This is the fifth in our series of short articles in which we try to shed light on some of the more confusing areas of the Companies Act 2006 (the “Act”). Since the topic of criminal offences under the Act is one which it is easy to gloss over, this article addresses a number of potentially confusing aspects of the law in the context of an overview of the Act's approach to criminal sanctions. It considers, among other things, a change from the Companies Act 1985 regime the effect of which is that a director can now commit a variety of criminal offences without actually intending to do anything wrong.

Background

Even those who use the Companies Act 2006 regularly can fall into the trap of neglecting to think about its general approach to criminal offences. We tend to note that a breach of a particular provision with which we are working constitutes a criminal offence, do all we can to avoid committing a breach and then, assuming we are successful, dismiss the matter without further thought.

Some elements of the Act's approach are not, however, obvious at first glance, and the following questions raise interesting points:

- how widely does the Act use the threat of criminal sanctions for a breach of its provisions? Clearly, certain provisions carry a criminal sanction, but what is the big picture?

- who is caught when, as if often the case, a provision imposes criminal liability on every officer of the company "who is in default"?

- in relation to such provisions, is the position of a corporate director any different from that of a director who is a natural person?

- how does a “daily default fine” for continued contravention of a provision work?

- does it really matter if you breach a provision which carries a criminal sanction?

Extent of the Act’s reliance on criminal offences

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The Act contains a surprisingly large number of criminal offences. Most of them are designed to punish misconduct by companies and directors, but some address the conduct of shareholders and even third parties. The offences are spread across a wide range of provisions; they are not restricted to substantive matters (such as the approval of accounts) but also cover matters which are essentially administrative (such as the obligation to keep copies of resolutions passed as written resolutions).

By way of an illustration of the variety of situations in which criminal liability can arise:

- if a company fails to file a special resolution with the registrar within 15 days after it is passed, the company and any officer who is in default commit an offence (section 30)

- if a company fails to include the required details in its register of directors, the company and any officer who is in default commit an offence (section 162)

- a director who fails to declare an interest in an existing transaction with the company commits an offence (section 183)

- where a sole shareholder takes a decision but fails to notify the company in accordance with section 357, he commits an offence

- where the directors fail to prepare a directors' report for a particular financial year, any director who failed to take reasonable steps to ensure that a report was prepared commits an offence (section 415).

The question as to whether it is appropriate for the Act to rely on criminal sanctions as heavily as it does is considered briefly at the end of this article. Whatever one's view, it is worth noting that at present the field of general company law contains a wider range of criminal offences than one might expect.

When is an officer "in default"?

Many of the Act's provisions on criminal offences impose liability on "every officer of the company who is in default". In relation to the requirement in section 336(1) for public companies to hold an AGM, for example, section 336(3) states: "If a company fails to comply with subsection (1) ..., an offence is committed by every officer of the company who is in default."

As is so often the case, it is dangerous to assume that words must be given their natural meaning, for "in default" is in fact a defined expression. The Act specifies that a director is in default if he "authorises or permits,
participates in, or fails to take all reasonable steps to prevent” a contravention (section 1121).

This is a wide definition, and a considerable departure from the position under the Companies Act 1985, which caught only those directors who "knowingly and wilfully" authorised or permitted the contravention. The effect of the new definition is that a director can find that he has committed a criminal offence without having the slightest intention of doing anything wrong. Although it is too early to say what impact the new definition will have in practice, this is in theory a significant change, and one of which directors need to be aware. Take, for example, the case of a director of a private company which has decided to dispense with its secretary. If he has not taken reasonable steps to ensure that measures are in place to ensure that the company complies with its filing obligations, he could potentially find that he has committed a criminal offence if the company fails to file a special resolution with the registrar as required by section 30.

What is the position of a corporate director?

In a group of companies, where boards may well include one or more corporate directors (subject, of course, to the proviso that all companies are now required to have at least one director who is a natural person), the question arises as to how the "officer in default" provisions apply to corporate directors.

Under section 1122, a corporate director commits an offence as an officer in default only if one of its own officers is in default. In other words, an officer of the corporate director must have authorised, permitted, participated in or failed to take all reasonable steps to prevent the breach. If this test is met, the offence is committed not only by the corporate director, but also by that officer.

How does a "daily default fine" work?

A number of provisions state that anyone who is guilty of an offence is liable not only to a one-off fine, but also to a "daily default fine" for continued contravention. The effect of this may seem obvious: a conviction results both in a one-off fine and in an additional fine for every day for which the breach continues.

This is not, however, the correct reading, for the Act specifies that the daily default fine is triggered only on a second or subsequent conviction (section 1125). Under section 228 (which contains the "daily default fine" wording), for instance, a director who commits an offence in relation to his company's failure to keep its directors' service contracts available for inspection by the shareholders is liable upon a first conviction only to a one-off fine. It is only if he is convicted for a second time that the daily default fine is imposed.

Consequences of a breach
Having established that the Act contains numerous criminal offences, and that there is considerable scope for directors to be caught by the "officer in default" provisions, the next issue to consider is that of enforcement. How likely is it that someone who breaches a provision in the Act which carries a criminal sanction will actually be prosecuted?

The short answer is that, although it depends to some extent on the provision, most breaches probably will not result in a prosecution.

Information on government websites indicates that the offences which attract the most attention from the authorities are those concerning accounts and annual returns. According to Companies House statistics, several thousand prosecutions are brought each year in connection with failures to deliver these documents (although by no means all of the proceedings result in a conviction). Even here, however, it is clear that criminal sanctions are very far from being the preferred option; more than 200,000 companies in England and Wales were subject to a civil penalty in connection with the late filing of accounts in 2009/2010.

Details are not easy to come by, but our understanding is that proceedings in relation to other offences under the Act are rarer still. The work of BIS's criminal investigations division appears to focus on insolvency-related matters rather than breaches of the Companies Act 2006, and the fact that BIS prosecuted a total of just 277 defendants in 2006/2007 suggests that it regards criminal proceedings in relation to the Act very much as the exception rather than the rule.

The fact that criminal prosecutions are relatively few and far between does not, of course, mean that companies and directors should feel free to breach the provisions of the Act. It should be noted, for example:

- that even if the authorities do not bring criminal proceedings, they may take other action in connection with the breach - for instance, they may issue a warning letter
- that a director who picks and chooses which aspects of the company law regime to comply with will almost certainly be in breach of his general duties, including his duty to exercise reasonable care, skill and diligence
- that the Act's requirements are there for a reason - using section 228 as an example again, a breach of the obligation to keep directors' service contracts available for inspection by the shareholders may, in practice, be unlikely to result in criminal proceedings against any of the directors, but the lack of transparency may annoy the shareholders, who have their own means of holding directors to account.
The possibility of reform

On the face of it, it does not seem sensible to keep on the statute books a raft of criminal offences which are rarely used. Is there any point in providing a criminal sanction for breach of the requirement to file special resolutions within 15 days when companies know that, in practice, the chances that they will face criminal proceedings are exceedingly slim?

One argument in favour of retaining little-used offences is that they are a symbol of the seriousness with which the government views a breach. It may not be practicable to take action against everyone who breaches the filing requirement, for example, but it is crucial to the efficient functioning of the UK companies regime that companies disclose details of certain key decisions in a timely fashion, and the use of a criminal sanction is a means by which the government can get that message across. Another argument, of course, is that criminal sanctions act as a powerful deterrent. In our experience, it is certainly true that it sometimes helps to focus clients' minds when we advise them that a failure to comply with a particular provision constitutes an offence.

Whatever the rights and wrongs of the current regime, there does seem scope for the government at least to give some thought to the possibility of reform, and there are two projects in the pipeline which will give it the opportunity to do just that.

- Over the summer, the Law Commission published a consultation paper proposing reforms to the way in which criminal offences are used across a wide range of areas. Although the paper refers to the Companies Act 2006 only in passing, it raises important issues concerning the effectiveness of criminal sanctions generally. It notes, for instance, that many offences are used only rarely, and proposes that low-level offences should be repealed if a civil penalty would suffice to punish wrongdoers and deter those who might be tempted to break the rules. Any changes flowing from the consultation paper are, however, some way off. While the consultation period closes quite soon, on 25 November 2010, the Law Commission's report may not be published until 2012, and no doubt any amendments to the Act which may emerge from the report will take some time to make their way through the legislative machine.

(Quite aside from its implications for company law specifically, the consultation paper contains a useful discussion of the general circumstances in which companies and directors can be found to be criminally liable. The paper runs to more than 240 pages, but it is well-written and anyone with an interest in this area might at least want to dip into the introductory section.)
As we have reported previously, BIS is currently carrying out a wide-ranging review of the Act. The review should, in theory, provide the ideal opportunity to assess whether the legislation strikes the right balance in its use of offences. That said, the very scope of the review may prevent the government from considering any but the most pressing issues, and the effectiveness or otherwise of the sanctions regime may not be at the top of its list of priorities.