

Corporate collapses – the role of lawyers
in the context of ASIC’s investigative and
enforcement powers (including their
accessorial civil and criminal liability)

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ASIC's Regulatory Role and Objectives

ASIC's regulatory role and objectives include:

- a) ensuring compliance with the corporations legislation;
 - b) protecting the public (including investors and creditors);
 - c) promoting public confidence in the effectiveness, integrity, transparency and accountability of the regulatory system;
 - d) assisting victims to obtain compensation;
 - e) punishing those who contravene the law thereby promoting specific and general deterrence; and
 - f) promoting effective regulation and the proper functioning of the economy thereby enhancing the prosperity of all Australians.
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Criticisms of ASIC

Policy of Federal government is to shift costs of litigation from ASIC to the private sector:

Corporations Act preserves private litigation for:

- Directors' duties and accessorial liability under equitable rules: ss 179 and 185 *Corporations Act*
 - Oppression: ss 232-235 *Corporations Act*
 - Derivative action: ss 236-237 *Corporations Act*
 - Insolvent trading: ss 588G and 588M *Corporations Act*
 - ASIC may assist private litigant's lawyer: s 25(1) *ASIC Act*
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ASIC's Power to Release Information

- Even if ASIC does not commence proceedings against lawyer, ASIC can release results of its investigation into the lawyer's conduct to:

A private litigant including a liquidator/creditors (see s 25(1) ASIC Act)

The relevant Law Society or Admitting Authority (see s 127(4)(d) ASIC Act)

The Commonwealth DPP (see s 127(3) ASIC Act)

Commencement of ASIC's Investigation

ASIC's General Approach:

- Early use of oral examination power
 - Immediately obtain asset preservation orders
 - Administrative, civil and civil penalty proceedings, then criminal proceedings
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Lawyers as Informants

- Motivation for informing –

Lawyers' potential liability as constructive trustees

- Knowing assistance rule – lawyers assist directors'/trustee corporations' breaches of fiduciary duty
- *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373
- Knowing receipt rule
- *Westpac v Savin* [1985] 2 NZLR 41
- Administrative receipt vs beneficial receipt
- Payment of client's money into Trust Account

Lawyers' potential liability as accessories under *Corporations Act 2001* (Cth) or *Criminal Code Act 1995* (Cth)

Lawyers as Informants cont...

Voluntary informant – protection

- Inadequate protection at common law: *A v Hayden* (1984) 156 CLR 532
 - A possible solution?
 - *Finers v Miro* [1991] 1 All ER 182
Sections 96 and 97 *Trusts Act 1973* (Qld)
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Lawyers as Informants cont...

- Pt 9.4AAA *Corporations Act* - protects some volunteers
 - Protects employees – “in-house” counsel: s 1317AA(1)(a)(ii) *Corporations Act*
 - Protects those who provide services such as lawyers in independent practice: s 1317AA(1)(a)(iii) and (iv) *Corporations Act*
 - But no evidential immunity
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Lawyers as Informants cont...

- Lawyers who inform pursuant to ASIC's statutory powers
 - s 92 of the *ASIC Act*
 - Evidential immunity: ss 68, 69 and 76 *ASIC Act*
 - *Clear statutory procedure and protection for lawyers in United States*
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Lawyer's Role when ASIC Investigation Commences

Lawyers should ensure that:

- all corporate documents and records are preserved;
- routine document destruction is suspended;
- automatic email deletion has been disabled; and
- they communicate with key personnel within the corporation to ensure that the above procedures are observed and that adequate record preservation procedures are implemented within the corporation

(see Dunphy B, “Corporate Duties of In-house Counsel”, Company Law and In-house Counsel Conference 2008, Marriott Hotel, Brisbane, 31 March 2008)

Lawyer's Role when ASIC Investigation Commences cont...

The lawyer should also provide advice to the client about:

- the legality of ASIC's decision to commence the investigation;
 - the formal validity of ASIC's oral examination notices, notices to produce books and search warrants;
 - excuses and penalties for non-compliance with ASIC's requirements; and
 - whether there are grounds for judicial review of ASIC's decisions on the above matters.
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Lawyers As Non-Suspects and Suspects

- ASIC's investigative notices can be issued to non-suspects and suspects
 - ASIC may issue investigative notices to any person (suspects and non-suspects) who it believes can provide relevant information: see ss 19 and 30-33 *ASIC Act*
 - Lawyers may be suspected of breaching the *Corporations Act* as “principal contraveners” or as “accessories” to their clients’ contraventions
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Lawyers As Non-Suspects and Suspects cont...

- **Lawyer's duty of due care and skill under general law and s 180 Corporations Act:**
 - s 180 Corporations Act extends beyond directors to officers
 - Courts have noticed an increasing tendency for lawyers to act as directors for clients: *Blunt v CAC* (1988) 6 ACLC 1077 at 1077-1078; *AFP v Propend Finance Pty Ltd* (1996) 188 CLR 501
 - Take out Directors' insurance rather than lawyers' professional indemnity insurance?
 - Lawyers may be deemed directors (shadow directors) or deemed officers under s 9 (b)(ii) and (iii)
Corporations Act:
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Lawyers As Non-Suspects and Suspects cont...

- Lawyers may be “deemed directors” where they voluntarily assume the role of a director without being properly appointed (de-facto director/trustee de son tort);
- or where they go beyond acting in their professional capacity, and act in an entrepreneurial capacity in relation to the activities of the corporation, and the board follows the lawyers’ entrepreneurial instructions (shadow director)
- see generally *ASC v AS Nominees Ltd* (1995) 62 FCR 504; 133 ALR 1 at 51-53; *ASIC v Sydney Investment House Equities Pty Ltd* [2007] NSWSC 434 at [9]; *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* [2007] FCA 963 at [497]; and *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* [2010] NSWSC 233 at [247].

Lawyers As Non-Suspects and Suspects cont...

- To avoid breaching s 180 of the *Corporations Act* or equivalent general law duty of care, lawyers (including “in-house” lawyers) should ensure that:
 - a) the corporation’s compliance policies are documented;
 - b) the directors, officers and employees are aware of their responsibilities under these policies;
 - c) they do not walk the “fine line” when giving advice about avoiding legal obligations;
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Lawyers As Non-Suspects and Suspects cont...

- d) they are not overly technical with the application of the law; and
- e) they create and maintain a proper documentary record of their own care and diligence.

(see Dunphy B, “Corporate Duties of In-house Counsel”, Company Law and In-house Counsel Conference 2008, Marriott Hotel, Brisbane, 31 March 2008)

Duty of care may be higher for directors who are appointed to the Board because they possess special skills: *ASIC V Rich* [2009] NSWSC 1229 at [7201]-[7202] ; *and Morley v ASIC* [2010] NSWSC 331 at [900] and [903].

Accessorial Civil Liability of Lawyers

- General law preserved by ss 179 and 185 *Corporations Act*
 - Knowing assistance rule – plaintiff must show that lawyer had actual knowledge of client’s contravention
 - Knowing receipt rule – plaintiff must show that lawyer had actual or constructive knowledge of client’s contravention
 - Applies where lawyers assist trustees (trustee corporations) and fiduciaries/directors
 - See *ASC v AS Nominees Ltd* (1995) 62 FCR 504
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Accessorial Civil Liability of Lawyers cont...

➤ Types of knowledge

- Actual
 - Wilfully shutting eyes to obvious
 - Wilfully or recklessly failing to make inquiries that an honest and reasonable person would make
 - Knowledge of circumstances which would indicate facts to honest and reasonable person
 - Knowledge of circumstances which would put an honest and reasonable person on inquiry
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Accessorial Civil Liability of Lawyers cont...

- Knowing receipt rule has wider operation than *Corporations Act* accessorial civil liability provisions
 - Constructive trust is a more powerful remedy than personal remedies (such as compensation order – s 1317H *Corporations Act*)
 - Property protected by the constructive trust does not fall into the assets subject to lawyer's personal bankruptcy: Note s 116(2)(a) *Bankruptcy Act 1966* (Cth)
 - However, plaintiff may obtain an injunction under s 1324 to facilitate compensation order under s 1317H by ordering the transfer of property to the corporation
 - Constructive trust may also operate retrospectively (and create a proprietary interest) back to date of breach: *Muschinski v Dodds* (1985) 160 CLR 583 at 615 per Deane J.
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Accessorial Civil Liability of Lawyers cont...

- Lawyers “Involved in [client’s] contraventions” – see s 79 *Corporations Act*
 - The plaintiff must show that the lawyer had actual knowledge of the client’s contravention – see *Yorke v Lucas* (1985) 158 CLR 661 at 669; *ASIC v Australian Investors Forum Pty Ltd (No 2)* [2005] NSWSC 267 at [114]-[118]; *ASIC v PFS Business Development Group Pty Ltd* [2006] VSC 192 at [391]; *HIH Insurance Ltd (in liq) v Adler* [2007] NSWSC 663 at [34]; and *Tweed v ASIC* [2008] AATA 514 at [100]-[101].
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Accessorial Civil Liability of Lawyers cont...

- The plaintiff must show that the lawyers have done something to implicate or involve themselves in the clients' contraventions of the corporations legislation so that there is a direct causal or practical connection between the lawyers' conduct and their clients' contraventions: see *ASIC v Doyle* (2001) 38 ACSR 606; [2001] WASC 187 at [212]-[215]; and *ASIC v Somerville* [2009] NSWSC 934 at [48].
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Accessorial Civil Liability of Lawyers cont...

- Accordingly, where the lawyers (with knowledge of the relevant facts) advise on, and recommend, a transaction to the directors that involves contraventions of the directors' duties under the *Corporations Act*, those lawyers are subject to accessorial civil liability in relation to those contraventions: see *ASIC v Somerville* [2008] NSWSC 788 at [6], [27] and [34]; *ASIC v Somerville* [2009] NSWSC 934 at [40], [41], [48] and [49]; and ss 79, 181(2), 182(2) and 183(2) of the *Corporations Act*
- The lawyer is not subject to accessorial civil liability under *Corporations Act* where lawyer has constructive knowledge of client's contravention
- But accessorial liability under the *Corporations Act* is not restricted to cases involving trustees or fiduciaries

Accessorial Civil Liability of Lawyers cont...

Civil proceedings against lawyer as accessory under *Corporations Act*

- Civil evidence and procedure rules: s 1317L
Corporations Act - Eg: *Jones v Dunkel* applies to
defendant/lawyer even where refusal to provide
evidence is based on privilege against self-
incrimination: see *ASIC v Adler* [2003] NSWCA 131 at
[658] and [659]
 - Balance of probabilities: s 1332 *Corporations Act*
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Accessorial Civil Liability of Lawyers cont...

- Usually no jury – judge decides questions relating to facts and law
 - ASIC must prove breach of physical elements of section by client and that lawyer had actual knowledge of essential facts that constitute a breach of the physical elements of the section
 - Lawyer, as accessory, could be subject to full range of civil remedies under *Corporations Act* including pecuniary penalty order, compensation order and disqualification order
 - Problem where legal practice operated through a company
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Accessorial Civil Liability of Lawyers cont...

- Professional indemnity insurance: “claims made and notified policies” and limitation period in s 1317K *Corporations Act*
 - Limitation period to recover trust property in relation to a breach of trust: 6 years or no limitation period for fraudulent breach of trust: s 27 *Limitations of Actions Act 1974 (Qld)*
 - *Lawyers’ professional indemnity insurance?*
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Accessorial Criminal Liability of Lawyers

- ❖ Once client/lawyer charged with offence, they are exempt from assisting ASIC in its investigation: s 49(4) *ASIC Act*
 - ❖ But lawyer and client may be required to assist ASIC in its investigation of offences not related to the current charge: *ASC v Lord* (1991) 33 FCR 144
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Accessorial Criminal Liability of Lawyers cont...

- The lawyer's accessorial criminal liability depends on the lawyer knowing that the client would act dishonestly and providing advice for that purpose: see *R v Brown* [1990] VR 820 at 824-825; and *Forsyth v Rodda* (1989) 42 A Crim R 197
 - Short of that kind of involvement lawyers are entitled, and indeed bound as professional advisers, to assist their clients by advising them as to the meaning and operation of the law.
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Accessorial Criminal Liability of Lawyers cont...

- The lawyer's accessorial criminal liability does not depend upon the advice being considered by others to be wrong, incomplete or immoral: see *R v Brown* [1990] VR 820 at 824-825; and *Forsyth v Rodda* (1989) 42 A Crim R 197
 - Lawyers are subject to accessorial criminal liability where they, knowing of the clients' unlawful purpose, join with their clients in effecting that purpose by providing advice or services or preparing documents that facilitate the clients' contraventions of the corporations legislation: see generally *Forsyth v Rodda* (1989) 42 A Crim R 197
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Accessorial Criminal Liability of Lawyers cont...

Criminal proceedings against lawyer as accessory
under *Corporations Act/s 11 Criminal Code Act
1995 (Cth)*

- Criminal evidence and procedure rules – *Jones v Dunkel* does not apply to accused/lawyer
 - Beyond reasonable doubt: s 13.2 *Criminal Code Act 1995 (Cth)*
 - ASIC/Commonwealth DPP must prove breach of both physical elements and fault elements of section by client and that the lawyer had actual knowledge of the essential facts that constitute a breach of the physical elements and fault elements of the section
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ASIC's Oral Examinations

- Formal investigation
- Challenging ASIC's notices

Role of lawyer at oral examination

- No evidence in chief or cross- examination
 - Claims of privilege
 - Obstruction
 - Section 23 *ASIC Act*
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ASIC may overrule examinee's choice of lawyer where:

- ASIC suspects lawyer is involved in contravention
 - Lawyers representing multiple examinees
 - Obstruction: s 65 *ASIC Act*
 - Section 22 *ASIC Act*: see *ASC v Bell* (1991) 32 FCR 517; (1991) 9 ACLC 1606 at 1609; *Stockbridge v Ogilvie* (1993) 11 ACLC 645 at 654; and *Gangemi v ASIC* (2003) 45 ACSR 383; [2003] FCA 494 at [31]-[37].
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ASIC's Notices to Produce Books

- Can be issued inside and outside a formal investigation
 - Produce books “forthwith”: see s 87(b) *ASIC Act* - but reasonable time to consult lawyer: *Scanlan v Swan* (1982) 61 FLR 468; and s 65 *ASIC Act*
 - Lawyers’ implied undertaking: see inconsistent decisions in *ASC v Ampolex* (1995) 38 NSWLR 504 and *Green v FP Special Assets Ltd* [1992] 1 Qd R 1
 - Lawyer’s lien not a reasonable excuse for non-compliance – but is preserved: s 37(6) *ASIC Act*
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Reasonable Excuse for Non-Compliance with ASIC's Investigative Requirements

- “Physical or practical difficulties” of compliance
 - *Corporate Affairs Commission (NSW) v Yuill* (1991) 172 CLR 319
 - *Re Deam* (1974) ACLC 27,799: Barrister attended a conference in Zurich – mere inconvenience – not a reasonable excuse for not attending oral examination
 - A reasonable excuse for non-compliance does not include legal/equitable excuses such as the lawyer's duty of confidentiality or legal professional privilege
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Legal and Equitable Excuses

- Lawyer's duty of confidentiality to the client is impliedly abrogated by *ASIC Act*: see *ASC v Ampolex* (1996) 14 ACLC 80 at 91 and 100; and *Parry-Jones v The Law Society* [1969] 1 Ch 1 at 9

Right to Silence, and Penalty Privilege and Privilege Against Self Incrimination

- Lawyer's role at ASIC's oral examination is to hold card with word "privilege" on it
 - Privileges expressly abrogated
 - Evidential immunity for examinee - oral examination statements not admissible in subsequent criminal or penalty proceedings
 - No evidential immunity in administrative or civil proceedings including disqualification proceedings (note s 1349 *Corporations Act*)
 - No evidential immunity for contents of documents
 - Sections 68 and 76(1)(a) *ASIC Act*
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Legal Professional Privilege

- Impliedly abrogated: see *Corporate Affairs Commission (NSW) v Yuill* (1991) 172 CLR 319 - applied in *ASC v Dalleagles Pty Ltd* (1992) 36 FCR 350; 108 ALR 305; 8 ACSR 109; 27 ALD 281; 10 ACLC 1104 at 1116, but compare *AWB Limited v ASIC* [2008] FCA 1877 at [23]
 - Evidential immunity for examinee - oral statements not admissible in any subsequent proceedings
 - No evidential immunity for documents
 - Sections 69 and 76(1)(d) *ASIC Act*
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Search Warrants

- ss 35 and 36 ASIC Act
 - s 3E Crimes Act
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Search Warrants cont...

A negative search of lawyer's premises is permitted where:

- the lawyer is implicated in the offence (either alone or together with the client);
 - the lawyer's filing system is so disorganised that no reliance can be placed upon it;
 - the lawyer tells the search team that the documents may have been misplaced in the files of other clients; or
 - the lawyer refuses to co-operate with the search team.
 - see *Crowley v Murphy* (1981) 52 FLR 123; 34 ALR 496 at 524 and 526; and Guideline 34. General Guidelines Between the Australian Federal Police and the Law Council of Australia as to the Execution of Search Warrants on Lawyers' Premises, Law Societies and Like Institutions in Circumstances where a Claim of Privilege is Made," 3 March, 1997
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Factors Governing the Types of Proceedings Commenced by ASIC

- Administrative, civil, civil penalty, or criminal proceedings, or a combination of these
 - Physical and fault elements
 - Standard of proof
 - Prospects of success
 - Regulatory purpose/objectives
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Factors Governing Outcomes for Defendants (Including Lawyers) in Civil Penalty Proceedings for Disqualification Orders and Pecuniary Penalty Orders

LONGEST periods of disqualification from corporate management (25 years or more) and the highest pecuniary penalties (\$250,000-\$450,000) may be imposed where the defendants:

Factors Governing Outcomes for Defendants (Including Lawyers) in Civil Penalty Proceedings for Disqualification Orders and Pecuniary Penalty Orders cont...

- engaged in serious and wilful contraventions that involved dishonesty and intent to defraud;
 - have previous convictions for similar activities;
 - have a high propensity to repeat similar contraventions in the future;
 - caused large financial losses; and
 - engaged in activities (such as in management or financial consultancy) where there is potential to do significant financial damage
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SHORTEST disqualification periods (up to 3 years) and the lowest pecuniary penalties (\$4,000-\$5,000) may be imposed where the defendants:

Factors Governing Outcomes for Defendants (Including Lawyers) in Civil Penalty Proceedings for Disqualification Orders and Pecuniary Penalty Orders cont...

- engaged in contraventions which did not involve dishonesty or fraud;
- committed the contraventions on the advice of professionals such as their lawyers;
- have repaid all of the amounts misappropriated;
- have shown remorse and contrition;
- have not contested the proceedings; and
- have good prospects of rehabilitation or reform

(see *ASIC v Adler* (2002) 42 ACSR 80; [2002] NSWSC 483 at [56] and [126]; *Rich v ASIC* (2004) 220 CLR 129; 78 ALJR 1354; 209 ALR 271; [2004] HCA 42 at [43], [49], [50], [52] and [56]–[57]; *ASIC v MacDonald (No 12)* [2009] NSWSC 714 at [268]; and Regulatory Guide 98, *Licensing: Administrative Action Against Financial Services Providers*” (April 2006))

Recovery of Compensation for Victims of Contraventions/Corporate Collapse

Collapse caused by breach of directors' statutory duties in ss 180-183 of the *Corporations Act*:

- ASIC/Corporation seeks compensation: s 1317H *Corporations Act*
 - Private litigation: see s 179 *Corporations Act* and s 25(1) *ASIC Act*
 - Insolvent trading provisions: s 588G and s 588M *Corporations Act*
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Financial services civil penalty provisions:

- Compensation: s 1317HA *Corporations Act*
 - Security deposit that has been lodged by a licensee with ASIC: regulations 7.303-7.307 *Corporations Regulations 2001* (now see Part 10.2 of the *Corporations Regulations 2001*, Division 38): see *Brown v ASIC* [2009] AATA 286 at [93], [94], [101] and [102]
 - Public interest action: see s 50 of the *ASIC Act*
 - Derivative action: ss 236 and 237 *Corporations Act*
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Conclusion

The lawyer should advise the client in relation to matters such as:

- a) whether the client should volunteer information to ASIC;
 - b) the formal validity of ASIC's investigative notices and search warrants;
 - c) the availability of judicial and administrative review of ASIC's investigative decisions;
 - d) steps that the client should take when ASIC's investigation commences including the preservation of documentary evidence;
 - e) the effect of the *ASIC Act* on the privileges and the availability of evidential immunity;
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Conclusion cont...

- f) the excuses and penalties for non-compliance with ASIC's requirements;
 - g) the right of clients to obtain investigative information from ASIC for private litigation;
 - h) the types of enforcement proceedings that may be commenced by ASIC;
 - i) the likely sanctions or regulatory outcomes that may be sought by ASIC; and
 - j) whether a settlement should be reached with ASIC.
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Conclusion cont...

Lawyers must become familiar with the provisions of the *ASIC Act* and the *Corporations Act* before representing clients in the context of ASIC's investigative and enforcement powers.
