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***OHS regulation***



**Working Paper 80**

**Insuring Directors Against Criminal OHS  
Wrongdoing**

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## 1. **About the Centre**

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## **Abstract**

This paper considers the question of whether it is possible for company officers, who are fixed with personal liability for criminal occupational health and safety offences, to insure against such liability. It will also touch on related issues to do with indemnities being provided by companies. The paper also raises questions about how regulators should respond where such insurance is common, though contrary to public policy.

## 1. Introduction

It is well recognised now that personal liability OHS provisions provide one of the strongest “drivers” for company officers to use due diligence to see to the implementation of company safety policies. An officer faced with a potential large criminal penalty has their mind strongly focussed on not falling foul of the law. But what if the officer knows all along that, should they be subject to such a penalty, the company, or an insurance policy, will come to the rescue? It is vital for company officers, and for regulators considering the impact of laws, to be aware of the law about insurance in these situations. As this paper will show, it is, however, a difficult question as to how regulators should respond where the policy of the law prohibits such insurance, but all the parties concerned continue to behave as if the insurance were legally valid.

In appropriate situations the law may fix personal liability for workplace injuries on company officers in tort (leading to a potentially large exposure of personal assets),<sup>1</sup> under the general criminal law (including manslaughter), both personally and as an accessory,<sup>2</sup> and under specific provisions targeted at company officers under workplace safety statutes.<sup>3</sup>

This paper addresses a topic which has, however, a substantial practical impact on issues of personal liability of officers: the question of insurance and indemnities. Is it lawful for an officer to insure against personal liability? Is it possible for a company to provide an indemnity against such liability?<sup>4</sup> The problems are summed up well by Herzfeld:

Indemnities, whether from the company or through an insurer, “protecting directors against liabilities incurred whilst performing their duties, including indemnities protecting directors of public companies, are of importance in ensuring that highly qualified and experienced people are attracted to assume the responsibility”.<sup>5</sup> On the other hand, “shareholders and

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<sup>1</sup> N Foster, “Personal civil liability of company officers for company workplace torts” (2008) 16/1 *Torts Law Journal* 20-68.

<sup>2</sup> N Foster, “Manslaughter by Managers: The Personal Liability of Company Officers for Death Flowing from Company Workplace Safety Breach” (2006) 9 *Flinders Journal of Law Reform* 79-111.

<sup>3</sup> N Foster, “Personal Liability of Company Officers for Corporate Occupational Health and Safety Breaches: section 26 of the Occupational Health and Safety Act 2000 (NSW)” (2005) 18 *Australian Journal of Labour Law* 107-135; “Individual Liability of Company Officers” *Conference on European Developments in Corporate Criminal Liability* (Offices of Clifford Chance, Canary Wharf, London. Sep. 2009), at: [http://works.bepress.com/neil\\_foster/34](http://works.bepress.com/neil_foster/34) .

<sup>4</sup> The fact that such insurance appears to be commonly offered, of course, does not determine the issue of its lawfulness. See the examples of insurance against fines and penalties offered by one large firm, and one commonly used insurance policy, noted in Herzfeld, Perry “Still a troublesome area: legislative and common law restrictions on indemnity and insurance arrangements effected by companies on behalf of officers and employees.” (2009) 27 (5) *Company and Securities Law Journal* 267-298 at 268-269 (though accompanied by words such as “to the extent legally possible”.)

<sup>5</sup> *Motor Trades Assn of Australia Superannuation Fund Pty Ltd v Rickus (No 3)* (2008) 69 ACSR 264; [2008] FCA 1986 at [17] (Flick J). See also *Whitlam v National Roads & Motorists’ Assn Ltd* (2006) 202 FLR 153; [2006] NSWSC 766 at [82] (Bergin J).

creditors should not be unfairly prejudiced by directors and officers (among others) being able to insulate themselves from liability for breaches of duty”.<sup>6</sup> That prejudice may occur because the shareholders and creditors must ultimately bear the financial burden of any indemnity or insurance premium. More significantly, it may occur because the existence of an indemnity or insurance arrangement will lessen the disincentive to wrongdoing provided by exposure to liability.<sup>7</sup>

## 2. Insurance

A number of aspects of insurance warrant some mention. One is the threshold question whether a director can themselves insure against the sort of personal criminal liability that may be imposed under the provisions mentioned. Another is the issue of whether a company may take out such insurance on behalf of a director. If so, would this create the “moral hazard” that such insurance would negate any incentive for a director to behave more responsibly?

In the following discussion two separate issues need to be kept in mind, although in practice they are closely related- interpretation and policy. The first is a contractual interpretation issue, as to whether the *terms* of an insurance policy dealing with a director’s liability cover the particular liability concerned. While there tend to be certain standard terms in insurance contracts of particular types, in the end in specific cases this will come down to interpreting the particular contract. However, the second issue can have an impact on this question- the issue of public *policy*. Some cases (discussed below) establish that as a matter of public policy a term of a contract which provides an indemnity against criminal liability should be regarded as void. A court in providing an interpretation of an insurance contract will have this public policy in mind.

Another important issue in the “public policy” cases has to do with the scope of the exclusion. The courts will rarely uphold a provision of a contract which provides insurance against a criminal penalty directly levied on the insured (“penalty of crime” insurance). But a contract of insurance may be so broadly worded that it covers liability for events which “amount to” criminal activity by the insured. The issues which will arise here include whether there is a public policy excluding recovery in relation to such events, and whether, if someone else is injured by this criminal activity, the injured person can have access to the insured’s funds by way of damages. It is useful to distinguish this “third-party damage resulting from criminal activity” case from the “penalty of crime” case mentioned previously.

### (a) Tort liability

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<sup>6</sup> Companies and Securities Law Review Committee, n 3 (1990), Introduction.

<sup>7</sup> Herzfeld, above n 4, at 269-270.

In relation to tort liability, “director’s and officer’s liability insurance” is very common.<sup>8</sup> Section 199B of the *Corporations Act 2001* (Cth)<sup>9</sup> prohibits payment by the company of insurance against “wilful” breach of duty, but does not exclude insurance against negligence.

**199B Insurance premiums for certain liabilities of director, secretary, other officer or auditor**

(1) A company or a related body corporate must not pay, or agree to pay, a premium for a contract insuring a person who is or has been an officer or auditor of the company against a liability (other than one for legal costs) arising out of:

- (a) conduct involving a wilful breach of duty in relation to the company; or
- (b) a contravention of section 182 or 183.

This section applies to a premium whether it is paid directly or through an interposed entity.

On the other hand, in practice it seems to be fairly common for existing “D&O” insurance policies covering negligence to exclude liability for personal injury.<sup>10</sup>

If it is possible that in some cases a director or officer may be personally liable for injury suffered by a company employee,<sup>11</sup> and were claims against directors for such personal tort liability to become more common, then the question arises whether extending the coverage of D&O insurance to such claims would be desirable.

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<sup>8</sup> See V Finch, “Personal Accountability and Corporate Control: the Role of Directors’ and Officers’ Liability Insurance” (1994) 57 *Modern L Rev* 880-915 and C Baxter “Demystifying D&O Insurance” (1995) 15 *Oxford Jnl of Legal Studies* 537-564 for excellent reviews of the policy issues involved in such insurance, and the UK situation; S Ansell “Directors’ and Officers’ Liability Insurance- Recent Reforms and Developments in Australia and New Zealand” (1995) 23 *Aust Business Law Rev* 164-173, S J Traves & R N Traves “Directors and Officers Liability Insurance: Reducing the Burden of Legal Liability” (1996) 26 *Old Law Society Jnl* 587-604, and M Waller & L Courtice “Insuring against environmental risks in Australia and some recent developments” (1998) 8 *Aust Product Liability Reporter* 172-181 for some comments from an Australian perspective; C Parsons “Directors’ and Officers’ Liability Insurance: A Target or a Shield?” (2000) 21 *Company Lawyer* 77-86; S Harrison & C McGill “The Liability Of Directors And Officers Under Mining And Petroleum Safety Legislation – What Are Their Duties, The Potential Penalties And What Can They Do To Protect Themselves?” (2006) 25 *Aust Resources and Energy Law Jnl* 65-89; Mark Lindfield & Michael Quinlan, “Directors' and officers' insurance” (2008) 22 (1) *Commercial Law Quarterly* 25-36.

<sup>9</sup> Formerly s 241A of the *Corporations Law*.

<sup>10</sup> See, for example, the article by Traves and Traves above at n 8 at p 604.

<sup>11</sup> See the article in n 1 above. Note that if the officer were also an employee of the company, they would have an effective immunity from suit in NSW under the *Employees Liability Act 1991* (NSW) s 3, where the company was also liable. But in many situations directors are not employees and could not rely on this Act.

On the one hand it might be argued that this would remove the deterrent effect of such claims. So Finch comments:

Will 'D&O' insurance undermine an individual's incentives to avoid wrongdoing? Such insurance does increase the danger of 'moral hazard' in so far as payments for wrongdoing will be made from insurance funds rather than the personal assets of errant directors. Thus, insurance could be said to subvert public policy, encourage unscrupulous directors to pursue questionable activities and dull the incentives of honest directors to be attentive to their duties...<sup>12</sup>

However, even where insurance is generally available there are a number of disincentives following from an insurance payout in these circumstances. There are penalties from within the insurance system (such as deductibles and increased premiums):

insurers can reduce moral hazard by, for example, imposing deductibles, restricting cover, imposing conditions and adjusting premiums in relation to the performance records of specific companies and individual directors.<sup>13</sup>

In addition there is the general deterrent effect of a public finding of liability by a court. A director against whom a finding of personal negligence had been made in relation to a workplace injury might find it uncomfortable to continue in the same company, and difficult to obtain an executive position in another company, for example. Consequences such as these will remain strong factors encouraging directors to behave with due diligence.

So there is a good case for allowing D&O insurance policies to operate in relation to civil (tort) liability, but for directors and officers to make sure that their insurance policies cover a possible liability for personal injury.

## **(b) Criminal liability insurance**

### **(i) The normal rule- no insurance for crime**

In terms of criminal liability, however, an insurance policy will generally not provide coverage for the consequences of a criminal conviction.<sup>14</sup> The normal rule was stated this way in *Burrows v Rhodes*:

It has, I think, long been settled law that if an act is manifestly unlawful, or the doer of it knows it to be unlawful, as constituting either a civil wrong or a criminal offence, he cannot maintain an action for contribution or for indemnity against the liability which results to him therefrom. An express promise of indemnity to him for the commission of such an act is void.<sup>15</sup>

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<sup>12</sup> Finch, above, n 8, at 888.

<sup>13</sup> *Ibid.*

<sup>14</sup> See, for example, *Ibid.*, 887: "insurance would be ruled out regarding acts involving dishonesty or a crime".

<sup>15</sup> [1899] 1 QB 816 at 828, cited and approved by Hope JA in *Australian Aviation Underwriting v Henry* (1988) 12 NSWLR 121, at 123G.

In the English Court of Appeal decision in *Lancashire County Council v Municipal Mutual Insurance Ltd*, Simon Brown LJ reviewed earlier authority and concluded:

For my part, I unhesitatingly accept the principle that a person cannot insure against a liability consequent on the commission of a crime, whether of deliberate violence or otherwise--save in certain circumstances, where, for example, compulsory insurance is required and enforceable even by the insured.<sup>16</sup>

**(ii) Exceptions to the rule for crime based on negligence**

The exception mentioned by his Lordship has arisen mostly in the case of motor accident cases. If the general rule were applicable a driver who through recklessness caused the death of a pedestrian (and hence might be regarded as guilty of manslaughter, or a “dangerous driving” offence) would not be able to recover under an insurance policy. This may mean, of course, that the *victim’s* family would be unable to recover, most drivers being unable to meet the requirements of a damages payout in those circumstances. To avoid this obvious problem the courts have usually interpreted an insurance policy covering reckless driving as including behaviour which would amount to a crime.<sup>17</sup>

In line with this authority, the NSW Court of Appeal held in *Australian Aviation Underwriting v Henry*<sup>18</sup> that an exclusion clause in an insurance contract dealing with motor accidents, which excluded injury caused by the insured’s “own criminal act”, should be read down to allow the deceased insured’s estate to claim under the policy even though he had been guilty of dangerous driving. Hope JA & Priestley JA (McHugh JA dissenting) held that the exclusion should not be held to apply to criminal acts which resulted from “negligence” or “inadvertance” rather than deliberate intention. A similar result followed in the South Australian Full Court decision of *Australian Associated Motor Insurance Ltd v Wright*.<sup>19</sup> As can be seen, this involves not “penalty of crime” insurance (the deceased’s estate would not presumably be able to recover for a dangerous driving fine that was imposed on the deceased before his death), but is a version of “third party damage resulting from criminal activity” insurance, though slightly extended here through the replacement of the deceased by the fictional legal personality of his estate.

Should such an exception be applied to a criminal prosecution of a company officer for either manslaughter or a “deemed” officer offence under a provision such as s 26 of the *Occupational Health and Safety Act 2000* (NSW)?

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<sup>16</sup> [1996] 3 All ER 545, at 554d-e. The earlier cases relied on were *Haseldine v Hosken* [1933] 1 KB 822, *Hardy v Motor Insurers’ Bureau* [1964] 2 All ER 742, and *Gray v Barr* [1971] 2 All ER 949. More recently this principle was supported by a differently constituted Court of Appeal in *Charlton v Fisher* [2002] QB 578, [2001] EWCA Civ 112.

<sup>17</sup> See *Tinline v White Cross Insurance Association Ltd* [1921] 3 KB 327; *James v British General Insurance Co Ltd* [1927] 2 KB 311.

<sup>18</sup> (1988) 12 NSWLR 121.

<sup>19</sup> (1998) 10 ANZ Ins Cas ¶61-390, BC9706546.

A prosecution for manslaughter will involve, not deliberate intent to harm, but carelessness (even if, of course, of a high degree). It might be argued, by way of analogy with the cases which allow access to an insurance policy in cases of death caused by reckless driving, that such access should also be permitted in the case of careless management conduct. That is, even though a director may be guilty of manslaughter in relation to the death of an employee, there should be no public policy bar to the director having access to an insurance policy to pay an award of damages which might be made against the director, to the worker's estate, flowing from the death.

That is not to say, however, that the officer *themselves* ought to be able to recover under an insurance policy a criminal penalty which might be imposed on them for either manslaughter or some other criminal conduct causing harm. In that situation there would seem to be no reason to vary the normal policy rule that "a person... may not stand to gain an advantage arising from the consequences of his own iniquity".<sup>20</sup>

### **(iii) Exceptions to the rule for "deemed" offences?**

But does the same logic apply to an offence which is "deemed" to be have been committed? The argument that access to a policy by an officer should be allowed in relation to penalties imposed via provisions like s 26 seems stronger, as a "deemed" offence involves no *mens rea*.<sup>21</sup> So in *James v British General Insurance Co Ltd* Roche J commented on the suggested general principle that public policy precludes an insured from claiming in relation to his own crime:

[T]he principle (if it is applicable at all) affects many other cases besides those of motor insurance. It affects a very large number of workmen's compensation insurances where workmen are injured by acts or defaults, even though inadvertant on the part of employers, which amount to breaches of the Factory Acts, such as neglect in the fencing of machinery and things of that sort. If the principle be right, that the mere fact that the assured has offended against the criminal law, however inadvertantly, precludes him from recovering under a policy of indemnity, then indeed the results are very far-reaching.<sup>22</sup>

His Honour's comments were, of course, *obiter dicta* as the case related to careless driving, but the general approach may commend itself to a court asked to decide whether a company director should be allowed to access an insurance policy when fined through the deeming provisions of s 26.

We have not yet reached an answer to this question, however. Before doing so it is worth noting that this general policy of the law concerning insurance, also then has

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<sup>20</sup> Lord Hailsham in *Gardner v Moore* [1984] AC 548, at 558, as cited by Rix LJ in *Charlton v Fisher* [2002] QB 578 at para [89]. For more recent analysis of the principle (sometimes referred to by the Latin tag *ex turpi causa*) see the decision of the House of Lords in *Moore Stephens (a firm) v Stone Rolls Ltd* [2009] UKHL 39, [2009] 1 AC 1391.

<sup>21</sup> That is, no "guilty mind".

<sup>22</sup> [1927] 2 KB 311, at 320-321.

implications for any attempt by a company to provide indemnification for the consequences of criminal activity, and is best considered under that general heading.

### 3. Indemnity for Criminal Activity

The difference between insurance and indemnity, briefly stated, hinges on whether or not there is another entity interposed between the person who is legally liable, and the person making a payment. Under an *insurance* policy the employer pays premiums on a D&O policy to an insurance company, and if liability arises the insurance company makes the payment. Under an “*indemnity*” arrangement, however, the employer simply promises that if the employee incurs a certain type of legal expense, the company will pay it on behalf of the employee.

Legal restrictions applying to companies in this area differ in approach between those dealing with an “*indemnity*” and those dealing with “*insurance*”. Logically an insurance policy will usually involve some sort of “*indemnity*”, but the difference, as noted above, lies in the question whether the source of a promised payment is from company general funds, or from a general policy provided by an insurer and paid for by the company.

Even if insurance is not obtained, then, can an indemnity be provided by a company in relation to an officer’s criminal liability? That is, may a company promise to reimburse amounts the director is required to pay in relation to breach of a provision of the criminal law? The question may arise in two ways: first, as to whether such a term in a director’s contract would be enforceable by the director, and secondly, as to whether a company may lawfully make such a payment even if not otherwise obliged to.

The Canadian decision in *R v Bata Industries Ltd (No 2)*<sup>23</sup> raised this issue. In handing down sentences for breaches of environmental laws on the company and its directors, Ormston PDJ had added a condition to the sentence of the company that it not indemnify the directors against their fines. His Honour did this under a power to impose “probation” conditions on sentences. On appeal to the Ontario Court of Appeal, however, the condition was overturned, as the Court of Appeal ruled that the power to issue a probation order had to be directed to the rehabilitation of the offender (the company), and this order had been made to ensure appropriate punishment for the individual officers, rather than the company.<sup>24</sup> Jurgeleit notes that a New Zealand decision, *Machinery Movers Ltd v Auckland Regional Council*,<sup>25</sup> agreed with the view of the trial court,

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<sup>23</sup> (1992) 70 CCC (3d) 394.

<sup>24</sup> *R v Bata Industries Ltd* (1995) OR (3d) 321. No comment was made as to whether a condition that the officers not **accept** such indemnification could have been attached to the officers’ sentences.

<sup>25</sup> [1994] 1 NZLR 492.

however, that it was appropriate to have ordered that the company not indemnify the directors.<sup>26</sup>

What is the position with such an indemnity under Australian law? The question is not entirely free from doubt.

The Australian Law Reform Commission discussed the issue in the following terms:

The most effective way of ensuring that an individual upon whom a penalty is imposed bears the burden of that penalty is to impose a penalty that cannot be paid, reimbursed or off-set by the corporation or any other person... The impact of a monetary penalty, and its deterrent effect, will be small or non-existent if the individual is reimbursed by the corporation by which he or she is engaged. The *Corporations Law* prohibits a company from indemnifying an officer of the company against a liability incurred by the person as an officer or from exempting an officer from such a liability. It does not prevent a company from indemnifying its officers in respect of liability to persons other than the company, provided the liability does not arise out of conduct involving a lack of good faith. This does not prohibit the indemnification of officers against penalties which do not relate to conduct involving a lack of good faith... It appears that the common law prohibits indemnification against criminal and civil penalties on the ground of public policy, regardless of whether a lack of good faith is involved. [See *Askey v Golden Wine Co Ltd and Ors* [1948] 2 All E R 35; *R Leslie Ltd v Reliable Advertising and Addressing Agency Ltd* [1915] 1 KB 652; *Hasledine v Hosken* [1933] 1 K B 822; *Burrows v Rhodes* [1899] 1 QB 816.] In the interest of certainty and in order to signal to corporations and officers that indemnifying officers and other persons implicated in contraventions against penalties is prohibited, the Commission recommends that s241 of the *Corporations Law* be amended to prohibit corporations from indemnifying their officers, employees or agents or any other person implicated in a contravention against criminal or civil penalties imposed upon the officers, employees or agents or other person.<sup>27</sup> [emphasis added; some footnotes omitted]

This overview is explained in more detail below.

### **(a) Statutory provisions dealing with indemnity for criminal fines**

Section 199A(2)(c) of the *Corporations Act 2001* (Cth) prohibits a company from indemnifying an officer for “a liability that is owed to someone other than the company or a related body corporate and did not arise out of conduct in good faith”.

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<sup>26</sup> C Jurgeleit, “Insurance Against Liability to Pay Statutory Fines and Penalties” (1996) 26 *Victoria University of Wellington Law Rev* 735-750. As Jurgeleit notes at 748, the *Machinery Movers* case did not involve the prosecution of a director, so the comments were *obiter*, but they do support the logic of the original *Bata* decision and emphasise the courts’ reluctance to allow indemnification of criminal penalties which involve any aspect of subjective fault by the officer concerned. The over-turning of the non-indemnification order was made on technical grounds, and was not a comment on the policy issues involved.

<sup>27</sup> Report No 68, *Compliance With The Trade Practices Act 1974* (1994), ch 10 at 10.34.

**199A Indemnification and exemption of officer or auditor**

*When indemnity for liability (other than for legal costs) not allowed*

(2) A company or a related body corporate must not indemnify a person (whether by agreement or by making a payment and whether directly or through an interposed entity) against any of the following liabilities incurred as an officer or auditor of the company:

- (a) a liability owed to the company or a related body corporate;
- (b) a liability for a pecuniary penalty order under section 1317G or a compensation order under section 1317H, 1317HA or 1317HB;
- (c) a liability that is owed to someone other than the company or a related body corporate and did not arise out of conduct in good faith.

This subsection does not apply to a liability for legal costs.

However, it seems clear that “liability” in this context does not refer to criminal liability.<sup>28</sup> This is shown by two factors. One is the inherent inappropriateness of referring to a criminal penalty payable to the Crown as a “liability... owed to someone”. The second factor is the structure of subsection 199A(3), dealing with *costs* as opposed to penalties:

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<sup>28</sup> See the comments on this issue in the Victorian Law Reform Commission Report *Criminal Liability for Workplace Death and Serious Injury in the Public Sector* (Melbourne: VLRC, March 2002), at 70-71: “It is not clear whether the prohibition of indemnification for liability in section 199A(2)(c) applies to criminal penalties, although the section is capable of this interpretation...” I disagree with the Commission on this point for the reasons discussed in the text.

*When indemnity for legal costs not allowed*

**199A(3)** A company or related body corporate must not indemnify a person (whether by agreement or by making a payment and whether directly or through an interposed entity) against legal costs incurred in defending an action for a liability incurred as an officer or auditor of the company if the costs are incurred:

- (a) in defending or resisting proceedings in which the person is found to have a liability for which they could not be indemnified under subsection (2); or
- (b) in defending or resisting criminal proceedings in which the person is found guilty; or
- (c) in defending or resisting proceedings brought by ASIC or a liquidator for a court order if the grounds for making the order are found by the court to have been established; or
- (d) in connection with proceedings for relief to the person under this Act in which the Court denies the relief.

Paragraph (c) does not apply to costs incurred in responding to actions taken by ASIC or a liquidator as part of an investigation before commencing proceedings for the court order.

Note 1: Paragraph (c)—This includes proceedings by ASIC for an order under section 206C, 206D, 206E or 206EAA (disqualification), section 232 (oppression), section 1317E, 1317G, 1317H, 1317HA or 1317HB (civil penalties) or section 1324 (injunction).

Note 2: The company may be able to give the person a loan or advance in respect of the legal costs (see section 212).

It will be noted that legal costs in relation to subsection (2) are dealt with by para 199A(3)(a), whereas costs incurred “in defending or resisting criminal proceedings in which the person is found guilty” are dealt with in para 199A(3)(b). In theory this might mean that “criminal proceedings” are not included in the class of proceedings for which someone could not be indemnified under subsection (2). But it seems more likely that subsection (3) is included out of “abundant caution”. It would be very odd to achieve a fundamental rewriting of the law (to allow indemnity against criminal fines under subsection (2)), by an implication drawn from another provision. On balance, then, it seems likely that the Act does not allow indemnity against a criminal penalty.

Herzfeld has a helpful discussion of the criteria for determining whether proceedings are “criminal proceedings” for the purposes of this provision, and concludes (correctly in my view) that proceedings taken under the *Occupational Health and Safety Act 2000* (NSW) are fairly clearly criminal proceedings for these purposes.<sup>29</sup>

The question of indemnity against a fine in criminal proceedings, then, as opposed to an order for costs, seems to be left to the common law.<sup>30</sup>

<sup>29</sup> Herzfeld, above n 4 at 281-282.

<sup>30</sup> As Herzfeld comments, “even if the indemnity or insurance of an officer is not prohibited by ss 199A or 199B of the *Corporations Act*..., it will still be subject to common law limitations”- above, n 4, at 290. He goes on to note on the same page that were the situation otherwise a company would be prohibited from

## (b) Common law principles on indemnity for criminal penalty

Ford offers the following analysis:

A contract to indemnify a person against criminal liability is illegal if the crime is one which can only be, or in fact is, committed with guilty intent: Treitel GH, *The Law of Contract*, 8<sup>th</sup> ed, p 382. The position is less clear where the crime is one of strict liability and the conduct of the offender is morally innocent (compare, for example, *Askey v Golden Wine Co Ltd* [1948] 2 All ER 35 with *Cointat v Myham & Sons* [1913] 2 KB 220), though by and large textwriters prefer the view that an indemnity can be given: Treitel, *supra*, p 383; *McGregor on Damages*, 15<sup>th</sup> ed, 1988, p 454.<sup>31</sup>

In *Askey* the plaintiff was a wholesaler of spirits and had purchased a large quantity from the Golden Wine Co. It turned out that these were contaminated by methylated spirits; the directors of Golden Wine were fined, and subsequently Askey was also fined for selling contaminated liquor. He took an action against the company and its directors to recover the criminal fine of £316 which he had been forced to pay.

Denning J in the King's Bench Division ruled that as a matter of public policy the court would not allow recovery in a civil action of a penalty imposed by the criminal courts.

[T]he punishment inflicted by a criminal court is personal to the offender, and... the civil courts will not entertain an action by the offender to recover an indemnity against the consequences of that punishment. In every criminal court the punishment is fixed having regard to the personal responsibility of the offender in respect of the offence, to the necessity for deterring him and others from doing the same thing again, to reform him, and ... to make him more exact and scrupulous in his supervision of the matters for which he is responsible. All these objects would be nullified if the offender could recover the amount of the fine and costs from another by process of the civil courts.<sup>32</sup>

A factor which also weighed with Denning J was that the plaintiff was not simply an innocent who had been caught by the absolute liability of the food contamination laws- he was said to himself be guilty of "gross negligence".<sup>33</sup> The legislation contained defence provisions of "due diligence" which the plaintiff had not been able to rely upon.<sup>34</sup>

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indemnifying an officer for the *costs* of criminal proceedings, but allowed to provide a full indemnity for the *penalty* itself, a result he describes as "absurd." Contrast s 234(4) of the *Companies Act 2006* (UK), which explicitly provides that no indemnity may be given to a director "against- (a) any liability of the director to pay- (i) a fine imposed in criminal proceedings..."

<sup>31</sup> Ford HAJ, Austin RP & Ramsay IM *Ford's Principles of Corporations Law* (10<sup>th</sup> ed; Australia: Butterworths, 2001) [8.410] at 372.

<sup>32</sup> *Askey v Golden Wine Co Ltd* [1948] 2 All ER 35, at 38D-E.

<sup>33</sup> *Askey v Golden Wine Co Ltd*, at 38C.

<sup>34</sup> *Askey v Golden Wine Co Ltd*, at 38B, referring to ss 83, 84 and 86 of the *Food and Drugs Act 1938* (UK).

Given that the reasons for not allowing an indemnity have to do with the personal culpability of the defendant, however, it is perhaps not surprising that in the case of criminal liability which is imposed *without* any personal responsibility, the courts have often adopted a different approach. Denning LJ himself revisited the issue as part of the Court of Appeal in *Strongman (1945) Ltd v Sincock*.<sup>35</sup> Strongman were a firm of builders who had done work on properties owned by the defendant, an architect, who had undertaken to obtain the necessary licenses but failed to do so. The lack of licenses meant that the work was illegal and the contract could not be sued upon directly. Strongman, however, sued the architect for breach of a collateral promise to obtain the licenses. To the defendant's argument that this would allow recovery for illegal work, Denning LJ commented:

It is a settled principle that a man cannot recover for the consequences of his own unlawful act, but this has always been confined to cases where the doer of the act knows it to be unlawful or is himself in some way morally culpable. It does not apply when he is an entirely innocent party.<sup>36</sup>

His Lordship distinguished his own previous decision in *Askey* on the basis that Askey had been personally careless.<sup>37</sup>

This approach was also seen in *Osman v J Ralph Moss Limited*.<sup>38</sup> Mr Osman had been told by the insurance agents Moss that he was insured against motor vehicle accidents, whereas in fact his insurance had lapsed. When he was involved in an accident, on top of his civil liability to the other driver, to add insult to injury he was fined £25 for driving without insurance. The UK Court of Appeal (Sachs, Edmund Davies & Phillimore LJJ) held that he was entitled to recover this amount from the agents. The Court distinguished *Askey* on the basis that Mr Osman, unlike Mr Askey, was “entirely free of culpable negligence”.<sup>39</sup>

This general approach has more recently been supported by the decision in *Safeway Stores Ltd v Twigger*.<sup>40</sup> There Flaux J said at [99] that:

*Osman* is clear authority for the principle that a fine or penalty will be recoverable where the claimant was not negligent or otherwise personally at fault, nor do I consider that the application of the principle is limited to strict liability offences properly so called.<sup>41</sup>

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<sup>35</sup> [1955] 3 All ER 90.

<sup>36</sup> *Strongman (1945) Ltd v Sincock* [1955] 3 All ER 90, at 93A-B.

<sup>37</sup> *Strongman (1945) Ltd v Sincock* [1955] 3 All ER 90, at 94A-C.

<sup>38</sup> [1970] 1 LLR 313.

<sup>39</sup> *Osman v J Ralph Moss Limited* [1970] 1 LLR 313, per Edmund Davies LJ. A similar reconciliation of the cases was offered by Eames J in the Supreme Court of Victoria in the unreported decision of *Krakowski v Trenorth Ltd (formerly known as Eurolynx Properties Ltd)* (27 August 1996; BC9603853), at 31-42. The case was not directly on point, however, dealing with the consequences of an alleged fraud rather than of a criminal act.

<sup>40</sup> [2010] EWHC 11 (Comm) (15 January 2010).

On appeal in that case, the English Court of Appeal held that where an offence had been committed by a company “intentionally or negligently”, it was contrary to public policy to allow the company to recover an indemnity against the penalty from former officers of the company whose behaviour had led to the imposition of the penalty.<sup>42</sup> Since the relevant conviction could not have been entered unless the company concerned had been guilty in this way, recovery of the indemnity was not possible.<sup>43</sup>

It has been suggested in other cases that the question whether or not public policy prevents indemnity against a criminal penalty could also be framed as a question about the “seriousness of the offence.”<sup>44</sup> But in the author’s view, it would be better to focus more explicitly on the issue as to whether or not the provision is one that creates “absolute” or “strict” liability, the issue of “seriousness” being far too indeterminate to be left up to judicial discretion.

Indeed, Herzfeld notes that there are plausible arguments based on public policy against allowing indemnification even of strict liability provisions, given that Parliaments have chosen in some cases to provide for such strict liability as an incentive designed to provide a strong incentive to take proactive steps to minimise risk.<sup>45</sup>

Whatever view is ultimately taken on this point, it seems clear that where a liability provision hinges to some extent (either in the primary statement of the offence, or in defences that are provided) on personal fault, that the law should not allow indemnification of the liability by a company.

For example, in *R v Northumbrian Water, ex parte Newcastle and North Tyneside Health Authority*,<sup>46</sup> Collins J in the Queen’s Bench Division considered the question whether an indemnity could be given by a health authority to a water authority in relation to possible criminal charges. The water authority had been requested to introduce fluoride into the water supply but were concerned that they might thereby in some circumstances incur a liability under s 70 of the *Water Industry Act 1991* (UK). Section 70 made it an offence to supply water which was unfit for human consumption, which was effectively a “strict liability” offence subject to a defence of “due diligence”.

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<sup>41</sup> This approach was also generally supported in the later decision of Vos J in *Griffin v UHY Hacker Young & Partners (A Firm)* [2010] EWHC 146 (Ch) (04 February 2010).

<sup>42</sup> [2010] EWCA Civ 1472 (21 Dec 2010), per Pill, Longmore & Lloyd LJJ.

<sup>43</sup> The members of the Court of Appeal explicitly declined to rule as to whether the same rule would apply to an offence of true “strict liability”, ie “where... the claimant may not have been at fault at all”- cf Longmore LJ at [18]. But the judgement provides further recent support for the view that where the offence involved “fault”, an indemnity is not possible. Pill LJ commented at [52] that “where there is a personal responsibility for the conviction, the principle *ex turpi causa* is normally applied.”

<sup>44</sup> See Herzfeld, above n 4, at 291, citing *Fire & All Risks Insurance Co Ltd v Powell* [1966] VR 513.

<sup>45</sup> *Ibid.*, at 293.

<sup>46</sup> [1999] Env LR 715.

Collins J held that an indemnity in relation to the possible criminal liability could not be given. He referred to *Osman*, but noted that the ratio of the decision was that the person who had been prosecuted bore “no moral blame”. He continued:

It seems to me that the decision in *Osman* is clearly limited to cases where there is true absolute liability and no conceivable fault (for want of a better word) on the part of the officer. That would not be the position here because a prosecution under section 70 is defeated by showing all due diligence...<sup>47</sup>

In other words, where an offence which is on its face absolute is subject to a defence of “due diligence”, then clearly in some sense there is “culpability” in an accused who cannot make out the defence. In those circumstances the policy of the law would be against allowing an indemnity for a criminal fine imposed under that legislation.<sup>48</sup>

The decision in *Northumbrian Water*, then, supports the view that a company officer could **not** legitimately seek an indemnity from the company against a fine imposed for an offence under s 26 of the *OHS Act 2000* (NSW). If the officer, when charged, is unable to make out a defence under either s 26(1) (a) or (b), then to some extent they will bear “personal culpability” for the offence, in failing to use “all due diligence” to prevent the relevant risk to safety.<sup>49</sup> If this approach were taken it would also, as previously noted, prevent the officer from seeking an indemnity against a fine that might be imposed in relation to a finding of manslaughter.<sup>50</sup>

The situation is summarised as follows in a leading Australian insurance law text:

**2-291** It is probably contrary to public policy to indemnify an insured against a fine or penalty where there is fault, since it is clearly intended to constitute a punishment upon and a deterrent to any offender. If the legislature, the primary arbiter of public policy, provides that an act or activity should be visited with a penalty, then the purpose behind that action should not be frustrated by insurance.<sup>51</sup>

The authors canvass the possibility, noted above, that where the offence is one of “strict liability” involving no fault on the part of the accused, a different view might be taken. But as we have seen, in the relevant sense (given the defences of “reasonable

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<sup>47</sup> *R v Northumbrian Water, ex parte Newcastle and North Tyneside Health Authority* [1999] Env LR 715, at 726.

<sup>48</sup> In *Safeway Stores* on appeal, above n 42, the Court of Appeal at [16]ff located the relevant policy in the maxim *ex turpi causa non oritur action* (“no action arises out of a dishonourable cause”), the narrowest version of which was formulated recently by the House of Lords in *Gray v Thames Trains Ltd* [2009] 1 AC 1339 at [32] as “a claimant cannot recover for damage which is the consequence of a sentence imposed upon him for a criminal act”.

<sup>49</sup> This view also receives support from the specific reference made by Denning J in *Askey* to the fact that Mr Askey had an opportunity to prove “all due diligence” when prosecuted- see above, n 32, at 38B.

<sup>50</sup> It would also, incidentally, clearly preclude provision of an indemnity or insurance policy covering a penalty imposed under s 27(1) of the proposed Model *Work Health and Safety Bill*, which includes in the statement of the offence a failure to “exercise due diligence”.

<sup>51</sup> D Derrington & R Ashton, *The Law of Liability Insurance* (2<sup>nd</sup> ed; LexisNexis Australia, 2005), at 126.

practicability” and “due diligence”) health and safety offences are indeed “fault based” offences, and so even if there were an exception for strict liability offences it would not apply to these offences. As they conclude:

2-293[A] penalty manifests the plain intention of the legislature to punish the offender and to deter breaches of its provisions.<sup>52</sup>

#### 4. Conclusion on Legality of Insurance and Indemnity

The result of the forgoing discussion may be summarised as follows:

- (1) There seems to be no bar to a company officer purchasing “director’s and officers” insurance to cover possible civil liability which might arise in particular circumstances. However, officers may need to renegotiate existing insurance policies if they do not already cover liability for personal injury or death of company workers.
- (2) Even though the death of, or injury to, a worker may occur in circumstances where a company officer would be guilty of manslaughter or another serious criminal offence, the courts would be likely to hold that the *victim* or the victim’s family would not be precluded from gaining access to the officer’s personal insurance policy if needed to cover an award of damages in respect of the incident.<sup>53</sup>
- (3) It seems, however, that such insurance could *not*, as a matter of public policy, be obtained for the officer’s benefit to cover the risk of a fine imposed for manslaughter or other general criminal offence.
- (4) It also seems that insurance (or an indemnity) may *not* legitimately be obtained in relation to the officer’s personal liability for a fine under provisions such as s 26 of the *Occupational Health and Safety Act 2000* (NSW), given that such provisions involve defences such as “due diligence” which the officer could use to defend himself or herself.<sup>54</sup>

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<sup>52</sup> Above, n 51 at 127. See also the statement in a leading UK text, *MacGillivray on Insurance Law* (11<sup>th</sup> ed ed N Legh-Jones, J Birds, D Owen; London: Thomson Reuters, 2008), 14-045: “In no circumstances may a plaintiff maintain an action to be indemnified for a fine or other punishment imposed for the commission of a crime” (at 375).

<sup>53</sup> To further avoid the “moral hazard” of officers relying on insurance policies in these situations, it might be possible to provide by statute that, in a civil claim made in circumstances where the officer has committed a serious criminal offence, the insurance company is obliged to pay the victim or their family appropriate damages, but is entitled to a right of recovery against the personal funds of the officer. I am grateful to my colleague Dr Jeffrey McGee for this suggestion.

<sup>54</sup> The same view should no doubt be taken of the personal liability offence under s 37 of the *Health and Safety at Work Act 1974* (UK), which includes in the definition of the offence the elements of “consent”, “connivance” or “neglect”. For recent cases touching on s 37, though not on this point of insurance or indemnity, see *R. v P* [2008] I.C.R. 96 (Court of Appeal), *R. v Chargot Ltd (t/a Contract Services)* [2009] 1 W.L.R. 1 (House of Lords).

If criminal fines imposed under s 26 and related provisions may not be the subject of an insurance claim or a company indemnity, then this will mean that company officers will need to pay even more careful attention to due diligence. On the other hand, it might be thought that the incentives to avoid a personal conviction of this sort are already fairly strong apart from the burden of the fine, and that to leave this burden with the individual will have the deleterious results of totally discouraging individuals from taking up company office. In that case consideration ought to be given to specific legislative amendment to allow insurance to be provided, or an indemnity to be given, in these circumstances. On balance, however, it is submitted that the common law on the matter strikes the right balance between imposing undue penalties not related to fault, and creating the “moral hazard” that officers will have little incentive to pay careful attention to issues affecting the life and health of their company’s workers.

## **5. Enforcing the Policy of the Law**

However, there is a remaining practical question. Anecdotal evidence suggests that, despite such insurance being contrary to public policy and hence legally unenforceable, it continues to be offered by insurance companies, and (presumably) payments continue to be made.

So Harrison & McGill, for example, note that their researches revealed that in 2006 “statutory liability insurance” was being offered by Specialist Underwriting/Lumley General Insurance Ltd and QBE Insurance, whose marketing materials indicate that the policies would “respond” to fines imposed for safety breaches in the mining and petroleum areas.<sup>55</sup>

The realities of the marketplace suggest to this author (though I would be grateful if others have any insight) that the reasons are as follows:

(1) Insurance companies find that offering insurance against criminal penalties is a profitable business.

(2) Company officers are clearly keen to protect themselves.

(3) Despite payments out on such policies being unlawful, to date there has not been a sufficient number of claims by officers (or else no one sufficiently large claim) for any insurance company to decline to pay on a claim.<sup>56</sup>

Presumably there may be other cases where companies in effect provide an indemnity, either by promising to pay criminal penalties on behalf of officers, or regularly in fact doing so under the guise of some sort of “ex gratia” payment. Of course it needs to be noted that such payments are themselves unlawful, under the principles

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<sup>55</sup> Harrison & McGill, above n 8, at 85 n 109. A specific example of a prosecution in the mining area is given, and the statement made that according to other sources “80% of the claims paid to date on these types of policies... have been for occupational health and safety breaches”.

<sup>56</sup> See eg Jurgeleit, above n 26, at 749: “it is improbable that an insurer would refuse to honour a fines policy, because of the damage that would do to its commercial reputation.”

previously noted, and hence arguably could be challenged by the shareholders of the company as a mis-use of company funds.<sup>57</sup>

This raises the question, then, as to whether there is a way of implementing the public policy against such indemnities and insurance policies? The key issue is that those who are being harmed as a result of the “moral hazard” created by such payments are the workers and members of the public who will be harmed or even killed by ineffective and slack safety management by the company. Yet these people are not directly represented in the formal dealings between the company officers, the company, and the insurance company.

I would like to suggest two possibilities for enforcement of this important legal policy area.

### **(1) Statutory reform**

One option would be for this area to be clarified by a very direct statutory provision. It has been suggested above that the law is already clear, but since it involves a mix of common law policy and statutory provisions, it would be easier to police if there was a specific prohibition. This could either be implemented in safety legislation, company legislation or in the general insurance legislation. Given that the reason for the provision is safety, it would perhaps make some sense to incorporate it there. If it were to be included as part of the harmonised model Act, it could provide for a specific criminal penalty for a company which either purchased insurance against, or provided a direct indemnity in relation to, payment of a criminal penalty relating to workplace safety imposed on a company officer. Complementary amendments could be made to the companies legislation and to the insurance legislation, making it clear that it was illegal to be involved in such an insurance or indemnity arrangement.<sup>58</sup>

### **(2) Action by regulators**

Legislative change of this sort may take some time. In the interim, it is suggested that it may be possible for a workplace safety regulator to take the initiative by seeking an injunction against the offering of such insurance policies. This could be done under the provisions of what used to be s 52 of the *Trade Practices Act 1974* (Cth), now s 18 of the *Australian Consumer Law*, contained in Sched 2 of the *Competition and Consumer Act 2010* (Cth), prohibiting a person, in trade and commerce, from “engag[ing] in conduct that is misleading or deceptive or is likely to mislead or deceive.” An insurance company is of course engaged in trade and commerce. By offering to sell insurance against the payment of criminal penalties, it is offering to enter into a contract which is

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<sup>57</sup> See *Ibid.*, at 749 : “Directors who have entered into such contracts on behalf of their company or who have caused their company to grant indemnities or effect insurance in breach of the Companies legislation could face claims from shareholders or from the company. Directors may have to pay the costs of the insurance personally.” Yet he also notes that it would be unlikely that this issue would arise as an internal company dispute except perhaps in the event of change in management or liquidation.

<sup>58</sup> A similar provision has already been included in the new *Australian Consumer Law*, ss 229-230, in relation to “pecuniary penalties” imposed on officers under the ACL.

itself illegal, unenforceable and contrary to public policy. This seems clearly to be “misleading and deceptive conduct”. Hence it should be possible for a person with appropriate standing to obtain an injunction from the Federal Court of Australia against the continued offering of such insurance. It seems clear that a workplace safety regulator would have such standing, and perhaps even that the ACCC would be able to take such an action with the support of a regulator.<sup>59</sup>

There is some precedent for such an action being taken by a public body. Faure & Heine report that, despite most commentators in Belgium arguing that insurance against criminal penalties was illegal, such insurance was available for many years.<sup>60</sup> But they note:

The policy was withdrawn from the market because of pressure from the Public Prosecutor’s office, who complained that through the policy, the wrongdoer would not have to pay for the consequences of his acts.

Of course even an action in relation to an Australian insurance policy may not be totally effective to overcome the problem. Faure & Heine record that in the shipping area, an international institution called a “Protection and Indemnity Club” was funded by a number of shipping companies, and registered in Bermuda.<sup>61</sup> However, it seems less likely in the occupational health and safety area that companies would be prepared to go to such lengths simply to avoid the application of public policy concerning insurance.

In short, if the true impact of personal liability provisions is to be felt, it seems that some action must be taken to make clear what has been the policy of the law for many years, that a criminal penalty must be paid by the person on whom it has been imposed. Only then will the law “bite” sufficiently for a real difference to be made.

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<sup>59</sup> Indeed, s 232(1)(b) of the *Australian Consumer Law* allows an injunction in relation to a breach of s 18 to be issued on the application of “the regulator [ie the ACCC] or any other person.”

<sup>60</sup> M Faure & G Heine, “The Insurance of Fines: the Case of Oil Pollution” (1991) 16 (No 58) *The Geneva Papers on Risk and Insurance* 39-58; the quote comes from 42, near n 15.

<sup>61</sup> *Ibid*, at 46. Faure and Heine refer to a case where, being made aware that a shipping firm was insured against a fine for pollution under these arrangements, a court in Hamburg declined to impose a fine, instead using provisions that allowed it to impound the offending ship. It may be doubted whether there would be an analogous strategy that would be effective in most OHS prosecutions (although of course if an offence was serious enough to warrant imprisonment, such as an offence under s 32A *OHS Act* 2000 (NSW), then perhaps a court might take into account the existence of any insurance arrangements in deciding whether or not to impose a custodial sentence).