

Lawyers Accessorial Civil and Criminal Liability under the Corporations Legislation

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1. LAWYERS AS INFORMANTS TO ASIC

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1.1 Motivation for informing - Lawyers' liability as constructive trustees in equity

- Knowing assistance rule – assisting directors' breaches of fiduciary duties
- *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 v beneficial receipt
- Payment of client's money into Trust Account

1.2 Motivation for informing - Lawyers' liability under corporations legislation as principal contravener: "officer" or "deemed director" – ss 9 and 180(1) *Corporations Act 2001*

1.3 Motivation for informing - Lawyers' civil or criminal accessorial liability under corporations legislation

- Civil: “involved in a contravention” - ss 79 and 180(2) *Corporations Act 2001*
- Criminal: s11 Criminal Code Act 1995 (Cth) and s 184 *Corporations Act 2001*

1.4 Voluntary informant – protection *Finers v Miro* [1991] 1 All ER 182 Sections 96 and 97 *Trusts Act 1973* (Qld)

- 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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1. LAWYERS AS INFORMANTS TO ASIC *cont...*

1.5 Lawyers who inform pursuant to ASIC's statutory powers

- s 92 of the *ASIC Act*

- Evidential immunity: ss 68, 69 and 76 *ASIC Act*

2. LAWYER'S ROLE WHEN ASIC'S INVESTIGATION COMMENCES

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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)

2. LAWYER'S ROLE WHEN ASIC'S 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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3. LAWYERS AS NON- SUSPECTS AND SUSPECTS

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- **ASIC's investigative notices can be issued to non-suspects and suspects**
 - **ASIC may issue investigative notices to any person (a non-suspect) 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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4. LAWYERS AS PRINCIPAL CONTRAVENERS

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4.1 Due Care and Skill: s 180(1) Corporations Act 2001:

- s 180(1) extends beyond directors to “officers” (defined in s 9)
 - Lawyers may also be “deemed directors” (de-facto directors or shadow directors) or deemed officers under s 9 (b)(ii) and (iii) Corporations Act:
 - 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 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].
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4. LAWYERS AS PRINCIPAL CONTRAVENERS *cont...*

4.2 To avoid breaching s 180(1) 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;**
- 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)

5. ACCESSORIAL CIVIL LIABILITY OF LAWYERS

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5.1 Liability in Equity

- **General law preserved by ss 179 and 185 *Corporations Act 2001***
 - **Knowing assistance rule – must show that lawyer had actual knowledge of client’s contravention**
 - **Knowing receipt rule -must show that lawyer had actual or constructive knowledge of client’s contravention**
 - **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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5. ACCESSORIAL CIVIL LIABILITY OF LAWYERS *cont...*

- **Knowing receipt rule has wider operation than *Corporations Act* accessorial civil liability provisions**
 - However, in *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296; [2012] FCAFC 6 at [267], [555] and [565] the court indicated that under both the knowing assistance and knowing receipt rules, the third party’s “liability arises as a matter of conscience not of property” and is “fault based” and therefore they should have the same “actual” knowledge requirements to make the third party liable.
- **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.**

5.2 Accessorial civil Liability under Corporations Act 2001

- Lawyers “Involved in [client’s] contraventions” – see s 79 *Corporations Act*
 - accessorial civil liability does not apply to a section of the *Corporations Act* unless that section expressly provides that it extends to a person who is “involved in” the contravention (as defined in s 79): See *Australian Securities and Investments Commission v Maxwell* (2006) 59 ACSR 373; [2006] NSWSC 1052 at [57] and [71]
 - 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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5.3 ASIC v SOMERVILLE [2009] NSWSC 934

FACTS

- **Directors of old/vendor corporations sought advice from Somerville because those old/vendor corporations had solvency problems. Not necessarily insolvent, but under threat of insolvency or at least likely to become insolvent. In each case Somerville wrote similar letters of advice.**
- **The only variations in the letters of advice were the figures about the fee of a deed administrator and the amount of the consideration for transfer of the assets.**
- **Somerville recommended that: the old corporations ceased to trade, new replacement corporations were formed with similar names, and agreements were entered into between those corporations transferring the assets of the old/vendor corporations to the new/purchaser corporations.**
- **The agreements all included clauses under which:**

5. ACCESSORIAL CIVIL LIABILITY OF LAWYERS *cont...*

- (a) the vendor/old corporation agreed to transfer assets to the purchaser corporation;**
 - (b) consideration = 100 “V” class shares in the purchaser corporation with the right to receive all dividends declared by the purchaser until the “purchase price” was paid;**
 - (c) the vendor/old corporation would receive payments invoiced prior to the settlement and apply those to debts of the vendor;**
 - (d) the trade creditor debts of the vendor remained with the vendor;**
 - (e) employees of vendor would be terminated and the purchaser would offer re-employment on the same terms; and**
 - (f) leases of plant, equipment and premises would be assigned.**
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5. ACCESSORIAL CIVIL LIABILITY OF LAWYERS *cont...*

- Dividends were never paid on the “V” class shares. The purchaser obtained the employees, premises and equipment of the vendor free of all liabilities of the vendor. The debts of the vendor (trade creditors, taxation debts and insurance premiums) were never paid.
- “In cross examination, Somerville said that he had given similar advice to that complained of on dozens of occasions, commencing about 10 years ago. He continued to give that advice even after he knew that ASIC was conducting the investigations which brought about these proceedings. He agreed that he had been told by Mr Krejci, one of the accountants involved in liquidating some of the companies, that Mr Krejci considered the transactions to be uncommercial but he thought that was incorrect. He said to Mr Krejci that no one had challenged the transactions and “until the Court proves otherwise I will continue to promote them”. (see *ASIC v Somerville (No 2)* [2009] NSWSC 998 at [30])

5. ACCESSORIAL CIVIL LIABILITY OF LAWYERS *cont...*

DECISION

- **Directors used information about old/vendor corporation's liabilities as the ground for their decision to transfer the business and assets of that old/vendor corporation to a new corporation for the purpose of defeating the creditors of the old/vendor corporation. Those directors were in breach of their duties in s 181 to act "in good faith in the best interests of the corporation and for a proper purpose" and s 182 to "not make an improper use of position to cause detriment to the old corporation." Directors also breached the duty in s 183 to not make an improper use of confidential information (at [42]-[44]).**

 - **The lawyer [Somerville] was "involved in [director's] contravention" under s 181(2), s 182(2) and 183(2). Somerville advised on, and recommended, the transactions that constituted a breach of the directors' duties under ss 181-183. Somerville prepared, or obtained, all documents necessary to carry out the transactions, he arranged the execution of all documents in all cases with knowledge of the relevant facts. In terms of s 79, Somerville "aided, abetted, counselled and by carrying out the necessary work procured the carrying out of the transaction." There was a direct causal connection between Somerville's involvement and the directors' breaches of duties (at [48]).**
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5. ACCESSORIAL CIVIL LIABILITY OF LAWYERS *cont...*

- Somerville was subject to a disqualification order under s 206C and was therefore prohibited from acting as a director of his own incorporated legal practice for six (6) years.
- In *ASIC v Somerville* [2009] NSWSC 1149 at [13] Somerville was refused leave to manage his incorporated legal practice under s 206G of the *Corporations Act 2001* because his business partner and co-director already had the full responsibility imposed by s 140 of the *Legal Profession Act 2004* (NSW) for the management of the legal services provided by the particular corporation. That burden, in terms of statutory responsibility, would not increase if that person was left as the sole director.
- Note also that directors may also breach their fiduciary duties where they have engaged in phoenix activity (*Ferrari Investment (Townsville) Pty Ltd (in liq) v Ferrari* [2000] Qd R 359 at 372-373 [47])

REFORMS SINCE ASIC v SOMERVILLE

Corporations Amendment (Phoenixing and Other Measures) Act 2012 (Cth)

- Section 489EA of the *Corporations Act 2001 (Corporations Amendment (Phoenixing and Other Measures) Act 2012 (Cth))* now gives ASIC the “administrative” power to make an order that a corporation be wound up where it is not carrying on a business. ASIC, rather than the court, will appoint the liquidator.
- This administrative power reduces the costs and delay that is otherwise associated with an application to the court for a winding up order.
- This legislation is designed to address the problem of corporations remaining dormant with unpaid debts in a situation where no creditor is prepared to expend further funds to apply to the court for a winding up order.
- It is designed to enable the liquidator to uncover any phoenix activity and commence relevant proceedings.
- The liquidation process will also enable employees to make a claim under the General Employee Entitlements Redundancy Scheme (a taxpayer funded scheme that enables employees of insolvent employers to recover unpaid wages and other entitlements).

(Anderson H, “The Proposed Deterrence of Phoenix Activity: An Opportunity Lost?” [2012] 34 Sydney Law Review 411at 424-426)

Corporations Act (Similar Names) Bill 2012

- **The *Corporations Act (Similar Names) Bill 2012* provides that directors may be liable for the debts of a corporation that has a similar name to the pre-liquidation name of the failed corporation but only where the new corporation is not carrying on business. The court or liquidator may make an exemption where the director “has acted honestly...and having regard to the circumstances of the case, ...ought fairly to be exempt.” In making this decision, the court will have regard to whether the assets of the failed corporation have become assets of the new debtor corporation (see proposed ss 596AJ(1), 596AM(1)(b) 596AK(3), 596AK(4)(b) and 596AL of the *Corporations Act 2001*).**
- **According Anderson, given that the phoenix activity that caused the harm related to the creditors of the failed corporation, it is anomalous that the Bill imposes liability on the directors for the debts of the new corporation rather than the failed corporation.**

5. ACCESSORIAL CIVIL LIABILITY OF LAWYERS *cont...*

- **The Bill does not apply where those who engage in phoenix activity form a new corporation that has a different name to the pre-liquidation name of the failed corporation. According to Anderson, “it is absurd” that the Bill is easily avoided by adopting a different name for the new corporation.**
- **The Bill does not apply where a similar name is adopted for the new corporation and the directors of the new corporation are related parties (such as spouses or children) of the directors of the failed corporation.**

(Anderson H, “The Proposed Deterrence of Phoenix Activity: An Opportunity Lost?” [2012] 34 Sydney Law Review 411at 424, 427, 432 and 436)

5.4 CIVIL PROCEEDINGS AGAINST LAWYER AS ACCESSORY UNDER CORPORATIONS ACT 2001

- **LAWYER AS ACCESSORY CAN BE SUBJECT TO FULL RANGE OF CIVIL REMEDIES INCLUDING PECUNAIRY PENALTY ORDER, COMPENSATION ORDER AND DISQUALIFICATION ORDER**
- **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**
- **Usually no jury – judge arbiter of 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**
- **Professional indemnity insurance: and limitation period in s 1317K *Corporations Act***

6. ACCESSORIAL CRIMINAL LIABILITY OF LAWYERS

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Section 11 of the *Criminal Code Act 1995* (Cth) and s 184 of the *Corporations Act 2001*

- ❖ 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
 - 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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6. ACCESSORIAL CRIMINAL LIABILITY OF LAWYERS

cont...

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- **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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6. ACCESSORIAL CRIMINAL LIABILITY OF LAWYERS

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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 lawyer had actual knowledge of essential facts that constitute a breach of the physical elements and fault elements of the section**
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7. ASIC's POWERS TO RELEASE INFORMATION

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- **Even if ASIC does not commence proceedings against lawyer, ASIC can release results of its investigation into the lawyer's conduct to the relevant Law Society or Admitting Authority: see s 127(4)(d) *ASIC Act***

 - **Release investigative information to lawyers of private litigants (plaintiffs or defendants) : see s 25(1) *ASIC Act***
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8. CONCLUSION

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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.
