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Dr Bill Wilson MSP introduced the Criminal Sentencing (Equity Fines) (Scotland) Bill in the Parliament on 1 June 2010. This Members’ Bill seeks to add to the range of sentences which a court can impose where a public limited company is convicted of a criminal offence. The new sentencing option – an “equity fine” – would allow the courts to impose a fine which must be paid from the proceeds of a new issue of shares in the company.

In his statement on legislative competence, the Parliament’s Presiding Officer indicates that, in his view, the provisions of the Bill are not within the legislative competence of the Scottish Parliament.

This briefing considers the perceived limitations of current sentencing options, the proposals in the Bill and the issue of legislative competence.
EXECUTIVE SUMMARY

This Members’ Bill seeks to add to the range of sentences which courts can employ where a public limited company is convicted of a criminal offence. It would allow them to impose what is referred to as an “equity fine”. As for other fines, a court would impose a fine of a specified amount. The difference is that the company would be required to pay that amount from the proceeds of a new issue of shares in the company.

In effect, the Bill provides that the court would, after determining the appropriate level of fine, order the company to offer for sale a specified number of shares at a specified price. The number of shares would be set at a level which should, if successfully sold at the specified price, bring in sufficient funds to pay the fine.

The policy memorandum argues that courts dealing with criminal offences committed by public limited companies should have a sentencing option which allows them to impose a financial penalty, the impact of which will be felt by the owners of the company (ie the shareholders). It is intended that the equity fine will achieve this through a dilution of the value of the shareholding of existing shareholders in the company.

Various arguments have been advanced in favour of having some form of criminal sanction targeted at shareholders (eg they may have benefited financially from cost-cutting measures which contributed to criminal breaches of health and safety or environmental protection legislation). It has also been argued that current options for imposing financial penalties on companies can impact on innocent parties (eg where a business ordered to pay a normal fine seeks to recoup its loss by reducing staff costs).

In his statement on legislative competence, the Parliament’s Presiding Officer indicates that, in his view, the provisions of the Bill are not within the legislative competence of the Scottish Parliament. This is on the basis that it seeks to legislate in relation to issues of company law which are reserved to the UK Parliament under the terms of the Scotland Act 1998. This assessment is disputed by the member in charge of the Bill. Schedule 5 to the Scotland Act 1998 provides that the “creation, operation, regulation and dissolution of types of business association” is a reserved topic. Public limited companies are a type of business association. Thus, the question of legislative competence turns on whether or not the Bill seeks to deal with the operation or regulation of public limited companies. The Justice Committee (lead committee in relation to the Bill) is planning to consider further information on the issue of legislative competence when it meets to scrutinise the Bill.
INTRODUCTION

The Criminal Sentencing (Equity Fines) (Scotland) Bill (the Bill) was, together with explanatory notes and a policy memorandum, introduced in the Parliament on 1 June 2010. It seeks to add to the range of sentences which a court can impose where a public limited company is convicted of a criminal offence. The new sentencing option – referred to in this briefing as an “equity fine” – would allow the courts to impose a fine which must be paid from the proceeds of a new issue of shares in the company.

Proposals for legislation in this area were consulted on by Dr Bill Wilson MSP (the member in charge of the Bill) in 2008 – Criminal Sentencing (Equity Fines) Bill: Consultation Paper (Wilson 2008). A summary of responses was published in 2010 – Criminal Sentencing (Equity Fines) Bill: Summary of Consultation Responses (Wilson 2010).

The consultation paper also sought views on what it described as a supplementary proposal “to allow courts to order company background inquiry reports to help them set more effective sentences” (Wilson 2008, p 5). This proposal was taken forward by way of amendment to the Criminal Justice and Licensing (Scotland) Bill and is now provided for in section 22 of the resulting 2010 Act.

The possibility of introducing equity fines was previously considered as part of the work of an Expert Group on Corporate Homicide (established by the then Scottish Executive). Its report (2005) concluded that:

“a wide range of penalties should be available to the court to enable sentences for organisations to reflect appropriately the specific circumstances of each case, including corporate probation, equity fines and community orders”. (para 17.8)

Further information on equity fines, and other types of sentence which could be introduced for corporate offenders, is set out in Annex B to the above report.

Although the concept of equity fines has also been considered outwith Scotland, work carried out during the preparation of this briefing did not identify any countries where the equity fine is already in use.

THE PERCEIVED PROBLEM

Organisations (including public limited companies) may, in the same way as individuals, be ordered to pay fines where they are convicted of criminal offences. As things stand, a Scottish court would impose a fine of a specified amount, leaving the convicted organisation to decide on what course of action might be required to cover the cost of the fine. This type of fine is referred to in this briefing as a “monetary fine” (the term used by the member in charge of the Bill).

The policy memorandum published along with the Bill identifies a number of possible problems with the use of monetary fines in relation to organisations:

- a business ordered to pay a monetary fine may seek to recoup this loss by reducing staff costs – it is argued that this can result in a failure to punish the real culprits
- a court considering the imposition of a monetary fine may decide to restrict the level of fine in order to minimise the risk of the organisation going out of business or having to lay-off staff in order to stay in business – it is argued that this can result in fines being set at too
low a level given the nature of some of the offences involved and the need to deter future offending

It is claimed that the potential injustice involved in a business seeking to cover a fine by reducing staff costs is particularly stark where an organisation is convicted of a breach of health and safety legislation designed to protect those same staff.

PROPOSALS IN THE BILL

Aim of a new sentencing option

The policy memorandum argues that the courts should have a new sentencing option which will allow them to impose a financial penalty on a public limited company, the impact of which will be most strongly felt by its owners (ie the shareholders). It is argued that it is right for the shareholders to bear the brunt of the penalty because:

- shareholders may have benefited financially from cost-cutting measures (producing bigger profits for the business and thus greater dividends and/or share value) which contributed to the criminal offence (eg a breach of health and safety or environmental protection legislation)
- it should be possible for the courts to impose criminal penalties which may either deter people from buying shares in companies which under-invest in measures designed to secure compliance with relevant legislation, or which may encourage existing shareholders to question relevant policies and practices of such companies
- it is reasonable to expect shareholders/potential shareholders to investigate the policies and practices adopted by companies for ensuring compliance with relevant legislation

The equity fine

As indicated above, the Bill would allow the courts to impose an equity fine on any public limited company convicted of a criminal offence. As for monetary fines, the court would impose a fine of a specified amount. The difference is that the company would be required to pay the fine from the proceeds of a new shares issue. It is anticipated that this requirement would result in the existing shareholders of the company bearing the financial impact of the fine through a dilution of the value of their shareholding in the company.

In effect, the Bill provides that the court would, after determining the appropriate level of fine, order the company to offer for sale a specified number of shares at a specified price. The number of shares would be set at a level which should, if successfully sold at the specified price, bring in sufficient funds to pay the fine.

Section 1(4) of the Bill provides that the price specified for the shares in the court order “must be less than the price at which shares in the company could be bought at the end of the working day immediately preceding the day on which the order is made”. In other words, the price must be set below the then market value of the shares. The lower the price set by the court: (a) the

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1 In cases where a monetary fine is imposed, a public limited company may have the option of raising funds to cover the cost of the fine by way of a new issue of shares in the company, but would not be required by the court to take this course of action.
greater the number of shares that would have to be sold to produce enough funds to pay the fine; and (b) the more attractive such shares are likely to be to potential investors.

Where the initial order does not produce sufficient funds, because the company is unable to sell all of the shares at the specified price, the court would have the power to vary the order – effectively allowing it to order the company to issue more new shares at a lower price. The court would also have the power to revoke the equity fine order, thus allowing the fine to be paid in the normal way.

The Bill does not set any lower limit for the share price which may be specified in the initial or varied court order setting out the terms of an equity fine.

Support for the proposals

The summary of consultation responses (Wilson 2010) highlighted four main reasons put forward in support of equity fines:

- present monetary fines are too low
- equity fines target those responsible for the policies of public limited companies
- equity fines target those who profit from crimes committed by public limited companies
- equity fines will deter investment in public limited companies with poor health and safety records

Concerns about the proposals

In addition to the issue of whether or not the Scottish Parliament has the power to legislate in the way set out in the Bill (discussed below under the heading of legislative competence), the proposals in the Bill have given rise to a number of possible concerns, including:

- the fact that the proposals do not provide any new sentencing options in relation to businesses which are not run as public limited companies (the equity fine is dependent on a business having shares which can be readily offered for sale)
- whether it is appropriate to target shareholders when they may include “innocent” shareholders such as small investors, employee-shareholders and pension funds
- potential complexities involved in the system (eg in determining the exact price at which the shares are to be sold and the type of share issue)
- potential difficulties in administering and enforcing equity fines when dealing with foreign companies

Some of the above concerns (and a number of others) are considered in Annex B of the consultation paper (Wilson 2008), which seeks to present arguments rebutting such concerns.

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2 The sale of more shares will result in a greater dilution of the current holding of existing shareholders.
3 Although the price set in the initial order would be below the then market value, and thus potentially attractive to investors, various factors (possibly including the imposition of a large equity fine) might depress the market value of shares in the company before all of the new shares are sold.
4 Paragraphs 11 and 12 of the policy memorandum seek to address this concern.
LEGISLATIVE COMPETENCE

In his statement on legislative competence, the Parliament's Presiding Officer said:

"In my view, the provisions of the Criminal Sentencing (Equity Fines) (Scotland) Bill would not be within the legislative competence of the Scottish Parliament.

The reasons for this view are that in my opinion –

(1) the Bill relates to the operation or regulation of limited companies (which are a type of business association) which are matters reserved under Section C1 of Schedule 5 to the Scotland Act 1998. Section 29(2)(b) of the 1998 Act states that a provision is outside the legislative competence of the Parliament if it relates to reserved matters; and

(2) sections 1 and 2 of the Bill modify the law on reserved matters in breach of paragraph 2 of Schedule 4 to the 1998 Act. Section 29(2)(c) of the 1998 Act states that a provision is outside the legislative competence of the Parliament if it is in breach of the restrictions in Schedule 4."

In short, the Presiding Officer's view is that the Bill seeks to legislate in relation to issues of company law which are reserved to the UK Parliament, under the terms of the Scotland Act 1998, and thus outwith the legislative competence of the Scottish Parliament.

The above mentioned provisions of Schedule 5 to the Scotland Act 1998 provide that the "creation, operation, regulation and dissolution of types of business association" is a reserved topic. Public limited companies are a type of business association. Thus, the question of legislative competence turns on whether or not the Bill seeks to deal with the operation or regulation of public limited companies.

The consultation paper preceding the Bill anticipated that there might be concerns relating to legislative competence. In arguing that the planned legislation would not deal with a reserved topic, it noted that:

"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. (…)

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.”

(Wilson 2008, Annex E)

Rule 9.14.18 of the Standing Orders of the Scottish Parliament (2009) includes the following provision in relation to parliamentary scrutiny of members’ bills:

"At Stage 1 of a Member’s Bill, the lead committee may recommend to the Parliament, on a motion of the convener of the committee, that the general principles of the Bill not be agreed to if (in the opinion of the committee) –

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5 There are a number of specific exceptions to this reservation which are not relevant for the purposes of the Bill (eg in relation to the creation, etc of charities).
(…) (b) having regard to the terms of the Presiding Officer’s statement on legislative competence under Rule 9.3.1, the Bill appears to be clearly outwith the legislative competence of the Parliament and it is unlikely to be possible to amend it at Stages 2 and 3 to bring it within legislative competence”.

The provision is intended to provide an accelerated procedure in such circumstances, avoiding the need for a committee to spend a lot of time on a full Stage 1 inquiry in respect of a bill that is, for the reason stated, unlikely to be fit to become law. Where a committee makes such a recommendation, the Parliament as a whole would have to decide whether to accept the recommendation (in which case the bill falls) or reject it (in which case the lead committee would be required to consider and report on the general principles of the bill in the normal way).

The Justice Committee (lead committee in relation to the Bill) is planning to consider further information on the issue of legislative competence, from the member in charge of the Bill, to help inform its decision on whether it should invoke the accelerated procedure under Rule 9.14.18.

**SOURCES**


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