Avoiding contempt of court for breach of freezing orders: it's a matter of trust

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Snapshot

- Freezing orders can be breached by trust-to-office transfers of 'frozen' funds.
- In some circumstances, solicitors (as well as clients) can be liable for contempt of court if frozen funds are used to pay unauthorised legal expenses.
- Care is needed in drafting freezing orders – and once they are made, effective procedures are needed to ensure that they are not breached.

For many solicitors, the only prospect more stomach-churning than discovering trust account deficiencies would be facing contempt of court charges; for others, the only thing more stomach-churning than contempt of court charges would be problems with the trust account. So when both of these circumstances come together, and a firm of solicitors faces contempt charges arising from the alleged breach of freezing orders made on the application of ASIC, the overall scenario has the makings of a Very Bad Day at the Office.

This scenario arose in a decision of the Federal Court of Australia in *Australian Securities and Investments Commission v One Tech Media Limited (No 3)* [2018] FCA 1071 ('***One Tech***'). Although the contempt charges against the firm (which, for present purposes, can be called '**the firm**') were dismissed, the Court identified 'serious deficiencies in the processes adopted by [the firm] to ensure that payments out of its trust account were permitted by the [freezing] orders' (at [47]). Accordingly, the case provides useful lessons on how to avoid the Very Bad Day at the Office being yours.

The context – freezing orders with 'carve-outs' for legal fees

Once upon a time there were 'Mareva orders'; today, Australian law appears to have settled on 'freezing orders' to describe orders which have the effect of preventing a party (or non-party) from dealing with their property. Although the High Court of Australia in *Cardile v LED Builders Pty Ltd* 198 CLR 380; [1999] HCA 18 suggested the title 'asset preservation orders', which retains some currency, 'freezing orders' is now the more common formulation, and is used in the relevant Rules and Practice Notes of State and Federal Courts.

Freezing orders are generally sought and obtained on an ex parte basis, as was the case in *One Tech*, where ASIC originally obtained orders on 26 July 2016. ASIC's case against the defendants in *One Tech* involved allegations of contraventions of the *Corporations Act 2001* (Cth) ('***Corporations Act***') arising from the conduct of a 'binary options' trading business. On 26 July 2016, a number of orders were made including an interim injunction under section 1324(4) of the *Corporations Act* that the defendants: 'be prohibited from selling, transferring, encumbering, disposing of or otherwise dealing with any of their assets or property' ['the **General Freezing Order**'].

The procedure where freezing orders are sought under section 1324 differs from the ordinary position in relation to injunctions in some important ways; for example, where ASIC applies for an injunction under the section, the Court may not require ASIC, or any other person, to give an undertaking as to damages (see *Corporations Act*, s 1324(8)). However, there are also a number of procedural issues which apply equally to statutory and 'ordinary' freezing orders. One of those common procedural issues is that defendants will usually be allowed an exception (often called a 'carve out') to the order to enable the defendants to meet ordinary living expenses, and to meet reasonable legal expenses in the proceedings in which the freezing orders have been made.

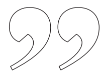
In *One Tech*, the 'carve outs' took the form of a number of further orders made throughout late 2016 which had the effect of continuing the General Freezing Order, but excluding from that order specified payments which were permitted to be made by the defendants into the trust account of the firm for the payment of legal expenses. The consequence of these variations was that by 14 December 2016, the defendants were entitled to pay legal expenses out of amounts held by the firm up to a cumulative total of $53,037.69 ('the **Permitted Amount**').

The allegations of contempt

Throughout January and February 2017, the firm continued to work on the matter and issued bills in the ordinary course, which were paid by trust to office transfers. However, in doing so:

- the firm issued an invoice for work relating to a separate matter unconnected with the proceedings. Although the Permitted Amount was expressed to be for 'legal expenses', and not 'legal expenses *in relation to the present proceeding*', it was held that the italicised words went without saying, so that the payment of this invoice breached the General Freezing Order; and

The decision provides a further illustration of the difficulties which can arise when carve outs to freezing orders are measured with unduly fine scales.



- the firm issued (and paid by trust to office transfer) three invoices which caused the total legal fees incurred to exceed the Permitted Amount by a total of $8,340.88.

The consequence of these matters was that the payment of these invoices by the defendants (when trust monies held by the firm were applied to satisfy invoices) involved breaches of the General Freezing Order. The defendants admitted their guilt in relation to charges of contempt brought against them, which left the question of whether or not the firm was also guilty of contempt of court.

Contempt by solicitors of orders binding their clients

The contempt charge against the firm was put on two alternative bases. The primary basis was that the firm had strict liability for breaching the General Freezing Order. Although it is the case that strict liability operates in relation to parties which are bound by Court Orders, the firm was not a party to the orders which bound its clients. Could the firm be liable on a strict liability basis even though it was not bound by the orders? The Court found it could not, and went on to helpfully set out the relevant principles (at [116]):

a) A person who is not a party to the proceeding and not bound by a court order is not subject to the strict liability for contempt that applies to a person bound by a court order that is breached;

b) A person who is not, in terms, bound by a court order (but who knows of it and who then does something that disrupts the situation created by it) may, but not necessarily must, be guilty of contempt of court; and

c) Such a person (as referred to in (b)) will be guilty of contempt where his or her conduct, coupled with knowledge of the court order, shows that they are flouting the authority of the court by doing something they know will prevent the court order from achieving its intended object.

Accordingly, without any element of intention to flout the orders being established on the part of the firm, the firm could not be in contempt of court. The alternative basis on which the charges were pressed was that the firm had made each of the impugned payments 'knowing that to be in contravention of the Court Order'. However, this alternative basis was also rejected because the Court accepted (at [93(f)]) the evidence of the solicitor with carriage of the matter that 'if he had known that any of the four payments exceeded the carve outs, he would not have allowed the payments to occur.'

Lessons from the decision

How could the need to defend (albeit successfully) the contempt charges have been avoided? ***The first answer*** is that the firm needed better procedures in relation to the transfer of monies on the defendants' files. The solicitor with carriage of the matter explained that he had instructed that no monies should be transferred on the relevant files 'without checking with me' but, as the Court noted:

- that instruction did not appear to have been given in writing; and
- there was no procedure for the solicitor to give his approval to a transfer in writing; and
- the procedure did not incorporate a process of calculating that the Permitted Amount had not been exceeded.

Together, those matters led to the characterisation of the firm's processes as involving 'serious deficiencies'. Any solicitor dealing with trust monies which are the subject of freezing orders should ensure that they have in place a procedure which includes at least these three elements.

The second answer is that the decision provides a further illustration of the difficulties which can arise when carve outs to freezing orders are measured with unduly fine scales. In many cases, an order which permits the expenditure of 'reasonable legal expenses' will be more appropriate than a fixed or capped 'carve-out' amount, particularly if there is a risk that interlocutory applications in relation to the variation of a capped amount will substantially erode the amount available under the cap.

The third answer is that the drafting of Court orders should always be done with an eye on the removal of ambiguity. In *One Tech*, the firm argued that there was ambiguity in the orders in that they did not specify whether the Permitted Amount was inclusive, or exclusive, of GST. If the Permitted Amount was exclusive of GST, then the figure by which the Permitted Amount was exceeded would have been reduced.

Although the Court held that the Permitted Amount was inclusive of GST, there would appear to be a reasonable basis for seeking in appropriate cases that any amount should be exclusive of GST, particularly where the party subject to the freezing orders will, in due course, receive an input tax credit. **LSJ**