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"Criminal Risk in Corporate Practice – Balancing Duties and Risk While Ensuring Corporate Compliance as an In-House Lawyer"

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The Corporate Law and Accountability Research Group (CLARG) was established in the Department of Business Law and Taxation, Faculty of Business and Economics, Monash University, in November 2005.

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Criminal Risk in Corporate Practice – Balancing Duties and Risk While Ensuring Corporate Compliance as an In-House Lawyer[*]

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What are the duties of in-house lawyers in general and to ensure the Board is fully informed under the *Corporations Act*, in particular?

What are the risks?

How can those risks be ameliorated?

The Duties of In-House Lawyers

An in-house lawyer has duties which he or she must discharge in the course of practice. More, now than ever, the in-house lawyer must be mindful that if he or she does not do so, sanctions, both civil and criminal, may be imposed.

An in-house lawyer's duties are owed as employees to an employer, and, as officers of the Court, to the client (the employer) and to the Court. Further, an in-house lawyer has obligations towards other stakeholders and advisers, such as creditors, shareholders, auditors, directors and financial advisers. Personal loyalties to colleagues, advisers and other business associates also come into play. Quite obviously, these duties, obligations and loyalties will on occasion conflict, leaving an in-house lawyer with a dilemma as to which should be heeded first, or which should be afforded priority. An external lawyer has the option to decide whether to cease acting for a client when it becomes apparent that the lawyer cannot reconcile any conflicting duties or may become improperly embroiled in a client's activities. Such an avenue may not be open to an employed in-house lawyer. As a result of corporate collapses such as HIH and Ion, and events concerning James Hardie and AWB Ltd, it is all the more imperative that an in-house lawyer be cognisant of the legal obligations imposed by reason of his or her position. As these events have demonstrated, the conduct of in-house (and external) lawyers may be subject to public scrutiny and criticism, including by the Courts and commissions of inquiry, and in the media.

The media, in itself, presents an over-arching problem for in-house lawyers and companies generally. Journalists seem to thrive on reporting tales of corporate woe

[*] This paper was presented to the Australian Corporate Lawyers Association, Victorian Corporate Counsel Day, 14 March 2007.

and misfortune, and large companies which find themselves in difficulty in particular, not to discount the interest generated when legal issues and lawyers are involved.

This paper discusses the various duties and obligations of in-house lawyers under the corporations law, with particular regard to criminal offences by reference to a number of recent cases which highlight the challenges facing in-house lawyers.

Duties under the Corporations Laws Generally

As noted in the Corporations and Markets Advisory Committee's report, *Corporate Duties Below Board Level*, personal liabilities are imposed upon those working for a corporation, below board level for breaches of:

- internal management duties;
- information disclosure duties;
- financial reporting duties;
- external administration duties.

(See chapter 2 of the CAMAC report generally and part 2.2.2 in particular regarding the duty to disclose information.)

Statutory obligations

In-house lawyers who are directors of a company will owe all of the duties directors ordinarily owe, including:

(a) the duty of due care, diligence and/or skill (section 180: civil obligation; common law)

(b) the duty of good faith (section 181: civil obligation)

(c) the duty not to improperly use position (section 182: civil obligation)

(d) the duty not to improperly use information (section 182: civil obligation)

(e) the duties referred to in (b), (c) and (d) punishable by imprisonment and/or fines (section 184)

Officers

While these duties apply to directors, they also apply to "other officers". The definition of "officer" contained in section 9 of the *Corporations Act* extends the application of these provisions to a person:

(i) who makes, or participates in making, **decisions that affect the whole, or a substantial part, of the business** of the corporation; or

(ii) who has the capacity to **affect significantly** the corporation's financial standing; or

(iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation).

Clearly, senior in-house lawyers will often fall within the scope of this definition and, as such, they have the same obligations as directors to the company and its shareholders.

False and misleading statements/information

Further to the "directors' duties", are the duties contained in sections 1307, 1308 and 1309 of the *Corporations Act*:

(a) Section 1307 deals with falsification of books: the concealment, destruction, mutilation or falsification of any books affecting or relating to the affairs of a company is an offence. This extends to electronic records.

(b) Section 1308 prohibits a person making or authorising a statement to ASIC which a person knows to be false or misleading. It is also an offence to fail to take reasonable steps to ensure that information on which a statement is based is not false or misleading or contain an omission which would make it so.

(c) Section 1309, in essence provides that an officer or employee must not mislead a director or the board, whether by commission or omission:

1309(1) An officer or employee of a corporation must not make available or give information, or authorise or permit the making available or giving of information, to a director being information that relates to the affairs of the corporation and that, to the knowledge of the officer or employee:

(a) is false or misleading in a material particular; or

(b) has omitted from it a matter or thing the omission of which renders the information misleading in a material respect.

1309(2): An officer or employee of a corporation must not make available or give information, or authorise or permit the making available or giving of information, to a director being information relating to the affairs of the corporation that:

(a) is false or misleading in a material particular; or

> *(b) has omitted from it a matter or thing the omission of which renders the information misleading in a material respect;*
>
> *without having taken reasonable steps to ensure that the information:*
>
> *(c) was not false or misleading in a material particular; and*
>
> *(d) did not have omitted from it a matter or thing the omission of which rendered the information misleading in a material respect.*

The section 1309 duties will apply to senior in-house lawyers who are "officers", but also to more junior, employee, in-house lawyers.

Persons "involved" in certain contraventions of a director's or officer's breach of duty will also be taken to have contravened that same duty: sections 181, 182 and 184 impose obligations not to be involved in such contraventions. A person will be "involved", by reason of section 79 of the *Corporations Act*, if and only if the person:

> (a) has aided, abetted, counselled or procured the contravention;
>
> (b) has induced, whether by threats or promises or otherwise, the contravention;
>
> (c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or
>
> (d) has conspired with others to effect the contravention.

Consequences of breach

Contraventions of the directors' duties provisions, and also the false and misleading information provisions discussed above could result in civil penalties, imprisonment and/or disqualification from managing corporations, among other things, depending upon whether civil or criminal proceedings are instituted (or both). Further, an employee may be dismissed and will likely suffer reputation damage, particularly where the proceedings, or any preceding inquiry, feature prominently in the media.

Case Studies

Set out below are a number of key issues. While some arise as a result of recent changes to the law, others can be expected to feature in discussion and reports, as a result of recent events. The Australian Law Reform Commission inquiry into legal professional privilege which will occur this year is just one of these. The issues discussed below are:

- whistleblowing
- the duties of lawyers generally, and legal professional privilege
- the criminal law and document destruction

- concealment of documents
- James Hardie and the duties of in-house lawyers (due care and diligence)
- AWB Ltd and duties to directors (misleading information)
- the *Trade Practices Act* and cartels.

Whistleblowing

Obligations on an in-house lawyer arising under the whistleblowing provisions in the *Corporations Act* may come into conflict with the duties discussed above.

Part 9.4AAA of the *Corporations Act* provides protection for whistleblowers. While the provisions do not impose a specific obligation upon any person to disclose information which he or she has reasonable grounds to suspect shows that a contravention of the corporations legislation may have occurred, they provide protection to officers and employees of the company and those who have a contract for the supply of goods or services to the company (including the employees of such contractors).

A qualifying disclosure will be one in which:

(a) the discloser informs the person to whom the disclosure is made of their name before making the disclosure; and

(b) the discloser has reasonable grounds to suspect that the company (or its officer) has (or may have) contravened a provision of the *Corporations Act*; and

(c) the disclosure is made in good faith.

The *Corporations Act* provides immunity to the discloser from civil or criminal liability arising out of a qualifying disclosure, as well as from the enforcement of contractual or other rights on the basis of the disclosure. The discloser also has qualified privilege in respect of qualifying disclosures. Further, any employee who has his or her contract of employment terminated on the basis of a disclosure can seek to have his or her employment reinstated through the Courts.

The disclosure of information in the qualifying disclosure or the identity of the discloser is prohibited and punishable by a fine, except to ASIC, APRA, the Australian Federal Police or to a person to whom the discloser consents to the information being provided. This raises the prospect that an in-house lawyer may learn information through a whistleblower which may be inconsistent with other information the lawyer has provided to the board. The in-house lawyer may then be acting in breach of section 1309 by failing to disclose the additional information to the board.

State legislation related to whistleblowers does not protect persons employed by corporations.

The Duties of Lawyers Generally

Putting aside the common law duties a lawyer owes to his or her client and to the Court, the *Legal Profession Act 2004* (Vic) prohibits unsatisfactory professional misconduct and professional misconduct:

> "*Unsatisfactory professional conduct*" includes conduct of an Australian legal practitioner occurring in connection with the practice of law that falls short of the standard of competence and diligence that a member of the public is entitled to expect of a reasonably competent Australian legal practitioner.
>
> "*Professional misconduct*" includes:
>
> (a) unsatisfactory professional conduct of an Australian legal practitioner, where the conduct involves a substantial or consistent failure to reach or maintain a reasonable standard of competence and diligence; and
>
> (b) conduct of an Australian legal practitioner, whether occurring in connection with the practice of law or occurring otherwise than in connection with the practice of law, that would, if established, justify a finding that the practitioner is not a fit and proper person to engage in legal practice.

An in-house lawyer will frequently be responsible for making claims for **legal professional privilege** over the company's documents.

Legal professional privilege

It is now widely accepted that legal professional privilege is a substantive general principle of the common law and not a mere rule of evidence: *Attorney-General (NT) v Maurice* (1986) 161 CLR 475. In recent times, though, it has been abrogated, and much criticised. In the James Hardie case, the Commonwealth Government abrogated all privilege in James Hardie's documents, for the purposes of ASIC's investigation. In the Oil-for-Food Inquiry into AWB Ltd, the Commonwealth Government amended the *Royal Commissions Act* in order that Commissioner Cole could determine privilege claims for himself, a power he did not previously have. Further, following the completion of that inquiry, the Commonwealth Government announced that the Australian Law Reform Commission would inquire into legal professional privilege. One of the terms of reference of the inquiry is whether further modification or abrogation of legal professional privilege in some areas would be desirable in order to achieve more effective performance of Commonwealth investigatory functions. If a recommendation for modification or abrogation is made, this would represent a significant and possibly detrimental inroad into a fundamental common law right.

Legal professional privilege is the shorthand description for the doctrine that prevents the disclosure of confidential communications between a lawyer and a client, confidential communications between a lawyer and third parties for use in or in relation to litigation which is either pending or in contemplation, and confidential material that records the work of a lawyer carried out for the benefit of the client such

as research memoranda, draft pleadings, summaries of argument and draft agreements whether or not they are given to the client.

To be protected by the privilege a communication must be for the ***dominant*** purpose of contemplated or pending litigation or for obtaining or receiving legal advice: *Esso Australia Resources Limited v Commissioner of Taxation* (1999) 201 CLR 49; *Australian Competition and Consumer Commission v Daniels Corporation International Pty Ltd* (2002) 213 CLR 543. Frequently, documents will be created or communications made for a multiplicity of purposes. Establishing dominant purpose is no easy task and is arguably a matter of impression. Justice Young, in one of the AWB privilege cases, summarised the process for determining purpose:

(a) the intended use of the document which accounted for it being brought into existence must be determined objectively;

(b) ordinarily the purpose will be that of the maker of the document, but it may be otherwise, where some other person such as a solicitor commissions a technical report; and

(c) it may be necessary to examine evidence concerning purpose of other persons involved in the hierarchy of decision making or consultation that leads to the creation of the document.

(See *AWB Limited v Cole* (2006) 152 FCR 382.)

These principles were applied in *AWB Limited v Cole*, in relation to a document which came to be known as the Sandman statement. The Court found that the document had multiple purposes: to submit it to Dr Sandman for comment and advice of a public relations nature, to submit it to AWB's external lawyer for legal advice, and to submit it to AWB executives to enable them to consider whether the statement should be made to the Cole Commission by AWB's CEO in the course of evidence. None of the purposes was paramount, and hence privilege could not be established.

Notwithstanding that the relevant dominant purpose can be established, a document or communication will not be privileged if it was created in furtherance of:

- a crime or fraud;
- a criminal or unlawful proceeding;
- fraud or dishonesty such as fraudulent breach of trust, fraudulent conspiracy, trickery or sham contrivances; or
- frustration of the process of the law itself, without contemplation of crime or fraud.

A lawyer should not make claims for privilege which are unsustainable and should be cognisant of the application of the crime/fraud exception when making claims on behalf of a company. Criticism was levelled in the James Hardie inquiry that many of the privilege claims could not be made out, and, if the circumstance had arisen in the

inquiry or later for a privilege claim to be determined over many of the documents, the crime/fraud exception may well have been raised as a bar to privilege.

The Criminal Law and Document Destruction

One area which has undergone change recently is the law relating to document destruction. Many companies have policies on the "retention of documents". Taxation laws and statutory limitation periods are two legal impediments upon a company's ability to dispose of documents freely.[1]

At common law, if a company destroys documents discoverable in a court proceeding after proceedings have been instituted against it or when proceedings are anticipated, a Court is entitled to draw adverse inferences against the company by reason of the destruction. One sanction which a Court may impose is that the company's defence could be struck out with the consequence that judgment is awarded in favour of the plaintiff, without the matter going to trial.[2]

Destruction of documents **during** the currency of a Court proceeding may also be a contempt of the Court, which carries with it criminal penalties. In the case of *Lane v Registrar of Supreme Court of New South Wales* (1981) 148 CLR 245, the High Court noted that destruction of documents (or other action or inaction) might be a contempt of Court if the Court considered that it was likely to amount to an interference with, or obstruction to, or having a tendency to interfere with or obstruct, the due administration of justice, using that term in a broad sense. Therefore destruction of a document which a person knows may be required to be produced will amount to contempt. The High Court also maintained that an intention to interfere with the administration of justice is not necessary to constitute a contempt; the critical question is whether the act is likely to have that effect, but the intention with which the act was done is relevant and sometimes important.

A more vexed question is whether destruction of documents when proceedings are **anticipated or contemplated** would amount to a contempt of Court or otherwise be subject to Court sanction. There is also a question whether such conduct might constitute a perversion of the course of justice.

In the case brought by the late Rolah McCabe against British American Tobacco Australia Services Ltd ("**the McCabe case**"), these issues arose for consideration, although not directly ([2002] VSC 73). Justice Eames made a finding that from March 1998, "it could have been reasonably anticipated … that other proceedings would be brought in Australia against the defendant" ("**BATAS**"). In fact, a class action known as the Nixon class action for damages for personal injury caused by smoking was commenced in March 1999 against BATAS. His Honour noted the special characteristics of BATAS, being a tobacco company and a major corporation with international affiliated companies having a world wide experience in litigation. Justice Eames found:

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[1] See, e.g. section 262A of the *Income Tax Assessment Act 1936*; sections 1317K and 1325(4) of the *Corporations Act 2001*.

[2] See the comments of Sackville J in *BT (Australasia) Pty Ltd v State of New South Wales (No 9)* [1998] 363 FCA (9 April 1998).

> *"The evidence discloses that from the time of the reformulation of its Document Retention Policy in 1985 until today, there has never been a period when it did not have legal advisers engaged on legal work connected with the defence of actual or potential litigation."*
>
> *"Far from it being the case that the program of destruction of documents was undertaken from 6 March 1998 in anticipation that all litigation had concluded, in my opinion, it was conducted in anticipation that further litigation would soon arise. There was an urgency in the task. … In my opinion, the belief held by the defendant in 1998 (as it was for the whole period from 1985) was that future proceedings were not merely likely, but were virtually certain, as indeed proved to be the case."*

Some of the document destruction in question occurred in 1998, and began days after a notice of discontinuance was signed in extant proceedings against BATAS (although the proceedings were not discontinued by the Court until April 1998). Another set of proceedings was also discontinued in March 1998. The destruction, as Justice Eames found, continued over several months.

On appeal ((2002) 7 VR 524), the Victorian Court of Appeal doubted that a defendant may claim "carte blanche to destroy documents, however imminent the proceeding against it and however relevant, and obviously relevant, the documents would be." The Court explained:

> *"… it seems to us that there must be some balance struck between the right of any company to manage its own documents, whether by retaining them or destroying them, and the right of the litigant to have resort to the documents of the other side. The balance can be struck, we think, if it be accepted that the destruction of documents, before the commencement of litigation, may attract a sanction (other than the drawing of adverse inferences) if that conduct amounts to an attempt to pervert the course of justice or (if open) contempt of court, meaning criminal contempt … Whether contempt, even criminal contempt, is possible before any proceeding has been instituted need not be examined on this occasion."*

The Court of Appeal did not, as a consequence of the views it took on various issues, and the submissions made by the parties, have cause to consider whether BATAS' destruction of documents, at least in the case of those documents destroyed in 1998, was done with the intention of prejudicing plaintiffs who might bring personal injury claims against it and whether such an action with such an intention would amount to a contempt of Court or a perversion of the course of justice.

To date, no similar case has been considered by an Australian Court.

Following much public debate about the destruction of documents by BATAS and the outcome in the McCabe case that Mrs McCabe's estate was required to repay the award of damages made by Justice Eames, the Victorian Government established an inquiry into document destruction. The Sallman Inquiry resulted in amendments being made to the *Crimes Act 1958* (Vic). The following provision now forms part of Victoria's criminal laws:

254. Destruction of evidence

(1) A person who—

(a) knows that a document or other thing of any kind is, or is reasonably likely to be, required in evidence in a legal proceeding; and

(b) either—

(i) destroys or conceals it or renders it illegible, undecipherable or incapable of identification; or

(ii) expressly, tacitly or impliedly authorises or permits another person to destroy or conceal it or render it illegible, undecipherable or incapable of identification and that other person does so; and

(c) paragraph (b) with the intention of preventing it from being used in evidence in a legal proceeding—

is guilty of an indictable offence and liable to level 6 imprisonment (5 years maximum) or a level 6 fine or both.

(2) This section applies with respect to a legal proceeding, whether the proceeding is one that is in progress or is to be, or may be, commenced in the future.

Section 254 clarifies the common law position in a number of respects: first, it applies where proceedings have not been commenced, including in circumstances where a proceeding "may be" commenced. Significantly, it applies to corporations as follows:

255. Corporate criminal responsibility for offence against section 254

(1) For the purposes of a proceeding against a body corporate for an offence against section 254—

(a) relevant conduct engaged in by an associate of the body corporate must also be attributed to the body corporate; and

(b) knowledge of an associate of the body corporate must also be attributed to the body corporate; and

(c) intention—

(i) of the body corporate's board of directors; or

(ii) of an officer of the body corporate; or

(iii) of any other associate of the body corporate if a corporate culture existed within the body corporate that directed, encouraged, tolerated or led to the formation of that intention—

must also be attributed to the body corporate.

(2) If an officer of a body corporate contravenes section 254, the body corporate must be taken to have also contravened that section and may

be proceeded against and found guilty of an offence against that section whether or not the officer has been proceeded against or found guilty of that offence.

(3) In a proceeding against a body corporate for an offence against section 254, brought in reliance on sub-section (2), it is a defence to the charge for the body corporate to prove that it exercised due diligence to prevent the contravention of that section by the officer.

(4) The means by which authorisation or permission as required by section 254(1)(b)(ii) may be established include—

(a) proving that an officer of the body corporate gave that authorisation or permission; or

(b) proving that the body corporate's board of directors gave that authorisation or permission; or

(c) proving that a corporate culture existed within the body corporate that directed, encouraged, tolerated or led to the relevant conduct being carried out.

(5) Sub-section (4)(a) does not apply if the body corporate proves that it exercised due diligence to prevent the authorisation or permission being given.

(6) Factors relevant to the application of sub-section (1)(c)(iii) or (4)(c) include—

(a) whether authority to commit an offence against section 254 or an offence of a similar character had been given by an officer of the body corporate; and

(b) whether the associate of the body corporate who carried out the relevant conduct or formed the relevant intention believed on reasonable grounds, or entertained a reasonable expectation, that an officer of the body corporate would have authorised or permitted the relevant conduct being carried out with the relevant intention.

(7) Subject to sub-section (8), it is not necessary that each element of an offence against section 254 that is attributed to a body corporate by force of sub-section (1) be supplied by the same associate of the body corporate.

(8) It is necessary that the elements referred to in section 254(1)(b)(i) and (c) be supplied by the same associate of the body corporate.

The applicable defined terms include:

"**corporate culture**" means an attitude, policy, rule, course of conduct or practice existing within the body corporate generally or in the part of the body corporate in which the relevant conduct is carried out or the relevant intention formed;

"**relevant conduct**" means the destruction, concealment, or rendering illegible, undecipherable or incapable of identification, of a document or other thing of any kind;

> "**relevant intention**" means the intention of preventing a document or other thing of any kind from being used in evidence in a legal proceeding.

The second reading speech for the amending act notes in relation to "corporate culture":

> *"'Corporate culture' will cover situations where corporate policies and processes provide implied authorisation or permission. For example, there may be situations where, despite the absence of formal policy documents, the reality was that non-compliance was expected."*

And continues:

> *"For example, the corporation could be liable where:*
>
> > *all of the elements of the offence were committed by an officer of the corporation (e.g., a director);*
> >
> > *some (but not all) of the elements of the offence were committed by the same associate(s) of the corporation (e.g., a director created the policy to prevent use in evidence and knew that the document would be required in litigation but gave it to an assistant to destroy); or*
> >
> > *all of the elements of the offence were committed by different associates(s) of the corporation (e.g., the board of directors created the policy to prevent use in evidence and a manager knew that the document would be required in litigation but gave it to an assistant to destroy)."*

These amendments have clarified and (possibly) extended an individual's and a corporation's obligations to retain documents which are reasonably likely to be required in evidence in a legal proceeding or a future legal proceeding. A significant part of an in-house lawyer's role will now include considerations relating to and advising upon the destruction and retention of a company's documents. Further, in light of the James Hardie style of case (discussed below), an in-house lawyer, as an officer of a company, may have duties of due care and diligence in advising his or her employer as to its document retention obligations. "Litigation strategy", in particular, must be developed in line with the new document destruction offences. Depending upon the view the courts take of the James Hardie case, a failure to provide advice with due care or a failure to take appropriate steps to implement a lawful document retention policy, may render an in-house lawyer liable to civil penalties under the *Corporations Act*, at the very least.

Concealment of Documents

The *Crimes Act* provisions also apply to the concealment of documents. Concealment arguably includes moving documents out of the jurisdiction, or into the possession of a third party (whether a related body corporate or not) with the consequence that documents are not discoverable in proceedings brought against the first company. This is a practice colloquially known as "warehousing" of documents. This issue also arose in the McCabe case where it was established that Clayton Utz, formerly the

solicitors for BATAS and other tobacco companies, had set up a database of documents, on the admission of one of the partners of Clayton Utz who was a witness in the case. According to the judgment, the database "was set up on behalf of the [Tobacco Institute of Australia]", of which BATAS was formerly a member.

A letter from a Clayton Utz partner to the Tobacco Institute of Australia was considered by Justice Eames. That letter proposed an arrangement whereby the Institute (which then had three tobacco company members) could "go on-line to gain access" to a number of "tobacco databases". The Clayton Utz partner advised that the Institute would not have power over those databases and could avoid discovery of them. The letter contended that that approach was lawful and in accordance with authority, namely *Lonrho Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627. However, the proposition for which this case is relied upon was highly qualified and has been distinguished on a number of occasions, including in *CE Heath Underwriting and Insurance (Australia) Pty Ltd v Fabric and Apparel Industries Pty Ltd* (Unreported, 28 November 1989), where Marks J held that the "[Court's] rules require disclosure of relevant documents which are not only possessed but are within power. This means that a party cannot be heard to say that it cannot provide inspection simply because it does not have the document. If this were possible, a party could hide from view any potentially damaging document by the simple expedient of handing it to someone else for safekeeping."

While some may have previously thought that a party could simply hand a document to a third party to avoid discovery, the Courts have generally considered that such a practice would not allow a party to avoid discovering that document. The Courts seem to be more willing to examine the wider circumstances in which the document ceased to be in possession of the party, and it may not be sufficient for an officer of a company to simply swear that the document is not within the possession or power of the company. This common law position is arguably now modified to some degree by the *Crimes Act* amendments. Theoretically, if a document was removed from a company's possession and passed into the hands of another party for safekeeping on the understanding that that document would be available to the company if it called upon it, but without any legal right to possession being granted, that removal should be disclosed in an affidavit of documents. However, such a removal may also constitute concealment for the purposes of section 254, and be punishable, if it could be established that in doing so, there was an intention to prevent a document from being used in evidence in a legal proceeding. For example, if a company restructures, and the ownership and/or control of its documents are transferred, it should be clear that the purpose for doing so is not to prevent those documents from one day being discovered in legal proceedings.

Obligations owed to the Board: James Hardie Special Commission of Inquiry and Civil Penalty Proceedings by ASIC

In February this year, ASIC commenced proceedings against a number of current and former directors and officers of the James Hardie group of companies. These proceedings followed an inquiry by David Jackson QC as commissioner in the Special Commission of Inquiry into the Medical Research and Compensation Foundation. The circumstances under investigation in that inquiry, and now the subject of court proceedings, are notorious, to say the least. One of the defendants to the ASIC

proceedings and in respect of whom findings were made in the Jackson report, was the company secretary of the former James Hardie Industries Limited ("**JHIL**").

Although the former company secretary is not the subject of criminal proceedings, the breaches of duty which he is alleged to have committed could potentially form the basis for future criminal proceedings, as occurred in the HIH case.

A number of findings made by the Commissioner in his final report relate to the former company secretary and in themselves provide important guidance to corporate counsel in carrying out their functions:

- the appropriateness of maintain confidentiality and/or making justifiable claims to legal professional privilege:

  > *"… the provisions in the consolidated financial statements of JHIL and its subsidiaries did not make provision for all future liabilities, but it also seems to have been a reflection of a passion, almost an obsession, for secrecy for its own sake. (*[The company secretary's] *approach appears to have been a main contributor to this development.) The James Hardie Group documents are littered with claims for legal professional privilege, in circumstances where the claims, if challenged, would have been very difficult to justify."*

- the obligation to make full disclosure to insurers and other third parties:

  > "[The company secretary's] *responses in cross-examination to questions going to the issue of good faith and a duty of disclosure to prospective insurers suggested to me that he had been endeavouring to avoid making full disclosure. Whilst he acknowledged in cross examination that he knew about "the duty of full disclosure" to insurers, he attempted to justify any failure to discharge such a duty by recourse to the need to maintain confidentiality. He was aware that "in view of the very short timescale an insurer may choose to rely on your actuary's numbers in order to provide a price". This approach, in my view, reflects poorly on a senior office holder of a publicly listed company."*

ASIC alleges the company secretary's duties and responsibilities to have been:

(a) to take reasonable steps to ensure the company's compliance with its *Corporations Act* obligations, and under the ASX Listing Rules, including providing advice and assistance to the company's directors in relation to such obligations;

(b) to review and provide legal and regulatory advice upon any proposal presented to the company's board, including as to strategic direction or restructuring;

(c) to provide legal and regulatory advice to the company's board in respect of any matter the board was considering including a proposal

concerning the strategic direction or restructuring of the company, or any public announcement made by the company.

ASIC alleges that the company secretary contravened section 180(1) of the *Corporations Act* (the due care and diligence duty):

(a) by failing to advise the board that it needed to consider whether a matter ought be disclosed to the ASX;

(b) by failing to obtain advice or provide his own advice to the board as to whether a matter ought to disclosed to the ASX; and

(c) by failing to advise the board to resolve that the company would disclose a matter to the ASX.

ASIC alleges further contraventions of section 180(1) by the company secretary, which are said to arise because of certain matters including:

- that if the board authorised the release of a statement, or if the Court was sent a statement, which was false or misleading, that the company may be in breach of obligations under the *Corporations Act* and the *Trade Practices Act*;
- that he had a duty to advise and warn the board if a false or misleading statement was presented to the board for its approval;
- that a draft information memorandum did not convey certain information, which he knew or ought to have known to be false or misleading;
- that he knew legal advice conveyed certain facts which he knew to be false;
- that he knew that a draft information sent to members of the board was misleading and omitted material information and failed to take steps to inform the board of such matters; and
- that he failed to obtain further advice on relevant matters and follow up on aspects of legal advice he knew to be inaccurate.

These alleged contraventions highlight some of the obligations an in-house lawyer has to ensure that information being presented to the board is accurate and factually correct, and to inform the board, when the in-house lawyer knows that such information is false or misleading, of that fact. These obligations extend to ensuring that the board and/or the company does not breach any laws, including the *Corporations Act* and the *Trade Practices Act*, in acting upon that information.

The James Hardie case illustrates that in-house lawyers have an obligation to fully and frankly disclose information, including the intentions of management, to all members of the board. It is not enough to give the appearance of proper disclosure,

particularly where decisions would be harmful to the company's reputation and jeopardise market perceptions of the company.

Obligations Owed to the Board: AWB Ltd and the Tigris Transaction

The Commissioner of the Oil-for-Food Inquiry made findings regarding AWB Ltd's General Counsel. The Commissioner found that he may have breached sections 1309(1) and 1309(2) of the *Corporations Act* when he:

- furnished information to one of the directors of AWB which was false or misleading and for which there was no factual basis, relating to the Tigris transaction (s 1309(1) breach); or

- even if he did not know that the information furnished was false or misleading, he failed to take reasonable steps to ensure that the information was not false or misleading (s 1309(2) breach).

Breaches of sub-sections 1309(1) and (2) may incur penalties of 5 years' and 2 years' imprisonment, respectively, in addition, or alternatively, to fines.

The Courts regard breaches of those sections seriously. The Commissioner stated in his report:

> *"It is a serious matter for an officer of a public corporation to knowingly provide materially misleading information in relation to the affairs of the corporation to a director of the corporation or to fail to take reasonable steps to ensure that information provided to directors is not misleading.* [General Counsel's] *actions were particularly serious because they resulted in Mr Lindberg approving the execution of the agreement with Tigris on a false basis and caused Mr Lindberg, who remained ignorant of the true position, to in turn provide the same false or misleading information to the other directors of AWB and AWBI."*

The Commissioner found that the "*Tigris transaction was a sham and [General Counsel] must have known that.*"[3] The similarities between the AWB case and James Hardie highlight the obligations of candour in-house lawyers owe to their boards. Moreover, as qualified lawyers, in-house lawyers will be expected to cast a more critical eye over legal documents than would be expected of non-legally trained officers and directors.

However, it should be noted that the Commissioner made no findings adverse to the board of AWB Ltd.

Criminal Penalties under the Trade Practices Act and Cartels

With the possibility looming that "hard-core" cartel or collusive conduct may be the subject of criminal sanctions in the near future (though no amending legislation has

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[3] In submissions to the Inquiry, General Counsel for AWB Ltd maintained that he had not breached any laws, including the provisions of the *Corporations Act* referred to above.

been introduced to Parliament at the time of writing this paper), in-house lawyers will have another reason to be familiar with this area of the law as well.

It is arguably incumbent upon in-house lawyers to provide advice to their boards or those they report to, about collusive arrangements prohibited by the *Trade Practices Act*; and where the in-house lawyer has knowledge of such arrangements, to inform the board or those persons they report to, that the company, or persons employed by the company, as the case may be, is or are engaged in collusive arrangements. The obligation upon officers to act with due care and diligence may require as much. The ACCC's leniency policy on cartel conduct may provide additional incentive for cartels or collusive arrangements to be terminated, particularly as public disclosure of them could jeopardise the reputation of the company. However, difficulties arise for an in-house lawyer (or anyone else) where the person to whom the lawyer ordinarily reports is said to be aware of, or approved of, the arrangements in question. This kind of scenario gives rise to inevitable conflicts between a lawyer's duties under statute and common law, and their duties as employees to obey directions given to them in the course of their employment.

Amelioration of Risks

There are a number of areas on which companies, and in-house lawyers in particular, should focus in order to avoid contravening the law, and the consequences some Australian companies have recently faced. A number are set out below, by way of example:

- Reporting lines between in-house lawyers, senior executives and the board: is it necessary or prudent for corporate counsel to be able to report directly to the board, and if so, on what kinds of issues?

- Long-term relationships between a company and a law firm (or firms): where a large percentage of a firm's income is derived from a few clients, or even just one client, there may be greater impetus for detriment to be caused to the company by reason of that relationship, because arm's length advice is not being provided.

- Communication policies: the practice of copying all and sundry into emails is unwise: one consequence may be that those who need to know certain information do not in fact acquire that information because they have simply been "copied" in on correspondence.

- Patterns of behaviour develop over time: in some cases, systemic problems develop, for example, in relation to communication or expectations. These must be reviewed, and where necessary, changed.

- Cover-ups: although internal audits may result in some contraventions or questionable practices being discovered, a culture of transparency and openness may be the best solution to avoiding such things. Even more importantly, when a matter is brought to the attention of management and/or the board, it should be dealt with up-front and directly. The "cover-up" may well cause more damage than the underlying problem.