

IT'S RISKY ON BOARD

Practitioners who choose to become company directors face conflicts of interest and other problems.

Practitioners should think carefully before taking on directorships.

While there is no broad prohibition on practitioners acting as company directors, any practitioner invited to sit on a board should be aware that there are significant risks, especially if the company is a client. Indeed, many firms now prohibit their practitioners from holding such directorships.

Risks facing a practitioner director include:

- loss of legal professional privilege where the practitioner is involved in communications in a capacity other than as legal adviser;
- not knowing the law relating to duties and responsibilities of directors – noting that a practitioner director may be held to a higher standard of care and skill; and
- potential disqualification from managing an incorporated legal practice (ILP) if disqualified as a director.

A particularly problematic aspect of the practitioner director's dual roles is conflicting duties that can arise. Under Rule 9 of LIV's *Professional Conduct and Practice Rules 2005*, a practitioner must avoid conflict between any interest of the practitioner (or associate

needs to remain conscious of any obligations regarding disclosure of confidential information of the company or a client to the other if the information is material to the other party's interests.

A bad mix

The following example highlights the dangers of mixing directorships with client relationships.

A practitioner was a director and shareholder of a company which was a client of his firm (a small practice).

The company borrowed a substantial sum of money from another company, with the practitioner signing a director's guarantee.

The lender company was also a client of the practitioner's firm.

Three years later, when the borrower company needed further funds, the practitioner arranged for the borrowings from the lender to be doubled. Two new directors of the borrower signed guarantees and the practitioner was released from his guarantee. He resigned as director.

corporate (other than the insured's firm and certain related entities).

Shadow directors

Practitioners should be careful not to find themselves in the position of shadow director. The definition of "director" in s9 of the *Corporations Act* includes:

- a person who is not validly appointed as a director if:
 - they act in the position of a director; or
 - the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.

In another example, a client company encountered financial difficulty. Consent orders were made for the practitioner to, among other things, act for the company in relation to sale of the business, appoint an agent to sell the property, appoint a suitably qualified person to manage the business until sold, instruct the manager regarding conduct of the business and be the sole authorised signatory for company cheques.

The practitioner soon became concerned about his possible exposure to a claim for insolvent trading. Consequently, the orders were vacated and the company's directors resolved to appoint the practitioner in identical terms and provide an indemnity to him in respect of liabilities arising out of the performance of his duties.

Shortly thereafter, the company was placed into liquidation. The liquidator brought an insolvent trading action against the practitioner, alleging he was a director as defined in s9 above.

Because the alleged liability was based entirely on the practitioner acting as a director, he was not indemnified by LPLC. Even if the liquidator was unable to establish the allegations, the practitioner could not claim defence costs from LPLC.

Conclusion

There is ample scope for arrangements enabling practitioners to provide continuing legal advice to company boards without requiring them to act as directors.

Practitioners choosing to accept board positions should obtain Directors' and Officers' (D&O) liability insurance cover sufficient to protect them and their firms. ●

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of the practitioner) and a client's interests. Meanwhile, a director is a fiduciary with respect to the company and is subject to various duties and obligations under common law and statute (see in particular Part 2D.1 of the *Corporations Act 2001* (Cth)), which include acting in the company's best interests and avoiding conflicts of interest. The company's constitution may impose additional requirements.

The ways in which conflicts of interest can manifest themselves are myriad. A practitioner director is in effect both lawyer and client. There is an inherent conflict in providing business and legal advice to a company, with potential for the practitioner's independence and objectivity to be compromised. Even between the practitioner and their firm, a conflict exists concerning fees for legal services. When other clients of the firm are considered, there is further scope for conflicts. For example, the practitioner

When the borrower went into liquidation, the lender, represented by the practitioner's firm, issued proceedings to recover the debt.

One of the borrower's directors who had given a guarantee joined the practitioner as a defendant by counterclaim. The director alleged misleading and deceptive conduct by the lender, aided and abetted by the practitioner. As against the practitioner, breach of duty in substituting the director as guarantor, as well as failure to advise on the nature and effect of the guarantee, was alleged. Furthermore, the lender threatened to sue the firm regarding the practitioner's release from the guarantee.

Insurance

Practitioners are reminded that, pursuant to clause 20.13 of LPLC's policy, LPLC will not indemnify an insured against any liability (or defence costs) arising from the insured acting as a director, secretary or officer of a body

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