

# SHOULD FAILING TO ACT DILIGENTLY BE A CRIME?

ADRIAN CHAN

Most people think that so long as they do not cheat, steal or act dishonestly, they would have carried out their duties as directors under the law.

However, this is not the case in Singapore and it should be realised that the standard of governance for directors sets a much higher bar than that.

What's more, the penalties for failing to exercise proper due diligence can be very high. In fact, it can be criminal.

## CRIMINAL SANCTIONS

The 2008 case of Chuan Soon Huat Industrial Group Limited is an important example. It is the first time that independent directors were convicted of a crime and punished for management's failure.

Chuan Soon Huat was a timber door maker, listed on the Singapore Exchange. The board of directors failed to disclose that the executive chairman was ill and no longer discharging his duties, and that there had been a change in effective control of the company.

This omission was deemed to be a breach of the obligations of a listed company to announce any information likely to materially affect the value of its securities.

Several directors including the two independent directors were charged and found guilty of the omission. The independent directors were fined and disqualified from acting as directors for a period of time. Chuan Soon Huat was eventually delisted from the Singapore Exchange.

A year later, in the AirOcean Group Limited case, Ong Chow Hong, the non-executive chairman and independent director, was found guilty of failing to use reasonable diligence in the discharge of his duties by approving the release of a public announcement by a listed company without reviewing the contents of the announcement. He was fined and disqualified from acting as a director.

Both these cases illustrate the application of Section 157(1) of the Companies Act. This provision places an obligation on directors to act honestly and to use reasonable diligence in the discharge of the duties of their office. The breach of this duty may constitute a criminal offence punishable by a fine and/or a jail sentence.

Put simply, under Section 157(1), one does not necessarily have to be guilty of fraud or negligence or show any loss to shareholders to be charged and convicted. Just failing to act diligently

can be criminal.

The question is: should this be so?

## DECRIMINALISING DIRECTORS' DUTIES

There is a clear distinction between fraud and dishonesty versus failing to act diligently.

When a director acts fraudulently or dishonestly, he or she usually derives a personal benefit. In contrast, failing to act diligently is not ordinarily prompted by personal gain.

Understandably, failing to act diligently can result in the company or other parties suffering losses. However, this can be addressed by having adequate safeguards to compensate for such losses and holding the director accountable for the loss.

Civil penalties and other compensatory remedies suffice for this purpose.

The present onerous provisions of the Companies Act can deter good candidates from becoming directors. In practice, it can also lead to directors conveniently stepping down at the first sign of trouble, rather than staying to help the company move forward.

The present regulatory framework should therefore be changed to ensure a proper balance between compensation, deterrence and punishment. Unfortunately, the recently proposed amendments to the Companies Act still do not decriminalise directors' duties.

As these amendments are debated in Parliament later this year, this matter should be revisited. At the minimum, we should institute mitigating measures to exempt directors from liability. Already, corporate and securities laws recognise situations where a director is not liable, such as when he acts honestly and reasonably.

The Companies Act gives the Court discretion to excuse a director from liability for negligence in civil proceedings under

such circumstances.

The Securities and Futures Act has provisions for instituting civil (rather than criminal) proceedings where there is no fraud or dishonesty involved.

A practical deterrent can be found in the Court's ability to disqualify directors who have failed to act diligently from acting as directors or management of companies for a prescribed period (as is presently the case for criminal convictions under Section 157). The concept appears to have worked well in the context of securities regulation and is a viable tool for regulators to take action against errant directors without resorting to criminal sanctions.

After all, the breach of a director's duty to act with reasonable care and diligence is no longer a crime in several other common law jurisdictions such as the UK and New Zealand. The time has come to adopt the same position in Singapore. ■