

CONSULTATION

Criminal Sentencing (Equity Fines) Bill

Proposal for a Bill to allow courts to obtain pre-sentence company background inquiry reports and impose equity fines.

Public consultation by

Dr. Bill Wilson MSP
July 2008

Supporting Statements

Centre for Corporate Accountability¹

“Bill Wilson's proposal to introduce equity fines is important because it seeks improved accountability of those that profit most from safety crimes.”

Families Against Corporate Killers²

“Very often it is workers or members of the public that bear the costs of fines for corporate manslaughter and homicide. Those proposals begin to challenge this gross injustice.”

Fire Brigades Union Scotland³

“Scotland must mark itself out as a fair and just society, where business is able to conduct its undertakings but must do so in a responsible and equitable environment.

“We would encourage the [equity fines] option to be available for as wide a range of offences as possible....”

Hazards Campaign⁴

“The Hazards Campaign fully supports these proposals for equity fines as an innovative and effective way of ensuring that companies rather than their workers are punished for committing serious crimes.”

¹ The Centre for Corporate Accountability is a human rights charity that provides advice to the bereaved and campaigns to enhance corporate accountability for safety offences.

² Families Against Corporate Killers is a support network of families who have been bereaved by deaths at work and are working for improved justice and accountability.

³ This extract has been taken from a longer statement. The full statement may be viewed in Annex D.

⁴ The Hazards Campaign is a network of trade union safety representatives that works for improved safety at work.

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In a Nutshell...

That monetary fines are ineffective deterrents to breaches of Scots criminal law has been widely argued. The recent ICL/Stockline report suggested an alternative penalty for criminal offences committed by companies, namely equity fines:

The ICL/Stockline Disaster: An Independent Report on Working Conditions Prior to the Explosion⁵ Universities of Strathclyde and Stirling, August 2007

“One solution developed by lawyers in the US is to impose fines upon the value of the firm, rather than upon its running costs. ‘Equity fines’ enable the courts to order offending companies to issue a set number of new shares in the firm that are [placed in a fund administered by the state]. This system punishes those that benefit the most from corporate offending (owners and shareholders) and avoids redistribution of corporate punishments to the most vulnerable groups. Such a system could greatly improve corporate criminal accountability.”

A Proposal for A New Sentencing Option

I am suggesting the introduction of this new sentencing option in Scotland (equity fines) to improve the ability to punish companies found guilty of criminal offences under Scots law, and therefore also to deter them from committing criminal acts, including (but not exclusively) those which may result in death and injury to individuals, or damage the environment.



Dr Bill Wilson MSP

It is forbidden to kill; therefore all murderers are punished, unless they kill in large numbers and to the sound of trumpets. (Voltaire)

⁵ Beck, M. *et al.* Available from WWW: http://www.hazards.org/icldisaster/icl_stockline_report.pdf [cited 22 July 2008].

Executive Summary

Penalties for corporate offences in Scotland should ensure that those who manage companies, and their shareholders, are motivated to make the necessary investments to provide safe environments for employees and members of the public as required by existing law.

In the large majority of cases, companies found criminally responsible for offences that result in death or injury currently have only minimal fines imposed upon them. Data presented in this document suggest that fines imposed at current levels are nowhere near sufficient to act as an effective deterrent. When it comes to corporate offending, justice, in the sense of fair punishment, is rarely seen to be done.

A further problem with the current system of monetary fines is that companies remain free to find the revenue to pay the fine from within their operating costs. This means that costs can be passed on to workers and consumers in the form of wage cuts, poorer service or price increases. In other words, the punishment can bite hardest on those groups that may have been victims of the offence in the first place.

Equity fines aim to overcome those problems. This approach to fining would enable courts to order convicted companies to issue a set number of new shares. The proceeds of those shares are then handed over to the state authorities. Such a system would punish those that benefit the most from corporate offending (owners and shareholders) and avoid the costs of punishment being passed on directly to workers or consumers. A system of equity fines has the potential to greatly improve accountability for corporate criminal offences.

The legislation proposed here would give the courts the option to impose equity fines on public companies found guilty of criminal offences. It is envisaged as the first stage in the development of a more comprehensive equity fines system which might eventually apply to both public and private companies. A supplementary proposal is to allow courts to order company background inquiry reports to help them set more effective sentences.

The objective of this consultation is to elicit the views of interested parties during the initial development of a parliamentary bill, a preliminary draft of which is provided in Annex A. Responses are invited from those who may be affected by the proposal and from those who have an interest in improving corporate accountability.

What is an Equity Fine?

An equity fine is a replacement for the standard monetary fine. In lieu of a monetary fine, the convicted company is obliged to issue a set number of new shares in the firm. These are then sold and the proceeds paid to the court. In effect, an equity fine is a fine which is imposed upon the value of the firm, rather than being imposed upon its running costs.

Why an Equity Fine?

An equity fine dilutes the value of the shareholding but does not directly impact upon the operational status of the company. By avoiding damaging operational status, the workforce, who may well have been the victims of the offence, are less likely to find themselves in a position whereby the continuation of the company, and thereby their employment, is in jeopardy. Under the current system of monetary fines, it is possible for a company to offset the costs of a conventional fine by reducing wage expenditure, cutting back on service, or increasing the price to the consumer in the short term. The resultant wage cuts, freeze on wage increases, or the dismissal of employees, all direct the costs of the fine towards the workforce and away from those who carry the responsibility for the crime. Clearly, any penalty which targets the guilty rather than the innocent is superior to one which does not. Equity fines, which impact upon shareholders, cannot be directly passed on to the workforce⁶.

Equity fines are of course targeted at shareholders, and it could be argued that many shareholders, being unaware of the company's illegal activities, are being inappropriately punished. However, the beneficiaries of the reduced costs associated with law-avoidance are the shareholders. Thus, whilst individual shareholders may not be aware of day-to-day management practices, they are the beneficiaries of these practices and, as such, it is appropriate that they pay the price. It can be further argued that such a system will encourage shareholders to hold directors to account for the company's record of legal compliance with respect to, for example, environmental issues or the protection of its workforce. If it is not considered acceptable for an individual to profit from criminally harming others or the environment, why then should it be appropriate for the owners of a company to do so?

Furthermore, the introduction of equity fines will act to encourage potential shareholders to consider the histories of companies prior to investment.

⁶ The case of employee-shareholders is discussed in the section titled "The Bill, Who Will Be Affected and the Main Impacts".

Companies which take their legal responsibilities seriously can only benefit from such an approach by investors.

Equity fines should go a long way to improving the accountability of those that benefit most from corporate offending.

Introduction

Motivation

That a judge can be influenced by the fear that a large fine may result in putting a company out of business was clearly indicated in Lord Brodie's ICL Stockline sentencing statement: "The fines handed down in court often do not reflect the financial gain a firm may have made by failing to comply with an obligation. This means that these penalties do not act as a deterrent and, in effect, give businesses an incentive to continue to fail to comply in return for a profit. In some cases fines do not fully reflect the harm done to society."

These last remarks echoed those of Professor Richard Macrory in his 2006 Review of Regulatory Penalties in the United Kingdom: "Criminal prosecution has an important role to play but regulators need the flexibility to deal with individual cases appropriately. In some cases rogues find it cheaper to ignore regulations and take the penalty than comply...."

When passing sentence on ICL Stockline, Lord Brodie also noted: "There is then to be taken into account the ability of the companies to pay a fine and yet remain in business and provide employment."

It is clear from Lord Brodie's statement that judges may not be keen on imposing conventional fines at a truly punitive level, because the current system risks putting companies out of business. This appears to be a concern in other, similar jurisdictions. Canada's "Westray" Bill, discussed in Annex C, explicitly instructs judges, when deciding the size of (monetary) fines, to take into account "the need to keep an organization running and preserve employment"⁷. At the same time, it is clear from their small size (see below) that most fines are unlikely to have significant punitive effect. The lack of options available to the courts to punish corporations might explain the low level of fines imposed on companies for serious offences.

Should an individual commit murder we do not ask if others will be put out of work if we jail the guilty party. At the same time, in the case of industrial incidents, we would not want to exacerbate the loss already suffered by putting surviving victims out of work. Nonetheless, the present situation, where derisory penalties may be imposed for fear of damaging companies'

⁷"Criminal Liability of Organizations. A Plain Language Guide to Bill-C45" (p.8) <http://www.mhdeng.com/billc45.pdf> [cited 25 July 2008].

commercial viability, is unacceptable. Alternative approaches to punishment — and, more importantly, deterrence — must be found.

This is why this document proposes a bill which will impose responsibility on shareholders while not directly threatening the viability of companies. Penalties in the form of equity fines will affect directors and those responsible for the way companies are run⁸ and therefore act as real deterrents. The puny penalties currently imposed may be perceived as insulting to the victims and their families rather than as acknowledgements that a criminal offence has been committed. Moreover, a significant factor in imposing derisory penalties is the concern by judges that a more significant monetary penalty may either be passed onto the victims, or may result in the failure of the company. In a just and fair society, companies convicted of jeopardising their employees by breaking the law must be held to account.

Equity fines are a recent but not entirely novel idea. The idea has been floated in other countries and in 2003 the Australian State of New South Wales seriously considered bringing equity fines into legislation but rejected them for reasons which were largely spurious and which are discussed in Annex B.

The introduction of equity fines should not involve any change in Company Law which is a reserved matter (see Annex E for more detailed discussion this point).

By introducing equity fines as a new sentencing option for judges faced with companies convicted of criminal offences, Scotland has an opportunity to lead the way, an opportunity to make a clear statement that companies convicted of criminal actions resulting in death or injury will be punished. Being a company should not be a mitigating factor.

The average fine for an offence related to the injuries or deaths of employees committed between 2001 and 2005 in Scotland was £17,482.67.⁹ For an offence involving a fatality the average fine was £27,760.64. However, when viewed as a median figure, fines begin to look even lower. The median fine for offences related to either injuries or deaths of employees is £4,000. Looking only at those offences involving a fatality, the median fine is £12,500. In other words, the fine for criminally causing the death of a worker or member of the public is less than £12,500 in 50% of

⁸ Directly if they are shareholders themselves and, whether they are shareholders or not, indirectly, through pressure exerted on them by (other) shareholders.

⁹ This figure is based on the average fine for 263 convictions between 2001 and 2005 on the HSE's Public Register of Convictions.

cases. Those figures indicate a further gap between the expectations of the public that justice be done in cases where there have been serious breaches of the law and the real severity of punishment faced by criminal companies.

The proposed bill seeks to make punishments for serious corporate offences more credible and narrow the apparent gap in justice by giving the courts the option of imposing a more targeted and effective sanction against public companies. It does not apply to private companies, partnerships or small traders. It may well be that additional legislation is desirable and views on this are welcome.

Difficulties in Setting the Levels of Fines

Ideally all fines, whether monetary or equity, should be set with full knowledge of a guilty party's financial affairs. The fact that there is currently no provision for courts to order inquiries to examine the affairs of small companies is surely a contributing factor to the low level of fines. This allows companies such as ICL Tech Ltd and ICL Plastics to provide their own information to the courts on the value of the company and remain unchallenged: "Difficulty is sometimes found in obtaining timely and accurate information about a corporate defendant's means [although courts can request corporations to furnish their accounts]¹⁰". In effect, therefore, corporations can profoundly affect the level of fines imposed upon them by judges fearful of putting them out of business. Neither do judges have available to them the previous record of offending companies at the sentencing stage. Prof. Hazel Croall, in a paper prepared for the Scottish Executive Expert Group on Corporate Homicide, reported that a number of authorities have suggested "that courts should routinely receive a form of Corporate Inquiry Report and should, where necessary, have powers to appoint a relevant expert to provide a professional assessment, paid for where appropriate by the company itself"¹¹.

History of Equity Fines

The idea of the equity fine originates from a proposal made by Professor John Coffee of Columbia University in 1981. As a proposal, it has received widespread support amongst the most respected academic experts in the field of corporate punishment. It has been debated by law reform groups in

¹⁰ Extract from R v Howe and Son (Engineers) Ltd. See Annex F for the reference and a more extensive extract.

¹¹ See Annex F for the reference and a more extensive extract.

Australia¹² and was supported by the Scottish Executive Expert Group on Corporate Homicide in 2005¹³.

The idea stems from the problem that Coffee described as the “deterrence trap”. If a fine is to be an effective deterrent, and the risk of being caught is low, then it will have to reflect the value of the savings from offending behaviour multiplied by the chances of getting caught. If a company calculates that it can save £15,000 by illegally omitting to replace a piece of machinery or pipe infrastructure for example, and it projects the chances of getting caught, prosecuted and convicted as, say roughly 100 to 1¹⁴, then a fine that will provide the necessary deterrent will need to be in excess of £1.5 million. However, fines of this magnitude are only imposed on the largest companies and for many, perhaps the majority, a fine of this size would make them insolvent. In other words, if fines were large enough to act as an effective deterrent, then they would tend to put convicted companies out of business. Equity fines are a way of avoiding the deterrence trap, because the fine will always be levied as a proportion of companies’ equity – and therefore there is a considerably reduced risk of making companies immediately bankrupt.

Equity fines would reduce the value of a company as a whole, rather than reduce the cash that a company had available to pay a fine at a particular moment in time. This is important for three reasons. First, as we have seen, it mitigates the problem of workers and customers absorbing the immediate impact of fines (“spillover” effects as Coffee calls them). Second, when fines are calculated in relation to company profits or turnover, this might not always reflect ability to pay. Published accounts are not always an accurate reflection of the financial situation; they may be vulnerable to creative accounting practices, especially in large group holdings. Third, the punishment is not easily written off against operating costs precisely because fixed assets as well as liquid assets and future earnings figure in the value of the punishment, rather than merely the cash that the company holds at a particular moment.

¹² The principle of share dilution was floated in the 1980s by the Australian Law Reform Commission and more recently by the New South Wales Law Reform Commission.

¹³ Croall, H. 2005, ‘Corporate Homicide: Expert Group Report 2005, Annex B: Penalties for Corporate Homicide.’, paper prepared for the Scottish Executive Expert Group on Corporate Homicide, August 17th 2005. Available from WWW: <http://www.scotland.gov.uk/Publications/2005/11/14133559/36003> [cited 22 July 2008].

¹⁴ Unless there is a major incident, the chances of being prosecuted are actually much lower. Even if a breach of health and safety law results in an injury, the ratio of injuries to prosecutions is much higher than 100 to 1. But this figure is likely to be a gross underestimate since the rate of inspections and visits to premises by HSE is extremely low. The Centre for Corporate Accountability reported in *Safety Last* (2002) that workplaces in the UK are inspected on average once every 20 years.

The Bill

Company Background Inquiry Reports, a Supplementary Proposal

To overcome the difficulties in setting the levels of monetary (and potentially equity) fines outlined in the Introduction, in addition to proposing equity fines this bill proposes a system of Company Background Inquiry Reports that would provide the courts information helpful to determining the most appropriate and effective sentences. It is stressed that the bill's major proposal (equity fines) is not dependent on the implementation of Company Background Inquiry Reports legislation; this latter suggestion is supplementary and could even improve the present system of monetary fines.

Who Will Be Affected by Equity Fines and the Main Impacts

Public limited companies

Public limited companies convicted of criminal offences will obviously be directly affected. Those not so convicted will have an added incentive to comply with the law.

Company employees

Employees will be at less risk of suffering wage cuts or curtailed future wage rises (presently a company might reduce wages in order to cover, directly, the cost of a fine). In the long run the intention is that the equity fines system will improve compliance with the law and so benefit both employees and visitors to company premises, including temporary contractors.

It might reasonably be asked: "What if company employees receive shares as part of their remuneration? Would this not diminish the perception that justice is being done?" There is a possibility that this would be the case. However, it can be argued that employees *knowingly* work for companies that issue shares as part of their remuneration. If they additionally *choose to retain these shares* (and potentially share in profits), then, like other small shareholders, they must expect to be held accountable for a company's activities to the extent of the number of shares they hold (see also Annex B).

It might also be asked, “What if the penalty dilutes the value of a prosecuted company and has a knock-on effect on non-shareholding company employees?” The answer to this is that *monetary* fines have a far greater potential to have a knock-on effect on employees. Equity fines can only be an improvement.

Shareholders and potential shareholders of public limited companies

Those who hold shares in companies convicted of criminal offences will see the value of those shares decline. Shareholders and potential shareholders, in general, will be motivated to invest in companies that comply with the law and also to make representations to companies that they take action to reduce the chances of being convicted of criminal offences, for example, by reducing the risk of damaging the environment or of their employees suffering injury or death.

Directors of public limited companies who either hold shares, or receive remuneration in the form of shares

They will be affected in the same way as other shareholders, and, in addition, may be further motivated to make sure that their companies are not convicted of criminal offences because of the damage their reputations might suffer if they were perceived to be responsible for a significant decline in their companies’ share prices.

Additional Implications and Potential Effects

Improving Justice

Courts will not feel under pressure to impose minimal fines solely out of fear that large ones might damage company viability. There will therefore be higher levels of financial penalties which should help to meet the expectation that justice be done.

The Workforce and/or Victims of the Crime

The main and immediate advantage to the workforce is that the company will not be encouraged, immediately and directly, to mitigate the effects of the fine by reducing wage rises or laying off its workforce.

The Myth of Capital Flight and Deterrence to Investment

It might be argued that introducing equity fines could result in either a flight of investment capital from Scotland or a reduction in Scottish inward investment. Available data do not suggest that this is likely. Whilst there is no direct evidence pertaining to the introduction of a system of equity fines in other jurisdictions, conclusions can be drawn from the performance of economies following the introduction of other forms of legislation intended

to reduce the incidence of corporate crime. A recent example from Canada is outlined in Annex C.

Ethical Investments

According to financial consultancy Celent (<http://www.celent.com/PressReleases/20070313/SRI.htm>; cited 22 July 2008) socially responsible investment (SRI) is booming in both the USA and Europe: “Celent predicts that the SRI market in the US will reach \$3 trillion by 2011, and the European SRI market grew from €1 trillion in 2005 to €1.6 trillion in 2007.”

This suggests that the proposed legislation may, in fact, impact positively rather than negatively on investment because it is likely to improve the ethical “brand image” of Scotland (and, by association, the image of those companies investing in Scotland). The proposed Bill raises the very real possibility that Scotland could benefit both economically and socially from encouraging the highest standards in corporate responsibility.

Law-Abiding Companies Have Nothing to Fear

Responsible companies will not expect to find themselves in the criminal courts. In the case of companies that are deliberately under-investing in measures to reduce the chances of environmentally damaging incidents or of their employees suffering injuries or death, and failing to comply with legislation in these and other areas, it must be asked whether Scotland should welcome such companies.

Equity fines, like other penalties already on the statute books, would only be imposed on companies found guilty of criminal offences. The intention of equity fines would simply be to further encourage companies to do what the law already requires them to do; equity fines can only encourage companies to take reasonable precautions to look after the environment and employees and otherwise comply with the criminal law pertaining to them.

Reducing Economic Burdens

Not only does failure to invest in measures to protect workers and the environment carry an unacceptable human cost, it also creates significant financial burdens on business and on the taxpayer. For example in 2002, HSE estimated the cost to British employers of injuries and deaths at work at between £3.3 and £6.5 billion each year¹⁵. Injuries at work also carry huge financial cost to the taxpayer in increased health and social security costs. The cost of such incidents to the economy more generally in the UK

¹⁵HSC Press Release C014:02 - 23 April 2002, <http://www.hse.gov.uk/press/2002/c02014.htm> [cited 25 July 2008].

was estimated at 40 million working days in the period 2001/2002¹⁶. If those figures are adjusted to Scotland, we can estimate that those hidden costs to employers and taxpayers can be counted in the hundreds of millions of pounds, and the working days lost to the economy can be counted in their millions. (And this is before we begin count the economic cost of environmental damage which results from criminal breaches of legislation.) Improving corporate accountability therefore makes sound economic sense.

Intangible Benefits

Scotland's international reputation as a progressive country that prizes social justice and takes the steps necessary to encourage responsible business would be enhanced if it were the first in the world to enact equity fines legislation. This might conceivably enhance the pride of its people and raise the country's international profile, with potential spin-offs in terms of increased tourism, attracting skilled workers, and increased investment by companies seeking to enhance their reputation.

Conclusion

Criminal actions by companies in Scotland — even those resulting in injuries and deaths — are not adequately punished or deterred by current legislation. Equity fines offer a remedy, allowing judges to impose significant penalties without immediately damaging companies' operating revenues. Judges can impose penalties with less risk of impacting primarily on innocent parties. Evidence suggests that tightening corporate legislation (by allowing judges the option of imposing equity fines) would not detrimentally affect investment; indeed, such legislation could have a positive impact on the economy and boost Scotland's image as a progressive nation.

¹⁶<http://www.hsc.gov.uk/press/2006/c06027.htm> [cited 25 July 2008].

The Consultation Process

It is hoped that this consultation paper will be distributed as widely as possible to those who will be affected by the proposed legislation. The consultation process is an important part of the bill's development, and we welcome any comments that you may have on the issue. Questions that may help you to formulate your response are set out below. All responses that we receive will be closely studied, and will help us to formulate the bill to reflect the concerns and interests of as many groups and individuals as possible.

It is important that this consultation exercise is accessible to as many people as possible. If English is not your first language, please let us know, and we will do our best to put you in touch with someone who can supply you with a suitable translation.

Questions

Responses to the following questions are invited from all interested parties.

- *Question 1: What effect do you think the availability of equity fines will have on the behaviour of companies in relation to compliance with the law?*
- *Question 2: For which offences should the option of equity fines be available to the courts?*
- *Question 3: How should courts obtain the necessary background and financial information on companies to determine the appropriate levels of equity fines?*
- *Question 4: How long so you think it will take to gather that information for the courts?*
- *Question 5: Would you like to see future legislation allowing new types of fines to be applied to private companies such as those involved in the ICL Stockline disaster?*
- *Question 6: Are there any equal opportunities or human rights issues that might arise from this proposal?*
- *Question 7: Do you have any other comments in relation to this proposal?*

Consultation Responses

Please return any responses to Bill Wilson by 1 December 2008.

Responses can be sent electronically to:

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or by post or fax to:

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Further copies of this consultation paper are available from the above address. It can also be downloaded from the Scottish Parliament website at:

<http://www.scottish.parliament.uk/s3/bills/MembersBills/index.htm>

To help inform debate on the matters covered by this paper and in the interests of openness it is intended all the responses submitted on this consultation document will be made public. You should therefore be aware that by submitting this response you are indicating consent to the publication of all the material contained in your response. Unless you indicate otherwise this will include your name and address and any other biographical information you have provided about yourself. You should note that personal data referring to third parties included in the response cannot be accepted without explicit written consent from the third party. This consent should be provided with your response.

Bill Wilson is not entitled to process your personal data by publication without your consent. If therefore you want parts of your response to remain confidential please indicate which parts are not for publication. Similarly, if you wish all of the contents of your response to be treated in confidence and not made public then please indicate so.

All responses will be included in any summary or statistical analysis, which will not identify individual responses.

Criminal Sentencing (Equity Fines) Bill Consultation Paper

In order to gather the views of those who may be affected by this proposal, Bill wishes to consult as widely as possible. He would be grateful if you could pass this document on to any other interested parties of whom you may be aware.

Annex A: Draft of Proposed Bill

Criminal Sentencing (Equity Fines) Bill

A Bill to allow courts to obtain pre-sentence company background inquiry reports and impose equity fines.

PART 1

COMPANY BACKGROUND INQUIRY REPORTS

- (1) Following a conviction of a public company under common law or statutory law in the Scottish criminal courts, and before sentencing, the court may order a Company Background Inquiry Report to be conducted.
- (2) Company Background Inquiry Reports should include –
 - (a) An appraisal of the financial health of the company based upon its published accounts and the known value of its assets.
 - (b) Consideration of previous convictions in the courts
 - (c) Consideration of previous enforcement action taken by regulatory authorities.
- (3) A public company convicted of a criminal offence under common law or statutory law in the Scottish criminal courts shall be liable on order of the court, to pay costs incurred in the completion of a Company Background Inquiry Report.
- (4) The costs incurred in the completion of a Company Background Inquiry Report are to be paid within __ days of conviction.

PART 2

SENTENCING OF COMPANIES

- (1) When imposing on a public company a sentence of a fine for a contravention of common law or statutory law in the Scottish criminal courts, the court must specify the method by which a fine shall be paid.
- (2) Those methods are –
 - (a) A cash payment; or
 - (b) A new issue of shares in the equity of the company to a value specified by the court, with the proceeds of the sale of

the share issue to be deposited at the court by which the order is made.

(3) The clerk of the court by which the order is made shall cause a copy of the order as so made to be served on an officer of the public company subject to the order.

(4) A fine imposed by a court under section (2) is payable within a time limit decided by the court.

(5) In respect of fines imposed under subsection (2)(b) above, the convicted party shall be required to submit to the court, within __ days of the fine being imposed, documentary evidence that a share issue has been made in compliance with the terms of the Company Sentencing Order.

PART 3

SECONDARY ORDERS

(1) A public company that, without reasonable excuse fails to meet the conditions of Part I (4) or (5) shall be guilty of an offence and liable on summary conviction to an additional fine not exceeding the value of the original fine.

(2) In respect of the procedure set out in Part 2, subsection (1), an officer of the public company subject to the order will be required to appear in court on the scheduled court appearance date.

PART 4

APPLICATION

(1) For the purposes of this Bill, a “public company” is a company limited by shares and having a share capital.

(2) For the purposes of this Bill, an “officer” is

- (a) the person occupying the position of Company Secretary or Joint Secretary or;
- (b) a person occupying a position as director of the company, by whatever name called

(3) The power to impose a fine in respect of Part 1, subsection (2) above applies only to cases where a public company has been found guilty of an offence in common law or in statutory law that is not considered a reserved matter under the terms of the Scotland Act 1998.

Annex B: Rebuttal of New South Wales Law Reform Commission’s Criticisms of Equity Fines

The Law Reform Commission (LRC) of New South Wales, Australia, considered the introduction of equity fines in 2003. The LRC’s arguments against equity fines (numbered here for convenience) are reproduced in italics and counter-arguments follow.

1. The burden of equity fines falls evenly across the entire class of shareholders rather than falling disproportionately on a few (such as low-level employees), effectively reducing the spread of loss. However, by failing to distinguish between powerful shareholders and those who exercise little or no control over the corporation’s activities, the equity fine is not necessarily fairer.¹⁷

The effect of an equity fine would be identical with respect to each individual share. The burden, therefore, would not fall squarely on each shareholder. Shareholders who own more shares would be more affected by a reduction in the value of shares caused by an equity fine. Shareholders owning more shares undeniably possess a greater ability to influence company policy, whether they choose to exert this influence by voting, by direct contact with the board of trustees, by membership on the board of trustees or by other means. Viewed in this light, equity fines do indeed distinguish between and “punish” shareholders according to their ability to influence corporate management, and it seems reasonable that the greater the influence on company policy possessed by a shareholder, the greater proportion of the effect of the fine he or she must bear.

Of course, equity fines are not “perfect”, in that a few shares may mean a great deal to a poor and relatively powerless person, but equity fines would at least be a significant improvement on monetary fines. As noted in the New South Wales criticism, they would prevent the burden of penalties being carried disproportionately by low-level employees (who may have no ability whatsoever to influence company policy). Such an iniquitous situation is readily envisaged with respect to monetary fines.

¹⁷ Section 7.16 of The New South Wales Law Reform Commission. 2002. Report 102 (2003) – Sentencing: Corporate offenders. *Lawlink New South Wales*. <http://www.lawlink.nsw.gov.au/lrc.nsf/pages/r102chp07> [cited 25 July 2008].

2. *By holding shareholders equally culpable for the actions of management, the power imbalance between large and small shareholders is ignored and the realities of corporate behaviour misrepresented. That a corporation may be defined simply as a conglomerate of shareholders is not disputed. However, in the event of corporate misconduct, a distinction should be made between those who were culpable and responsible, on the one hand, and those who were unaware of or powerless to stop the misconduct, on the other hand. It has been said that the notions of limited liability and bankruptcy demonstrate that, in some instances, shareholders are to be taken as possessing an identity that is distinct and separate to that of the corporation. These principles recognise that in reality, the majority of shareholders are as innocent and impotent as low-level employees and creditors, often powerless to influence policy or regulate the corporation's conduct or bring about reforms following a corporate conviction.*¹⁸

Although in theory small shareholders individually may have virtually no influence in the corporation, small shareholders as a group possess significant influence on corporate management. Shareholders of all “sizes” choose to invest in a corporation. Given the volatile nature of the stock market, each shareholder implicitly takes a calculated risk by purchasing a share of ownership in that corporation. As an owner and benefactor of the profits and liquidity of the corporation, each shareholder should also be expected to investigate the calculated risk of investing in companies that may be fined for criminal activity. Small shareholders deeming investment in a corporation too risky would create an incentive for larger shareholders, members of the board of trustees and so forth, to improve that company's procedures. In summary, while the LRC of New South Wales argues that small shareholders unfairly bear the burden of an equity fine when each small shareholder has virtually no influence on corporate management, it is readily counter-argued that, as a group, small shareholders potentially possess a great deal of influence on the board of trustees and corporate management, and that every individual shareholder expecting to gain from a company's activities also implicitly approves of that company's policies and therefore must assume a measure of responsibility for that company's actions proportionate to any expected gain.

3. *A related criticism of the equity fine is that it “decreases the value of all stockholders' common shares, yet offers no guarantee of managerial impact”. Although it is often appropriate to apportion blame for corporate misconduct on large shareholders who either form part of management or have a degree of influence over corporate behaviour, punishing these “guilty” shareholders by way of individual sanctions would be fairer than imposing a penalty that penalises all shareholders.*¹⁹

¹⁸ Section 7.18 *op. cit.*

¹⁹ Section 7.19 *op. cit.*

To some extent this argument is merely a reformulation of the previous one, and it has already been argued that all shareholders bear some responsibility for a company's actions. The LRC of New South Wales argued that individual sanctions aimed at large shareholders might be more appropriate. However, the mere possibility of other sentencing mechanisms does not justify continuing the use of the current flawed sentencing mechanisms. The creation of an additional sentencing option allowing judges to identify large shareholders and appropriately focus the punishment upon those shareholders is an interesting suggestion, perhaps worthy of further research and consideration in the future. Nevertheless, this possibility does not justify not acting now to improve the current methods and mechanisms available to judges for punishing corporate crime and should not impinge on considerations regarding the present relatively modest proposal for the addition of equity fines to the range of penalties judges may impose on companies found guilty of criminal offences.

4. Equity fines share the same problem as monetary fines, in that they do not require the organisation to correct any systemic faults that may have given rise to the offence in the first place. In short, the fine is a non-interventionist sanction, as it does little to rectify a corporation's defective internal procedures or ensure that individuals in the company are disciplined. Share dilution does not automatically necessitate any investigation into individual accountability, so there is no direct link between the sanction and prevention, its intended effect.²⁰

There is fault in assuming that statutory punishment should (and, by implication, could!) universally define the nature of offending corporations' defective "internal procedures" and disciplinary actions and then dictate/micromanage precise rectification measures. The breadth and depth of legislation designed to cover every eventuality would be spectacular! Although equity fines do not directly "rectify a corporation's defective internal procedures or ensure that individuals in the company are disciplined", a fine or punishment of sufficient degree should cause corporate management to carry out systematic fault evaluations on its own. Conversely, an insufficient or minimal punishment may cause a corporate manager to justify criminal activity because the cost of evaluating and changing corporate policy and behaviour exceeds the calculated cost of paying intermittent monetary fines. Rather than increasing a normal monetary fine where negative externalities are spread among a larger group of persons *who may have no power to affect company policy*, equity fines focus the full fine on owners possessing the ability to influence corporate management to rectify that company's flawed procedures.

²⁰ Section 7.21 *op. cit.*

Furthermore, a punishment directed at shareholders may actually encourage future shareholders to invest in those companies which go to greater lengths to avoid breaking the law. The incentive to invest in corporations aiming to generate short-term profits through cost-cutting irresponsible behaviour decreases as the risk of an equity fine, which will directly affect share prices, increases. Those companies preparing to go public should ensure that their regulations do not deter potential investors from purchasing their shares.

5. The desire or ability of shareholders to bring about fundamental change in a corporation's structure or conduct is critical to the rehabilitation of non-financial values. Although shareholders should, in theory, take an interest in ensuring that internal mechanisms are sufficient to prevent misconduct, many are simply focussed on short-term profit, and are no more likely to be concerned about an equity fine than they would an ordinary cash fine. Where the shareholder remains remote, the equity fine is little more of a deterrent than the monetary fine. Perhaps the more substantial the shareholder's holding and the more severe the potential loss, the greater the interest the shareholder would take in ensuring compliance.²¹

The share-dilution effect of equity fines directly reduces the price of individual shares. Where a monetary fine may not affect a corporation's market share value, and may be diverted to the workforce by way of decreasing wages, freezing wage increases, or dismissing employees, equity fines directly affect the ability of all investors to make short-term profits and therefore will most likely cause much more concern than ordinary cash fines. Therefore, the argument that an equity fine serves as little more of a deterrent than a monetary fine seems insubstantial, to say the least.

6. Various regulatory agencies opposed equity fines in their submissions to the Commission, citing a number of administrative difficulties. Some agencies highlighted the problem of a government agency managing and investing the funds of a private company. A potential perception of a conflict of interest arises. For example, having an agency like the NSW Department of Fair Trading or the Australian Tax Office manage the shares of a corporation that has contravened the laws that these agencies enforce raises issues relating to the proper relationship and dealings between them and convicted corporations.

The Australian Stock Exchange expressed concerns that the liquidation of securities to maximise their return would be a difficult topic on which to draft satisfactory and effective legislation. By their nature, securities increase and decrease in value. They will never have a definite value as opposed to a fixed fine amount. The ASX queried how one would

²¹ Section 7.22 *op. cit.*

*decide when best to sell to maximise return.*²²

Although the LRC of New South Wales foresaw problems in administering, liquidating, and legislating for equity fines, these objections do not necessarily limit Scotland's ability to incorporate equity fines as a sentencing mechanism for corporate crime. Where government institutions may experience difficulty in these matters, especially with regard to conflicts of interest, the ability to contract the management and liquidation of these funds could be delegated to a Scottish independent investment firm. Legislation for these delegations could consist of guidelines for liquidation and distribution of funds to be determined by the judiciary. Moreover, it is important to note that the current proposal does not call for shares to be held and managed by government-appointed agencies. Rather, it calls for shares to be issued and promptly sold. Thus no ongoing relationship between an offending company and government-appointed institutions is envisaged.

²² Sections 7.24 and 7.25 *op. cit.*

Annex C: No Evidence Tougher Corporate Legislation Impacts Adversely on Economy, An Illustration: Canada’s “Westray” Bill (Bill C-45)

There is no evidence to suggest that inward investment has been negatively influenced by corporate crime legislation in other OECD nation. Although equity fines have not yet been introduced, a recent example of a country where corporate crime legislation was tightened is Canada. In 2004 Canada introduced the “Westray Bill” (Bill C-45).

Essential Points of Bill C-45

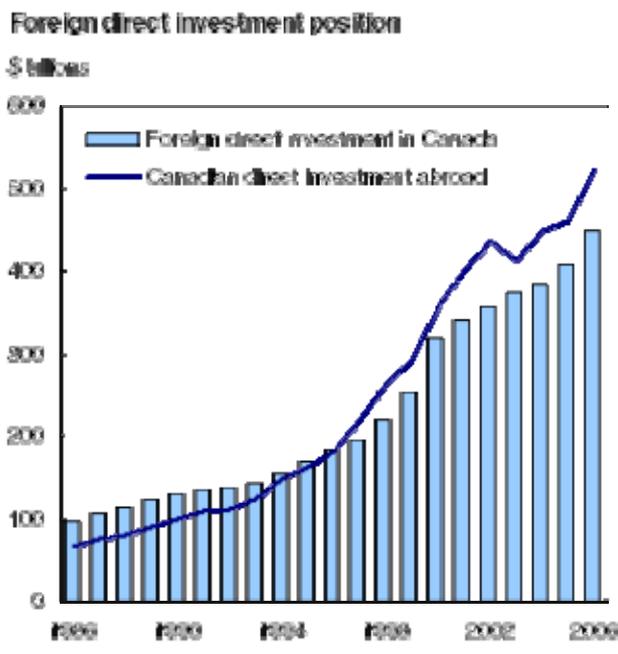
- (1) The Bill made it possible for corporations/organisations to be convicted of crimes.
- (2) The Bill decreed that an organisation is responsible for the negligent acts or omissions of its representatives. The Bill provided that the negligent conduct of two or more representatives could be combined to constitute an offence. It therefore made it clear that it was not necessary that a single representative commit an entire act for an organisation to be convicted.
- (3) The Bill increased the amount an organisation could be fined. As noted elsewhere in this consultation document, however, it implicitly recognised the limitations of monetary fines in stating that judges should take into account, when deciding the size of fines, “the need to keep an organization running and preserve employment”.

More comprehensive information may be found here:

<http://canada.justice.gc.ca/eng/dept%2Dmin/pub/c45/> [accessed 22 July 2008].

Foreign Direct Investment

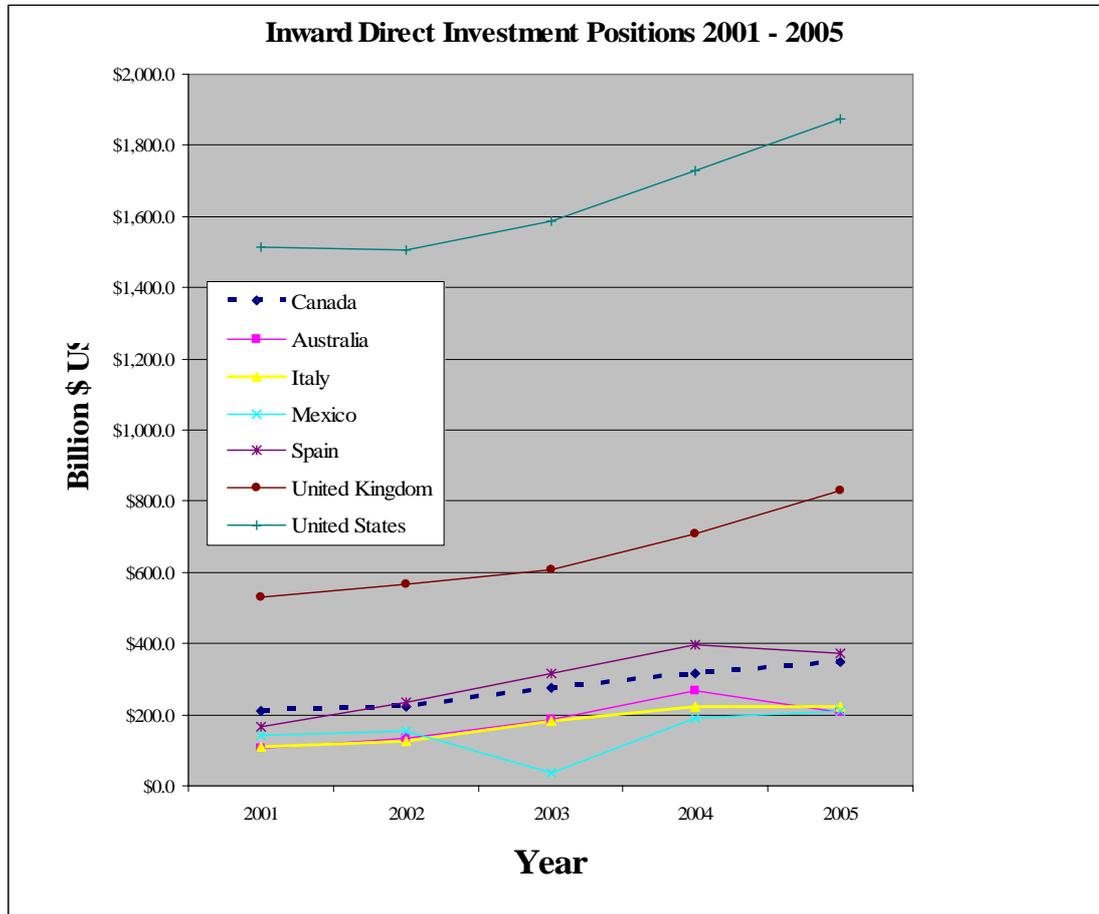
Evidence from “Statistics Canada” (Canada’s national statistics agency) shows no appreciable impact upon inward investment following the introduction of this bill:

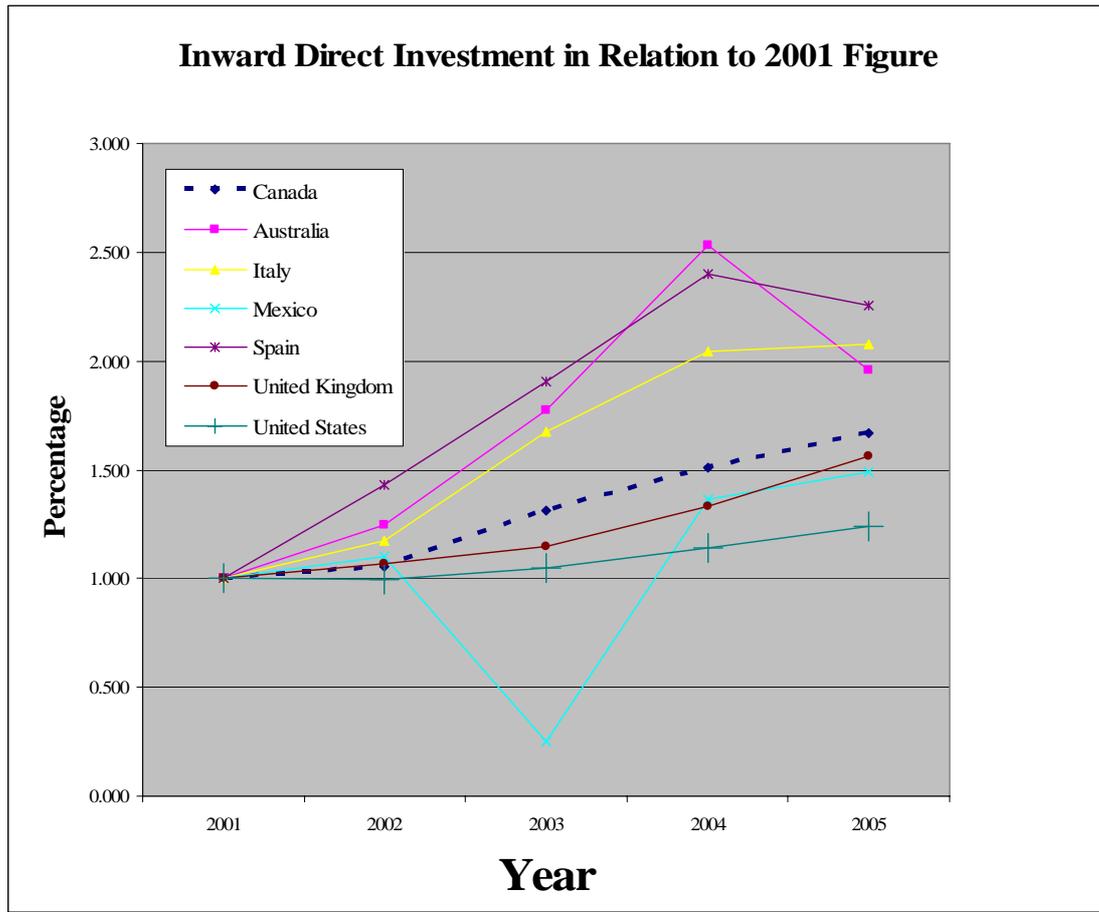


(Graph taken from Statistics Canada: <http://www.statcan.ca/Daily/English/070509/d070509a.htm>; cited 22 July 2008)

Statistics Canada noted that “foreign direct investment in Canada hit \$448.9 billion at the end of 2006, up \$41.3 billion, or 10.1%, from the end of 2005. This was also the fastest percentage gain since 2000. The increase was mostly the result of acquisitions of major Canadian firms by foreign investors, which was also the case in 2000”. Bill C-45 appears to have had no discernible impact upon on Canadian direct investment trends.

Similar data were obtained from the OECD website for Canada and several comparable countries (from documents such as http://www.oecd.org/document/19/0,3343,en_2649_34489_39503891_1_1_1,00.html; accessed 22 July 2008) and the following graphs prepared:





At the time this consultation was prepared data were not available for 2006. While the absence of an effect of Bill C-45 on the direct investment pattern for Canada cannot be proven, the growth in direct investment in Canada immediately following the introduction of Bill C-45 (in 2004) is not noticeably different from that of comparator countries.

Annex D: Fire Brigades Union Scotland Supporting Statement in Full

The principal objective of any court-imposed punishment on a corporation must be to act as a deterrent both to that company in its future business practices and also to the wider commercial world. Scotland must mark itself out as a fair and just society, where business is able to conduct its undertakings but must do so in a responsible and equitable environment.

The Fire Brigades Union Scotland believes that a balance must be struck between legislation, advice, enforcement and where necessary – punishment. It is, however, counterproductive to punish an offender to such an extent as to put them in a position where they can no longer continue trading, as this would disproportionately punish the employees of the business rather than those responsible for the infringement. Similarly putting a commercial undertaking into a position where the easiest way to recover from a fine is to reduce the number of employees, their salaries or their benefits such as pension rights. Such a position runs contrary to what a trade union should be about.

We believe that the idea of equity fines warrants further exploration as a means to punish corporate offenders. Directing the punishment to those responsible must be a fundamental ethos of any justice system.

Given the current obsession with equity growth through liberalised markets, where success is determined along narrow lines by percentage increases in stock prices and price against earnings ratios, it seems a reasonable proposition that affecting the offender's market standing will be more of a deterrent than simply taking away a cash sum.

It is perhaps a sad state of affairs when there is a reliance on market forces to protect the public, the environment and workers safety and health. But that does seem to accurately reflect how far the modern world has fallen in terms of corporate responsibility. The only thing that seems to affect corporate actions is the only thing they care about – share value. We must be able to live in a country where the health of the population and our natural heritage is protected from the unlawful actions of industrial processes. A variety of legislation is currently in place in an attempt to secure that. However the number of deaths, injuries and accidents is testimony to the fact that legislation alone cannot prevent these tragedies.

The imposition of a court fine is currently likely to appear as a single line entry in an accounting journal that most people, even investors, are unlikely to read let alone appreciate the implications of. We believe that equity fines are far more likely to be noticed by shareholders in a company, especially when they see value removed from their holding, whether that be personal or at a corporate investment level. Shareholders are also more likely to demand explanations from company officers and executives.

The FBU has a long and proud tradition of campaigning not just on behalf of our members but also in terms of wider community safety. For example whilst health and safety legislation is normally thought of as protecting employees when at work, it does of course also apply to others who may be affected by the work process being undertaken. That can include members of the public but also crucially for our members it applies to other persons entering a premise, for example the self employed or in our case persons responding to the location. The FBU will be most interested in the implications should our members become injured at an incident that subsequently leads to a prosecution of the premises operators.

In any prosecution there is a desire to see justice done. As trade unionists we would have a conflict of interest if a court imposed sanction had such an effect on the guilty company as to put them out of business or to adversely impact on the employment of their workers. We see equity fines as a way of better reflecting the seriousness of any transgression by allowing the courts to hand down substantial value fines without jeopardising the future of the company itself.

In addition to the imposition of a fine we would also like to explore the possibilities of compensation claims being imposed in a similar way. The ability of courts to impose compensation awards could potentially lead to awards better reflecting the impact any injury or death has had on our member or their families.

We see the use of equity fines as an option which does not affect current legislation but purely as a means of sentencing. We would encourage the option to be available for as wide a range of offences as possible but definitely including the terms of the Fire (Scotland) Act 2005.

It is our belief that these proposals will not act as an obstacle to businesses wishing to set up or trade in Scotland, although the punishment of foreign companies may require clarification within the consultation document. It in fact sets no higher burden in terms of complying with existing legislation. It

will send out a clear message to the corporate world, “responsible business is welcome here”.

Annex E: Devolved, Not Reserved Legislation

The proposed bill would not introduce a new law or amend existing criminal law. In its draft form (Annex A) it merely creates a new sentencing option.

This area of policy is firmly within the scope of the Scottish Parliament, since sentencing policy is a matter that is in the portfolio of the Justice Minister and is administered by Scottish Courts

A Sentencing Advisory Panel review on the subject of corporate penalties is currently being conducted. This body is charged with conducting consultation exercises on sentencing policy and then reporting its recommendations to the Sentencing Guidelines Council. The remit of the Council is to issue guidelines to courts only in England and Wales, and indeed this is made clear in the documentation for the current consultation. In Scotland, the system is entirely separate. No sentencing council sits in Scotland. Indeed, in Scotland there is no permanent body that is dedicated to issuing guidelines. The Court of Appeal was given the power to issue guideline judgements in 1995. A Scottish Sentencing Commission sat between 2003 and 2006 and some of its recommendations were introduced in 2007 under the Criminal Proceedings etc. (Reform) (Scotland) Act 2007, but this Commission finished its deliberations without considering the sentencing of companies.

So, a major anomaly exists in the way that any changes in sentencing will apply in Scotland. Can we assume that the guidelines that will eventually be issued by the Sentencing Guidelines Council will simply be adapted to Scotland? If this is the case, those guidelines will be imposed after a consultation exercise that has excluded Scotland.

There may, however, be concerns about the degree to which the proposed bill impacts upon business activities, not least from within the business community itself. We address some of those issues elsewhere, but for the moment it is important to note that in schedule 5 of the Scotland Act, the creation, operation, regulation and dissolution of types of business association are defined as reserved matters. Of course what constitutes “operation” and “regulation” of business is a matter of debate. In this respect it is important to note that the bill would not specify how the share issue should be made, merely that the company must make an issue of shares in order to pay the fine. It therefore does not impact upon the ongoing management or operation of a business and imposes no new regulatory mechanism or authority upon business. It is also important to

note that the mere fact of having an effect upon business does not make an Act of the Scottish Parliament incompetent. Two recent examples, of bills which had obvious effects on businesses, illustrate this point. The Smoking, Health and Social Care (Scotland) Act 2005 and the Christmas Day and New Year's Day Trading (Scotland) Act 2007 were deemed competent despite their obvious and direct effects. A third example, the Emergency Workers (Scotland) Act 2005 is described as “an Act of the Scottish Parliament to make it an offence to assault or impede persons who provide emergency services; and for connected purposes”. This makes it clear that modifying Scots criminal law to improve the safety of specified individuals is not a reserved matter.

It might be argued that the very act of obliging a business to issue shares is a form of regulation. However, were such an argument to be followed it could equally be argued that obliging a company to pay a monetary fine is a form of regulation. If this argument were taken to its logical conclusion then the Scottish Parliament could not set a minimum fine for a crime resulting in the loss of life on the grounds that such a fine was regulating the business.

An extension of the above argument would be that businesses might need to restructure or change their operating practices to cope with the effects of equity fines. The obvious counterargument is that monetary fines of other than trivial magnitude are surely likely to have a more significant impact on the day-to-day operation of businesses. Equity fines, as they do not directly reduce the money available to a business for its daily operations, are, if anything, less likely to affect the operation of businesses, other than that they should encourage them to obey existing legislation.

The provisions of the proposed new court order would certainly have an impact upon companies who offend, just as a very large fine would. However, this is not the same as legislation which has an ongoing regulatory effect upon business generally. (And, arguably, two Acts deemed competent had such effects!) In addition, Clause 101 of the Scotland Act 1998 Chapter 46 (“On the Interpretation of Acts of the Scottish Parliament etc.”) states:

- (1) This section applies to—
 - (a) any provision of an Act of the Scottish Parliament, or of a Bill for such an Act, and
 - (b) any provision of subordinate legislation made, confirmed or approved, or purporting to be made, confirmed or approved, by a member of the Scottish Executive,

which could be read in such a way as to be outside competence.

(2) Such a provision is to be read as narrowly as is required for it to be within competence, if such a reading is possible, and is to have effect accordingly.

The proposed Criminal Sentencing (Equity Fines) Bill should be read narrowly, as applying to sentencing only, and therefore considered to lie within competence.

Annex F: Company Background Inquiry Reports

The difficulties courts presently experience in obtaining adequate information on a company's financial situation has been discussed:

***Extract from Decision, R v Howe and Son
(Engineers) Ltd***

available on WWW:

<http://www.corporateaccountability.org/rb/sentencing/howe.htm>

[cited 24 July 2008]

“Any fine should reflect not only the gravity of the offence but also the means of the offender, and this applies just as much to corporate defendants as to any other. See section 18 (3) Criminal Justice Act 1991. Difficulty is sometimes found in obtaining timely and accurate information about a corporate defendant's means. The starting point is its annual accounts. If a defendant company wishes to make any submission to the court about its ability to pay a fine it should supply copies of its accounts and any other financial information on which it intends to rely in good time before the hearing both to the court and to the prosecution. This will give the prosecution the opportunity to assist the court should the court wish it. Usually accounts need to be considered with some care to avoid reaching a superficial and perhaps erroneous conclusion. Where accounts or other financial information are deliberately not supplied the court will be entitled to conclude that the company is in a position to pay any financial penalty it is minded to impose. Where the relevant information is provided late it may be desirable for sentence to be adjourned, if necessary at the defendant's expense, so as to avoid the risk of the court taking what it is told at face value and imposing an inadequate penalty.”

Unfortunately, despite the statement that “the court will be entitled to conclude that the company is in a position to pay any financial penalty it is minded to impose”, it appears, from data presented elsewhere in this consultation document, that fear of unintended consequences (such as job losses) may cause judges to impose inadequate sentences. That courts should be given the power to order reports into a company's financial circumstances, as a remedy for this, has been suggested elsewhere:

Extract from “Corporate Homicide: Expert Group Report 2005”

Annex B: Penalties for Corporate Homicide

a paper²³ prepared for the Scottish Executive Expert Group on Corporate Homicide; August 17th 2005, by Professor Hazel Croall

available on WWW:

<http://www.scotland.gov.uk/Publications/2005/11/14133559/36003>

[cited 24 July 2008]

“The provision of Inquiry reports

“The court regularly receives background information on individual offenders by whereas it may receive only haphazard information on company accounts, sometimes based on solicitors version of 'draft' accounts as happened in the *Topek (Bar)* case cited above. It was further recognised in *Home* that it was difficult to obtain 'timely and accurate' information about the defendant's means. Information provided by the company is more likely to be in the context of mitigation and is more likely to stress its poor position than to provide full details of assets (Croall and Ross 2002). In the United States a Federal Law officer undertakes an investigation into each convicted corporation. There have accordingly been suggestions (Bergman 1992; CCA 1999; Law Reform Commission, NSW 2003) that courts should routinely receive a form of Corporate Inquiry Report and should, where necessary, have powers to appoint a relevant expert to provide a professional assessment, paid for where appropriate by the company itself.

“The Law Reform Commission of New South Wales received positive responses in their consultation about this suggestion. Suggestions as to which information should be provided (Law Reform Commission NSW 2003; Bergman 1992; Jefferson 2001) include details of:

- any prior convictions;
- any new compliance systems implemented to prevent repetitions of the offence;
- what existing compliance systems were already in place;
- the previous positive and negative record of the corporation;

²³ The full paper is recommended reading. It echoes many of the points made throughout this consultation, not least the inadequacy of the penalties currently imposed on companies found guilty of breaches of criminal law and the advantages of equity fines.

Criminal Sentencing (Equity Fines) Bill Consultation Paper

- any attempts at reparation;
- any prior convictions of high level personnel of the corporation.
- financial information such as the company's turnover and annual profits;
- the history of the company's relationships with regulators and in for example, safety cases, its general health and safety record.”