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BARRISTERS OPERATING AS CORPORATIONS

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There has been increasing pressure to allow barristers to incorporate. The motivations for the proponents include the potential tax benefits of incorporation. However, detractors suggest that incorporation might be inconsistent with barristers' duties or might insulate barristers from punishment for misconduct. This paper therefore considers whether there is a persuasive reason to prevent barristers from incorporating. The paper shows that incorporation would not be inconsistent with barristers' duties, would not insulate barristers from punishment for misconduct, especially in the presence of barristers' liability insurance, and might facilitate lower legal fees. The paper concludes that barristers should be allowed to incorporate because allowing incorporation would not convey a disbenefit.

A. Introduction

This paper analyses whether barristers should be allowed to operate as sole proprietor corporations. Barristers traditionally operate as individuals and do not benefit from the corporate form in the UK[1] and in many Australian jurisdictions.[2] However, the corporate form has several potential benefits for barristers, including tax benefits. In New South Wales, there has been a recent (albeit unsuccessful[3]) push to allow barristers to operate as corporations.[4] This follows

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1 In the UK, this is the outcome of allowing a barrister to be either (i) self-employed, which implies that the barrister is not an employee of the company that they own (see Bar Standards Board, Code of Conduct pt IV on self-employed barristers, read with the definition of "self-employed" in pt X), or (ii) an employed barrister, in which case the barrister can only provide services to the company, not to other third parties (see Pt V of the Bar Standards Board Code of Conduct).

2 For example, barristers cannot operate as part of a corporation in Victoria under the Victorian Bar Incorporated Practice Rules 2009 (Vic), r 144 and in New South Wales under New South Wales Barristers" Rules 2011 (NSW), r 16.

3 L Mezrani, "Barristers Reject Incorporation Motion" (18 September 2013) <http://www.lawyersweekly.com.au/wig-chamber/news/barristers-reject-incorporation-motion> accessed 2 October 2013.

4 Lawyers Weekly, "Exclusive: Bar Head Don't Care Too Much for Money" *Lawyers Weekly* (14 August 2013) <http://www.lawyersweekly.com.au/news/exclusive-bar-head-don-t-care-too-much-for-money> accessed 26 August 2013; J Whealing, "Barrister Turns Another Page"

the trend in other jurisdictions to allow barristers to incorporate.[5] While there may be many benefits for barristers of operating as a corporation,[6] this article focuses more on whether there is any persuasive reason to prevent barristers from incorporating.

Several concerns are often raised about the prospect of a barrister operating as a corporation; however, this paper argues that they are not sufficient to militate against allowing barristers to operate as corporations. First, there is the issue of whether barristers' duties to the court are consistent with barristers' fiduciary duties to the corporation. That is, a possible concern is whether barristers can owe duties to at least two parties (the court and the corporation) simultaneously. This paper argues that barristers can satisfy both duties. Aside from the theoretical literature, which indicates that boards can consider multiple stakeholders,[7] both case law[8] and statute law[9] have already considered situations in which directors owe duties to multiple stakeholders, such as creditors. Further, case law has indicated that shareholders cannot act unanimously and unilaterally to prejudice the interests of another party to whom the directors owe a duty.[10] Allowing barristers to operate as corporations would not undermine barristers' duties to the courts.

Secondly, there is the argument that the corporation involves "social norms" that are inconsistent with barristers' duties and their standing as a profession. Specifically, the shareholder wealth maximisation paradigm, which is the social norm associated with corporations, is often said to be inconsistent with barristers' professional standards. However, such an argument ignores the fact that doctors (who also owe professional duties, and have a similar status in society) can successful operate as corporations. Further, it is naïve, and normatively invalid, to assume that barristers should operate other than as rational utility-maximising individuals. Indeed, economic theory posits that an efficient

Lawyers Weekly (15 August 2013) <http://www.lawyersweekly.com.au/folklaw/barrister-turns-another-page> accessed 27 August 2013.

5 See, eg New Zealand: Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 (NZ), r 14.2(f).

6 For example, the possibility of tax benefits is considered in *Lawyers Weekly* (n 4).

7 M Blair and L Stout, "A Team Production Theory of Corporate Law" (1999) 85 Virginia Law Review 247.

8 See, eg the finding that there can be duties to creditors. Such duties exist in both the US (*Credit Lyonnais v Pathe Communications* No 12150, 1991 Del Ch) and in Australia (*Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 New South Wales Law Reports 722, [732]). On the US laws see B Becker and P Stromberg, "Fiduciary Duties and Equity–Debtholder Conflicts" (2012) 25 Review of Financial Studies 1931; CR Morris, "Directors' Duties in Nearly Insolvent Corporations: A Comment on Credit Lyonnais" (1993) 19 Journal of Corporation Law 61.

9 See, eg the provisions on insolvent trading in Corporations Act 2001 (Cth), s 588G. Further, the relevant UK law explicitly indicates that directors can consider other interests, including the desirability of maintaining a strong business reputation, when acting to promote the success of the company: Companies Act 2006 (UK), s 172(1)(e).

10 *Kinsela v Russell Kinsela* (n 8) [732].

market (including for barristers services) can operate if and only if individuals operate as rational utility maximisers. Thus, the corporate form could actually be normatively consistent with, and could promote, barristers' duties and social position.

Thirdly, it is sometimes argued that the corporate form could insulate barristers from punishment for misconduct. Specifically, the argument is that barristers could "hide behind the corporate veil" to avoid being personally liable for damages for misconduct. Instead, they could argue that the corporation is liable and they could ensure that the corporation has insufficient assets to pay damages. However, the clear counter-argument is that, if barristers are unable to satisfy their punishment, then they can be forbidden to practice themselves—that is, the punishment can still be served upon the barrister as an individual in addition to, or instead of, serving punishment on the corporation. Additionally, the court could regard this as an additional situation in which corporate "veil piercing" could be justified, as the barrister's misconduct could be seen as an abuse of the corporate form as a method used purely to avoid legal obligations. Legislative changes could also instigate specific rules to address such concerns, such as those considered in response to "phoenixing".[11] Finally, to the extent that engaging in misconduct would undermine the barrister's corporate value, it could constitute a breach of directors' duties, which could give rise to various remedies and, in some cases, could enable a regulator to seek sanctions against the director. Thus, the corporate form could potentially reinforce punishment for misconduct.

The remainder of this article considers these arguments in more detail. It concludes that barristers should be allowed to choose to operate as corporations because there is no persuasive reason for why it would be inconsistent with their duties.

B. Are Barristers' Duties Compatible with the Corporate Form?

The first concern is that barristers' duties to the court are incompatible with their fiduciary duties to the corporation. Directors owe duties to their corporation. These duties exist under common law and also, in many cases, under statute.[12] The duties include the duties of care,[13] duties in relation to conflicts

[11] On phoenixing, and the potential response thereto see, eg H Anderson, "The Proposed Deterrence of Phoenix Activity: An Opportunity Lost?" (2012) 34 Sydney Law Review 411.

[12] For a useful summary see, eg P Hood, "Directors' Duties under the Companies Act 2006: Clarity or Confusion?" (2013) 13 Journal of Corporate Law Studies 1.

[13] Corporations Act 2001 (Cth), s 180; Companies Act 2006 (UK), s 174.

of interest,[14] the duty to act for a proper purpose and, most relevantly, the duty to act in the interests of the company as a whole.[15] This gives rise to three main issues: (i) whether the duty to act in the company's interests is compatible with the barrister's duties to the court; (ii) whether it is possible to owe multiple duties; and (iii) whether the barrister's position as shareholder would allow him/her to override his/her duties.

The duty to act in the company's interests is not inconsistent with the barrister's duties to the court. The relevant duties in both the UK and Australia require that the director act for a proper purpose and in the interests of the company as a whole.[16] This issue, then, is whether performing barristers' duties could conflict with this directors' duty. The answer is that it would not so conflict. A barrister can act as a barrister only if he/she complies with his/her duties. Were the barrister to not satisfy his/her duties to the court, then he/she could not practise and the company could not earn an income. Therefore, it is in the company's interests that the barrister satisfies his/her duties to the court. Thus, the barrister satisfying his/her duties to the court also satisfies his/her duties to the company. Consistent with this, the UK law explicitly countenances that the director should have regard to "the desirability of the company maintaining a reputation for high standard of business conduct".[17] In this context, that would imply satisfying the barristers' duties to the court.

The barristers' duties would not contravene directors' duties to not put themselves in a position of conflict with the companies' interests.[18] While it is true that holding conflicting directorships/positions,[19] or other fiduciary duties,[20] can result in a breach of directors' duties, barristers' duties are not such a conflicting duty. This is because satisfying such duties is a necessary prerequisite for the company continuing to operate as a barrister-corporation. Thus, satisfying barristers' duties is a necessary prerequisite to the company generating income. Thus, satisfying those duties would not relevantly constitute a conflict.

The law has recognised that directors can, and sometimes should, satisfy multiple duties simultaneously. Aside from the fact that upholding the duties to the court also ensures that the company can earn an income, directors

[14] Corporations Act 2001 (Cth), ss 182–83; Companies Act 2006 (UK), ss 175, 176. These duties are supplemented with duties to declare any conflict of interested: Corporations Act 2001 (Cth), s 191; Companies Act 2006 (UK), s 177.

[15] Corporations Act 2001 (Cth), ss 181. Companies Act 2006 (UK), ss 171, 172.

[16] Corporations Act 2001 (Cth), ss 181; Companies Act 2006 (UK), s 172. *Re Smith and Fawcett Ltd* [1942] Ch 304, [1942] 1 All ER 542; *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286, [1950] 2 All ER 1120.

[17] Companies Act 2006 (UK), s 172(1)(e).

[18] The statutory duty against conflicts is in Corporations Act 2001 (Cth), ss 182–83 and in Companies Act 2006 (UK), s 175.

[19] *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461; *Liquidators of Imperial Mercantile Credit Assoc v Coleman* (1873) LR 6 HL 189.

[20] *Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co* [1914] 2 Ch 488.

are capable of satisfying multiple duties. This is implicit in the hypothetical "team production" model of the corporation, where directors help to satisfy the interests of myriad stakeholders in the corporation.[21] Further, the law has long recognised that directors must consider creditors' interests.[22] While this is not a direct "duty" to the creditors, they must nonetheless consider creditors' interests when meeting their duties to the company. In the present context, that would involve considering their duties to the court when exercising their duties to the company as a whole. The relevant UK legislation explicitly indicates that the consideration of such interests (i.e. duties to the court) is necessary as it would both "foster the company's business relationships" with the court[23] and would help to maintain the company's reputation for "high standards of business conduct".[24]

Shareholders (ie a barrister acting alone) cannot abrogate the duties to other parties. The main issue is whether barristers, as shareholders, can act in a way that would override directors' (or other) duties, and thus act in a way that would abrogate barristers' duties to the court. The court has held that shareholders cannot do so. For example, *Kinsela* indicates that shareholders cannot use the doctrine of unanimous assent to undermine the duty to consider creditors when making a decision when the company is in a parlous financial situation: here, Chief Justice Street stated "where, however, the interests at risk are those of the creditors I see no reason in law or in logic to recognize that shareholders can authorize the breach [of directors' duties]".[25] That is, a barrister could not use his/her position as a shareholder to unilaterally decide to ignore duties to the court, much as shareholders cannot unilaterally override directors' duties to creditors.

C. Is the Social Norm of a Corporation Incompatible with Barristers' Duties?

The next issue is whether the social norms associated with corporations would create the appearance of incompatibility with barristers' duties.

The corporate firm is typically seen as a rational wealth-maximising organisation; the dominant conception of the corporate form is that it should promote

[21] Blair and Stout (n 7).

[22] Such a requirement is enshrined in Companies Act 2006 (UK), s 172(3). *Re Smith and Fawcett* (n 16); *Kinsela v Russell Kinsela* (n 8); *Australian Securities and Investments Commission v Somerville* (2009) 259 ALR 574; *Walker v Wimborne* (1976) 137 CLR 1; *Credit Lyonnais v Pathe Communications* (n 8). See also S Marshall and I Ramsay, "Stakeholders and Directors' Duties: Law, Theory and Evidence" (2012) 35 University of New South Wales Law Journal 291.

[23] Companies Act 2006 (UK), s 172(1)(c).

[24] Companies Act 2006 (UK), s 172(1)(e).

[25] *Kinsela v Russell Kinsela* (n 8) [732].

shareholder wealth maximisation.[26] This is notwithstanding the aforementioned situations in which directors must consider other parties' interests. One possible concern is that this creates the appearance of a conflict between the motives of the corporation (and its directors) and the presence of duties to the court. There are at least two key responses to this concern.

First, shareholder wealth maximisation is not the sole norm that is associated with corporations. Corporations are sometimes seen as maximising the welfare of all stakeholders, including external parties.[27] Relevantly, in the case of a barrister-corporation, this would include the court. Thus, the presence of a barrister-corporation would help to enhance public awareness of corporations that promote goals in addition to shareholder wealth maximisation.

Secondly, notwithstanding the above argument, rational utility maximisation promotes social welfare. In an efficient market, prices are set by rational utility (ie wealth) maximising individuals.[28] This is premised on the existing of rational wealth-maximising buyers and sellers. The corporate form promotes wealth maximisation. Thus, the corporate form promotes the existence of an efficient market that contains wealth-maximising sellers of legal services, who will compete on price. Therefore, the wealth-maximising aspects of the corporate form are consistent with establishing a price for barristers' services that reflects the fair value that consumers are willing to pay for those services. This is the logic that underlies allowing financial markets to set the prices for various financial securities. Subsequently, shareholder wealth maximisation and the implications of market competition promote the establishment of efficient and fair prices for barristers' services. This helps to enhance consumer welfare.

Therefore, the nature of the corporate form, and the shareholder wealth maximisation paradigm, is consistent with barristers' duties, barristers fulfilling their responsibilities to the court, and could promote market efficiency and competition over legal fees.

[26] SM Bainbridge, "In Defense of the Shareholder Wealth Maximization Norm" (1993) 50 Washington and Lee Law Review 1423; MJ Roe, "Shareholder Wealth Maximization Norm and Industrial Organization" (2001) 149 University of Pennsylvania Law Review 2063.

[27] Blair and Stout (n 7); A Kecskes and others, "Do Firms Do Well by Doing Good When They Do It Right?" (Virginia Tech 2013) Working Paper.

[28] See, eg AS Kyle, "Continuous Auctions and Insider Trading" (1985) 53 Econometrica 1315; LR Glosten and PR Milgrom, "Bid, Ask and Transaction Prices in a Specialist Market with Heterogeneously Informed Traders" (1985) 14 Journal of Financial Economics 71; J Hasbrouk, "One Security, Many Markets: Determining the Contributions to Price Discovery" (1995) 50 Journal of Finance 1175.

D. Would the Corporate Form Insulate Barristers from Punishment for Violation of Their Duties?

The third concern is that barristers could use the corporate form to escape punishment for violation of their duties. The specific concern is that if a barrister were to operate as a corporation, then any "punishments" or costs awards would be awarded against the corporation, rather than against the barrister. Subsequently, the barrister could leave the corporation undercapitalised, thereby ensuring that the company lacks the resources to pay the relevant fee.[29] However, there are several responses to this concern.

First, the mere presence of the corporate form does not prevent the court from assigning punishment to the barrister in question. Indeed, existing legislation envisages the possibility of imposing punishments on officers and directors in their capacity as officers and directors.[30] Further, the corporate form does not insulate individuals from the repercussions of misconduct committed as individuals.[31] The House of Lords, stated as much in *Standard Chartered Bank v Pakistan National Shipping* when considering a case for deceit against a defendant (Mehra) who was acting for his company. The court stated that the mere fact that he was acting for a company "cannot detract from the fact that they were his representation and his knowledge. He was the only human being involved in making the representation."[32] That is, the corporate form could not insulate from liability for individual wrong-doing.

Secondly, it is likely that if the barrister were merely to use the corporate form as a veil to protect himself/herself from punishment, then the court could engage in veil piercing. Courts are generally reticent to engage in corporate veil piercing, and will not merely do so because the corporate form conveys an advantage of allowing a party to avoid liabilities.[33] However, courts have indicated a willingness to engage in veil piercing if the corporate form merely exists to allow shareholders to avoid their legal obligations.[34] For example, Lord Sumpton stated in *Prest v Petrodel Resources Ltd* that veil-piercing could be appropriate "when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control".[35] Furthermore, if a corporation is seen as a "sham" or a "simulacrum", then the court will also be willing to pierce the corporate veil.[36] Misconduct is not for

[29] This is much the same as in *Walkovsky v Carlton* (1966) 223 NE 2d 6.
[30] See, eg the penalty provisions in the Corporations Act 2001 (Cth).
[31] See, eg *Standard Chartered Bank v Pakistan National Shipping Corporation* [2002] UKHL 43.
[32] *Standard Chartered Bank* (n 31) [20].
[33] See, eg *Walkovsky v Carlton* (n 29); *James Hardie Pty Ltd v Putt* [1998] NSWSC 434.
[34] See, eg *Jones v Lipman* [1962] 1 WLR 832, 835–36; *Gilford Motor Co Ltd v Horne* [1933] 1 Ch 935, 955–61.
[35] *Prest v Petrodel Resources Ltd* [2013] UKSC 34, [35].
[36] *Re FG (Films) Ltd* [1953] 1 WLR 483, 485–86.

the purposes of promoting the corporation. Instead, it would be non-corporate conduct that the barrister would pursue for personal ends, and would be to evade an "existing legal obligation" or an "existing legal restriction". Thus, if a barrister were to engage in widespread misconduct and were to claim that the corporate form provided protection, then the court could arguably engage in veil piercing. While legislative veil-piercing amendments would help to clarify the situation, it is likely that established veil-piercing would help to mitigate the consequences of misconduct.

Thirdly, it is unlikely that barristers would be able to engage in phoenixing to sidestep penalties. Phoenixing occurs if a manager establishes a new company that does substantially the same activities as the manager's prior failed company. Phoenixing can be regarded as an abuse of the corporate form, which can permit incompetent or unscrupulous people to continue to operate value-destroying businesses.[37] The concern is that if the court punishes the barrister's company (rather than the barrister himself/herself) and the barrister were to leave it undercapitalised (and unable to pay a fine) or the court were to disbar that particular company, then the barrister could simply establish a new company while leaving the old company to shirk its responsibilities. This could create the problematic situation of a barrister phoenixing the corporation.

The ideal remedy to the issue of phoenixing would be to explicitly allow for the barristers' association to apply to the court to prevent a barrister from running a barrister-corporation. This is much like some regulations that allow for Australian Securities and Investments Commission (ASIC)[38] and the Australian Crime Commission[39] in Australia to go to court to disqualify a director in some situations. In the UK, repeated violations could come within the Company Directors Disqualification Act 1986 (UK), section 3, which provides for disqualification from being a director for repeated violations of directors' duties. In Australia, in severe situations, misconduct would come within the Corporations Act 2001 (Cth), section 206C, where ASIC could petition the court to disqualify a person for violating a civil penalty provision. Arguably, engaging in misconduct would prejudice the operations of the corporation (ie by knowingly exposing it to fines and punishment, and potentially risking disbarment). Subsequently, the actions would potentially violate the officers' duties as laid down in section 180.[40] This would expose them to penalties under section 1317E,

[37] Anderson (n 11).

[38] See, eg Corporations Act 2001 (Cth), s 206C.

[39] Competition and Consumer Act 2010 (Cth), s 86E.

[40] Such a situation is increasingly possible due to the increasingly stringent expectations that regulators have of directors: G Golding, "Tightening the Screws on Directors: Care, Delegation and Reliance" (2012) 35 University of New South Wales Law Journal 266; B Gibson and D Brown, "ASIC's Expectations of Directors" (2012) 35 University of New South Wales Law Journal 254; JG Hill, "Centro and the Monitoring Board—Legal Duties versus Aspirational Ideals in Corporate Governance" (2012) 35 University of New South Wales Law Journal 341.

following which ASIC could apply to have the person disqualified from acting as a director of a corporation. Therefore, it is arguable that the existing law in both Australia and the UK would prevent barristers from simply using a succession of corporations to avoid punishment for misconduct. Overall, legislative amendments would be ideal, although arguably unnecessary, to mitigate the issue of phoenixing.

Fourthly, notwithstanding the presence of a separate legal form, barristers' indemnity insurance would provide for compensation in many cases. In most cases, barristers must possess professional indemnity insurance.[41] Often minimum levels of insurance are prescribed.[42] Such insurance would cover many of the situations in which the barrister would be liable. Given that there are minimum levels of insurance, there is only limited scope for barristers to leave the company undercapitalised and avoid financial obligations.

E. Would the Corporate Form Facilitate Other Social Benefits?

One argument in favour of allowing barristers to operate as corporations is that it could reduce legal fees.[43] The premise is that the corporate form can convey taxation advantages. Assuming that such taxation advantages exist, the issue is then whether they might lead to a social benefit. It is not the purpose of this paper to discuss the tax advantages of the corporate form. Instead, this paper asks the question: is there a possibility that incorporation will reduce legal fees? If there is a possibility of lower legal fees, and there is no reason to believe that the fees would increase, then the corporate form is beneficial.

The courts,[44] legislation[45] and academic articles[46] have identified access to justice as an important goal, as manifested by a "just, quick, and cheap" legal system. One way to reduce the cost of legal proceedings is by reducing lawyers' fees. Barristers are unlikely to reduce fees merely because they gain access to the corporate form. However, barristers will face less cost pressure if they

[41] See, eg the UK Bar Standards Board Code of Conduct Rule 402.1; in NSW see the Legal Profession Act 2004 (NSW), s 403.

[42] For the 2013–14 period, the minimum level of insurance is AUD 1.5 million <http://www.nswbar.asn.au/docs/professional/practice_nsw/pii_index.php>.

[43] This argument is raised in *Lawyers Weekly* (n 4).

[44] See, eg *Aon Risk Services Australia v Australian National University* (2009) 258 ALR 14.

[45] The Civil Procedure Act 2005 (Cth), s 56(1) states that "The overriding purpose of this Act and of rules of court, in their application to civil proceedings, is to facilitate the just, quick and cheap resolution of the real issues in the proceedings".

[46] There is also academic support for the notion of promoting a just quick and cheap legal system: D Boniface and M Legg, "Cost, Delay and Justice: The High Court of Australia Recognizes the Importance of Case Management in Civil Litigation—Aon Risk Services Australia Limited v Australian National University" (2010) 39 Common Law World Review 157.

can incorporate. Subsequently, while there will be no "downward pressure" on barristers' fees, there will also be less "upward pressure" on them than would otherwise be the case. Subsequently, allowing barristers to incorporate has the potential to reduce barristers' fees. Thus, it could promote cheaper access to justice. Therefore, since allowing barristers to incorporate could yield lower fees (and there is no reason to believe it could possibly result in higher fees), there is the possibility of increased access to justice.

F. Conclusion

This paper analyses whether barristers should be allowed to operate as sole-proprietor corporations. There have been recent calls to change the barristers' rules to allow barristers to operate as corporations rather than as individuals. The motivation for these moves has included the potential for taxation advantages from operating a corporation. This paper considers whether barristers should be allowed to have the choice to operate as corporations.

The paper considers the main arguments against allowing barristers to operate as corporations. It finds that the arguments against incorporation are unpersuasive. First, the corporate form and directors' duties are compatible with the barrister exercising other duties to the court. Secondly, there is no normative incompatibility between the corporate form (and rational shareholder wealth maximisation) and barristers exercising duties to the court. Thirdly, the corporate form would not allow barristers to avoid punishment for misconduct. Indeed, to the extent that such conduct can undermine corporate value (for the barrister's corporation), it could violate directors' duties and expose the barrister to penalties under the Corporations Act. Additionally, allowing barristers to act as corporations may enable them to reduce legal fees, thereby increasing access to justice. Therefore, this paper concludes that barristers should be allowed to operate as corporations, for such an operation would not be inconsistent with, and may even promote, barristers' duties to the court.