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Examination and Prosecution Risks Will Increase for Directors and Third Parties Amid the Economic Uncertainty

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For the past year, many Australian businesses, ranging from very significant publicly listed corporations, to much smaller family businesses, have benefited from public and private relief measures intended to soften the impact of COVID-19.

Although those measures were introduced as a direct result of pandemic-related concerns, the economic reality in many sectors was already uncertain and many businesses were facing challenges. The pandemic accelerated and increased the operating and trading pressures.

In March and April 2021, many of the public and private relief measures will either be formally terminated or be eased off. There has already been an uptick in external administrator appointment activity by directors and third parties and, in all likelihood, that trend will likely gather pace even though key government agencies, including the Commissioner of Taxation, are not in enforcement mode.

Risk of Public Scrutiny and Reputational Risk Considerations

Under the Corporations Act (Cth) (Act), one of the key investigative measures available to external administrators is the power to issue examination summonses and orders for production. Those processes permit external administrators to compel production of information and documents relevant to a company's examinable affairs, including from third parties. They also permit the public examination of individuals under oath generally before state superior courts. Often the examination and compulsive production processes are only precursor proceedings to more serious cases that have either already been set up or are in the process of being investigated.

Although directors and officers are often a key target group of mandatory examinations, third parties can also be served with summonses. In order to satisfy a court that an examination summons should be issued to a third party, an external administrator must establish that the person:

- Has taken part or been concerned in examinable affairs of the corporation and has been, or may have been, guilty of misconduct in relation to the company
- May be able to give information about the company's examinable affairs

The definition of a company's examinable affairs is very broad under the Act and means:

A. The promotion, formation, management, administration, restructuring or winding up of the company

B. Any other affairs of the company

C. The business affairs of a connected entity of the company, in so far as they are, or appear to be, relevant to the company or to anything that is included in the company's examinable affairs because of A and B above

In terms of process, examination targets often have no way of determining if and when an examination may take place as external administrators normally keep confidential, for obvious reasons, their investigative and prosecutorial intentions. Further, the issuance of summonses are usually dealt with on an *ex parte* basis.

The fact that directors, officers or third parties are subject to examination processes akin to recorded depositions does not necessarily mean that they are the intended or actual targets of any court action. It may be that the external administrators are simply seeking information and documentation in proper connection with the examinable affairs of the company and they consider their examinees can shed light on those matters. Nonetheless, there is always the prospect of stigma and reputational risk as a result of being involved in public examinations, particularly in a high-profile or sensitive corporate collapse context.

Cross-over With Criminal Prosecutions

It is not uncommon for examination processes under the Act to be taking place while criminal investigations or prosecutions are also on foot. Despite the apparent inactivity of the Commissioner of Taxation, in 2021, we have already seen other federal and state authorities (and external administrators) take serious investigative and prosecutorial steps to address corporate misconduct and misfeasance. As the evident distress in many sectors continues, it is likely there will be more cross-over between criminal prosecutions and external administrations.

Examinations Conducted in Open Court Unless Special Circumstances Are Established

The Act permits the court to give very wide directions about the manner and conduct of examinations. Directions can include everything from the matters to be investigated, the procedure to be followed and access to the records of examination. Examinations are required to be held in open court except to such extent (if any) as the court considers that by reason of special circumstances, it is desirable to hold any examination in closed court.

Although it is open to an external administrator (or other eligible applicant) to make an application and submissions to the court on the appropriateness of closed court proceedings, the onus falls on the examinee to establish special circumstances. Sometimes, the pendency of criminal proceedings may, but will not necessarily, establish special circumstances warranting a closed court order. The fact that overlap with concurrent or pending criminal prosecutions may not be sufficient to establish special circumstances and limit potential prejudice indicates the extent to which the principles of open justice are imbedded as part of the Act.

In *Re Eurostar Pty Ltd* (In Liq) [2004) NSW SC 462, Campbell J explained at [13]:

"Part of the purpose of conducting examinations in public is that there is a public interest in all aspects of the circumstances which led to a corporate collapse being available to all those who might be interested. Incorporation is a privilege which is made available because there is seen to be public benefit in it, but there is a public interest in that privilege not being abused. The privilege of incorporation is given on terms that, if the company collapses, its affairs can be examined, and that examination will ordinarily be in public. In at least some instances, publicity of information given in examinations can cause information which was otherwise not available to be brought to the attention of those investigating the circumstances of the corporate collapse. There needs to be a good reason before full openness to public scrutiny of what is said in such examinations should be removed."

Taking Proactive Steps

There are protections afforded to directors, officers and third parties under the Act and at law. However, in order to avail themselves of those protections, directors should take proactive steps, including by engaging legal counsel early, anticipating, where possible, the processes that may follow an external administration and taking appropriate preparatory actions.

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