempt to match their economic achievements. For example, Hansmann and Kraakman claim that the predominance of the shareholder primacy model will inevitably lead to widespread convergence of the institutions of corporate governance.[280]

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[273] Pistor et al note that 'Legal systems that have facilitated this process of adaptation and were able to respond to new legal lacunae created by change have proved to be more successful over time. From the perspective of legal innovation, common law countries have been more successful than civil law countries ...'. K Pistor, Y Keinan, J Kleinheisterkamp and M D West, 'The Evolution of Corporate Law: A Cross-Country Comparison' (2002) 23 (4) *University of Pennsylvania Journal of International Economic Law* 791, 794.

[274] There are endless varieties of democracies too: Otto Kahn-Freund, 'On Uses and Misuses of Comparative Law' (1974) 37(1) *Modern Law Review* 1, 11-12.

[275] Hill, 'Persistent Debate' above n 270, 747.

[276] Malaysia is an example.

[277] See for example, Paul J Omar, 'The Emergence of a New European Legal Order in Insolvency' (2004) *International Company and Commercial Law Review* 262; Paul J Omar, 'Four Models for Rescue: Convergence or Divergence in European Insolvency Laws? Part I' (2007) *International Company and Commercial Law Review* 127; Paul J Omar, 'Four Models for Rescue: Convergence or Divergence in European Insolvency Laws? Part 2' (2007) *International Company and Commercial Law Review* 171; M C di Luigi, 'An Invasive Top-Down Harmonisation or a Respectful Framework Model of National Laws? A Critique of the Societas Europaea Model' (2008) *International Company and Commercial Law Review* 58.

[278] Hill gives the example of the transplantation of corporate governance laws to Russia in the 1990's commenting upon the 'conundrum of corporate governance – the fact that the transplantation of demonstrably good laws may be totally ineffective' Hill, 'Persistent Debate' above n 270, 750 (footnotes omitted).

[279] Hansmann and Kraakman, above n 268, 450.

[280] According to Hansmann and Kraakman, '[t]here are three principal factors driving consensus on the standard model: the failure of alternative models; the competitive pressures of global commerce; and the shift of interest group influence in favour of an emerging shareholder class.' Ibid 443.

The prevalence of multinational corporations and their desire to operate in acceptable regulatory environments is also a factor, as is the need for cross listing on foreign stock exchanges. The pervasiveness of international legal, accounting and consulting firms, as well as investment banks, can also lead to a demand for more homogeneity in corporate laws. [281] Not all economic influences, of course, lead to convergence of laws. It can in fact be more economically efficient to have different laws, to take advantage of local conditions.[282] It is true to say that some multinationals might deliberately seek to locate some of their operations in countries with more liberal laws than their original countries of incorporation, precisely to avoid certain stringent requirements, for example in relation to labour laws or emissions controls.

Practical considerations can mitigate against following the examples of legislative reform set by other countries. Inertia is a powerful force, since law reform of any kind, including convergence with other jurisdictions, generally requires legislative action, often following extensive and costly government consultation processes. The availability of alternative means of protecting a certain cohort of corporate stakeholders can also result in dissimilarities of laws, simply because the foreign laws are not required; on the other hand, where protection cannot be found through other means, such as contract, the 'force of logic'[283] can drive relevant stakeholders to seek a superior method of protection, often borrowed from another jurisdiction.

The issue of evolution of local laws and path dependence [284] can have a marked effect on the uptake of laws originating in other jurisdictions. The similarities of laws amongst Commonwealth countries demonstrate their common ancestry, but they also owe much to similarities in culture, property rights, parliamentary and judicial systems, accounting standards and a variety of other supporting mechanisms. This is known in the literature as 'complementarity',[285] where laws which fit well with a broad range of local institutions are likely to survive.

Conversely, laws which are inconsistent with their local environment, possibly because they were transplanted from a jurisdiction with different norms, are less likely to be successful or remain true to their original format. Schmidt and Spindler note that the cost of changing laws or institutions may outweigh the possible efficiency or welfare gain which the change is intended to achieve.[286] There needs to be a commitment to maintain the newly introduced laws, [287] which, by definition, did not originate organically from that country, and therefore are arguably unlikely to be a

[281] Ibid 449.
[282] Ibid 464.
[283] Ibid 449.
[284] In relation to corporate governance, see for example Lucien Bebchuk and Mark J Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1999) 52(1) *Stanford Law Review* 127.
[285] Ibid 140; R H Schmidt and G Spindler, 'Path Dependence, Corporate Governance and Complementarity' (2002) 5 (3) *International Finance* 311.
[286] Scmidt and Spindler, above n 285, 314.
[287] Bebchuk and Roe describe the tendency to revert to prior practice as 'persistence', above n 284, 136.

'natural fit'. Schmidt and Spindler stress that 'a local optimum may be different from a global optimum'.[288]

Kahn-Freund points to the degree of adjustment required to suit the laws' new home and the chances of rejection of the transplant, making an analogy between the transplantation of a kidney from one body to another and of a carburetor from one car to another.[289] Any particular instance of transplantation of laws is a point on this continuum from kidney to carburetor, and is affected by the political, economic, practical, and evolutionary factors outlined above. Kahn-Freund also points to environmental factors such as increasing industrialisation, urbanisation, world-wide communications and the ease of movement of people as contributing to a more homogenous world for law, including corporate law. [290]

Of course, the issue of convergence and divergence of laws across jurisdictions needs to be considered against the background of the need for laws to grow and develop within jurisdictions. Each individual instance of legal evolution, especially in response to the political and economic needs of the particular country as noted above, has the capacity to bring further diversity to laws.[291]

This Section has sought to examine briefly why laws may be similar or different across jurisdictions. It does not seek to conclude whether they *should* be similar or different. What has become apparent from the examination of the six areas of law in this article is that similarity of laws is associated with the protection of powerful corporate stakeholders – shareholders and revenue authorities, as well as the conspicuous environment lobby – whereas diversity of laws correlate with vulnerable and often forgotten stakeholder cohorts – unsecured trade creditors, employees and tort creditors.

The fact that stringent laws correlate with widespread international similarity, and conversely that lenient laws correlate with widespread dissimilarity, perhaps should come as no surprise. It is arguable that the reasons behind their stringency underpin their adoption throughout the jurisdictions examined. For example, it was noted above that many jurisdictions have laws requiring directors to pay the unremitted taxes of their companies at the time of corporate insolvency. It is unsurprising that protecting the national revenue base is a major political consideration throughout the world, and that similar measures of providing against corporate default should be embraced.

Likewise, the extensive acceptance of similar capital raising laws reflects the globalisation of the international securities market and the need to ensure the confidence of shareholders. Common or similar laws in relation to the protection of the environment, demonstrates the effectiveness of national and international lobby groups. It also shows recognition by governments that the protection of the

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[288] Scmidt and Spindler, above n 285, 315: 'What constitutes the nearest, and seemingly most attractive, local optimum depends on the starting point at which a given biological or social system happens to be at a given point in time'.
[289] Kahn-Freund, above n 274, 5-6.
[290] Ibid 9.
[291] Pistor et al note that '[t]he corporation has been a remarkably resilient institution for 200 years of industrialisation and modernisation largely because of its capacity to adapt constantly to a changing environment.' Above n 273, 793-4.

environment is important for political and economic reasons, as well as for its own sake.

In contrast, the protection of vulnerable stakeholder groups[292] – unsecured trade creditors, employees and tort claimants – is internationally diverse. Employees generally benefit from unemployment benefits and sometimes from government schemes, which takes much of the impetus away from calls to hold directors personally liable for their unpaid entitlements. Trade creditors get relatively little sympathy from courts and legislators, and are expected to protect themselves through a variety of measures such as diversification and through pricing their goods and services to self-insure against loss. As a disparate group, they lack the political power to lobby for a better deal. Likewise, tort creditors lack a common voice to call for legislative protection, in the event of corporate insolvency.

This leads to a simple hypothesis – that the forces which have resulted in stringent laws within a country are the same as those which lead to convergence internationally. The converse applies equally - the forces which have brought about a tepid response to protection of a stakeholder group within a country tend to produce laws which are not likely to be emulated internationally.

Another, perhaps cynical, observation can be drawn from the examination of the laws in Parts II and III. It is that when legislators are committed to defending a particular institution – in particular, the revenue base and the securities market – the laws they pass can be quite draconian, with very little opportunity for directors to escape liability. There is no apparent fear that the imposition of liability will make directors risk averse, to the detriment of their companies and the economy, or that talented businesspeople will be reluctant to accept directorships with such a harsh liability regime.

This sort of argument, in Australia at least, appears to be reserved for discussions of liability in relation to insolvent trading or the protection of employee entitlements,[293] yet it has been shown above that these are two of the least generous forms of protection available to corporate stakeholders. Australia's new government is raising the issue again, and it will be interesting to see what forms of directorial liability come under the closest scrutiny in this regard.

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[292] See further Jonathan Lipson, 'Directors Duties to Creditors: Power Imbalance and the Financially Distressed Corporation' (2003) 50 *UCLA Law Review* 1189, 1193. Interestingly, Lipson includes taxing authorities in his description of 'low VCE creditors'. These are parties who 'lack volition, cognition and exit'. This describes creditors who lack voluntariness in their dealings with the company (tort creditors, taxing authorities, terminated employees); lack information (cognition) about the true state of company affairs; and lack the ability to exit from these relationships because of the absence of a market to sell their rights against the company.

[293] Byrne has argued that 'the more serious cost is the effect the liability regime will have on the performance of the director. Their inability to efficiently cope with the liability would logically mean further incentive to avoid the riskier ventures which raise the potential losses. It is this cost which may be seen to be of significant social consequence. It is extremely difficult to measure the size of such cost and, therefore, whether or not it will outweigh the benefits to creditors …'. Mark Byrne, 'An Economic Analysis of Directors' Duties in Favour of Creditors' (1994) 4 *Australian Journal of Corporate Law* 275, 283. See also V Yeo and J Lin, 'Insolvent Trading – A Comparative and Economic Approach' (1999) 10 *Australian Journal of Corporate Law* 216, 234; David Noakes, 'The Recovery of Employee Entitlements in Insolvency' in Ian Ramsay (ed), Company Directors' Liability for Insolvent Trading (2000) 129, 139.

E. CONCLUSION

Jurisdictions throughout the world lift the corporate veil to impose liability on directors for corporate faults and defaults. A range of jurisdictions and six areas of law were chosen here for comparison. It was seen that there was widespread similarity in the laws relating to capital raising, and also considerable overlap with laws relating to the recovery of unremitted taxation instalments and protection of the environment. On the other hand, there was noticeable dissimilarities with insolvent trading laws, recovery of employee entitlements and protection of tort creditors.

This served to illustrate two points - that there are many ways in which to legislate to achieve similar objectives, and that in certain areas, some governments do not consider legislation to be required whereas others consider it necessary.

While there are many reasons for convergence and divergence of laws, based on political, economic, practical and evolutionary reasons, this article noted a pattern appearing from the areas of law examined – that areas of stringent liability on directors broadly but not precisely corresponded with widespread international adoption of similar laws, and conversely that more lenient laws were unlikely to be copied internationally. In other words, even where formats differ, governments appear to agree on which questions of law require a firm legislative response, and which do not. Whether these assessments are correct is a matter for other research.[294]

[294] See for example, Helen Anderson, 'Corporate Social Responsibility – the Case for Unsecured Creditors' (2007) 7(1) *Oxford University Commonwealth Law Journal* 93 – 124; Anderson, 'Suggestions for reform' above n 73.