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Abstract

[extract] Concern about the abuse of the corporate form has led to some useful European research, and the topic has received attention from the OECD. Since September 11 2001, we have had greater concentration on the financing of terrorism. This has led to international initiatives which have in turn resulted in domestic legislation. The legal and self regulation adopted by this and recent measures such as the US Sarbanes-Oxley Act of 2002 resulting from collapses such as Enron, is beginning to have an impact on the traditional roles of lawyers. New responsibilities are being imposed on lawyers to act as gatekeepers in domestic and international transactions and on occasion to act as whistleblowers where there is reason to suspect that abuse of the corporate form is facilitating crime or terrorist activities.

Keywords

sham, abuse of the corporate form, international law, terrorism, finance, Euroshore report, Transcrime report, OECD Report Behind the Corporate Veil – Using Corporate Entities for Illicit Purposes, Financial Action Task Force

PIERCING THE CORPORATE VEIL IN AN ERA OF GLOBALISATION AND INTERNATIONAL TERRORISM AND THE EMERGENCE OF THE LAWYER AS GATEKEEPER AND WHISTLEBLOWER

By John H Farrar & Christoph Pippel***

We tend to take it as axiomatic that courts and legislatures can pierce the corporate veil in order to combat crime.¹ Indeed this has been extended to civil fraud.² While this has been taken as axiomatic in most legal systems, the reasoning is often circular. There is a need for a clearer explanation in terms of principle and there are differences between systems as to transparency in the formation and ownership of companies. These give rise to problems which have become worse as a result of globalisation and the abolition of exchange controls. Now we have the impact of international terrorists who have learned from the experience of international fraudsters and drug dealers in money laundering and similar illicit activities. Concern about the abuse of the corporate form has led to some useful European research, and the topic has received attention from the OECD. Since September 11 2001, we have had greater concentration on the financing of terrorism. This has led to international initiatives which have in turn resulted in domestic legislation. The legal and self regulation adopted by this and recent measures such as the US Sarbanes-Oxley Act of 2002 resulting from collapses such as Enron, is beginning to have an impact on the traditional roles of lawyers. New responsibilities are being imposed on lawyers to act as gatekeepers in domestic and international transactions and on occasion to act as whistleblowers where there is reason to suspect that abuse of the corporate form is facilitating crime or terrorist activities.

In this article we shall examine:

First, the increasing tendency, particularly of English courts, to categorise such illicit uses of the corporation as shams and see whether one can find a better foundation for intervention than this which is consistent with principle;

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1 See generally *Ford's Principles of Corporations Law* 11th ed by HAJ Ford, RP Austin and IM Ramsay, LexisNexis Butterworths, Chatswood 2003, [4.250].

2 Ibid.

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Second, the recent European research into illicit use of companies in the Euroshore and Transcrime reports;

Third, the main recommendations of the OECD Report *Behind the Corporate Veil – Using Corporate Entities for Illicit Purposes*;

Fourth, the work of the Financial Action Task Force ('FATF') on the financing of terrorism;

Fifth, recent antiterrorist measures; and

Last, the impact of these on the legal profession and the emergence of the concept of the lawyer as gatekeeper and whistle blower in relation to such transactions.

Form, Substance and the Question Begging Doctrine of the SHAM

There have been references in Commercial Law from time to time to certain transactions being sham transactions. A leading dictum is that of Diplock LJ in *Snook v London and West Riding Investments Ltd*³ in 1967 where he said '... for acts or documents to be a "sham", with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating'.

In *Gilford Motor Co v Home*⁴ the English Court of Appeal held that a person could not incorporate a company as 'a cloak or sham' to enable him to commit a breach of covenant under his service contract as managing director. *Gilford Motor Co v Home* was followed by Russell J in *Jones v Lipman*⁵ where he referred to 'a device and a sham, a mask which [the first defendant] holds before his face in an attempt to avoid recognition by the eye of equity', and a similar approach has been adopted in recent cases in the United Kingdom, New Zealand and Australia.⁶

This approach was referred to, but not applied in, *Adams v Cape Industries Plc*⁷ where the English Court of Appeal referred to piercing the veil in cases of sham or façade. There have been increasing tendencies in English cases to use this as a justification for piercing the corporate veil.⁸ One of the present authors has maintained for nearly twenty years that the use of the sham doctrine in relation to

3 [1967] 2QB 786 at 802.

4 [1933] Ch 935, 957, 969.

5 [1962] 1 WLR 832, 836.

6 See *Farrar's Company Law* 4th ed by JH Farrar and BM Hannigan, Butterworths, London (1998) 72 and the cases cited at Footnote 15.

7 [1990] Ch 433, 539 et seq.

8 Ibid.

piercing the corporate veil involves a category of circular or illusory reference⁹, i.e. the court uses this reasoning to express disapproval of a particular use of the corporate form. It is thus the expression of a conclusion rather than a piece of analytical reasoning leading to a conclusion. It is good that Lord Cooke of Thorndon acknowledged this in 1996 in his lecture 'A Real Thing: Salomon v A. Salomon & Co Ltd'.¹⁰

It is submitted that it is better to rest the argument on principle – the law will look to substance as well as form¹¹ and will not allow the corporate form to be used to facilitate crime or civil fraud. As the court said in the New York case of *International Aircraft Trading Co v Manufacturers Trust Co*¹² the court will pierce the veil to prevent fraud or to achieve equity. The general principle was perhaps better expressed by Sanborn J in *United States v Milwaukee Refrigerator Transit Co*¹³ where he said:

If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons

This was accepted as a sound proposition by Rogers AJA in *Briggs v James Hardie & Co Pty Ltd*¹⁴ for the purposes of Australian Law.

The Recent European Research

The Euroshore Report

This report, produced by the University of Trento in Italy, states that 'Crime involving legal persons constitutes a serious problem that penetrates the public and legitimate private sector and threatens the transparency of (international) trade as well as that of society as a whole'.¹⁵

9 Ibid.

10 *Turning Points of the Common Law*, Sweet & Maxwell, London (1997) 17. See also Robert Walker J in *Re Polly Peck International Plc* [1996] 2 All ER 433 at 447b.

11 See for example Lord Romilly MR in *Parkin v Thorold* (1852) 16 Beav. 59, 66-7; 51 ER 698, 701; Fullagar J in *Re Bairnsdale Food Products Ltd (in liq.)* [1948] VLR 264, 268, 2 ALR 315, 319.

12 297 NY 285, 292, 79 NE2d 249, 252.

13 142 F2d 247, 255.

14 (1989) 7 ACLC 841.

15 FATF, *Review of the Forty Recommendations – Consultation Paper*, 30 May 2002, 53 (reporting that in March 2000, the T.M.C. Asser Instituut in co-operation with the Ministry of Justice of the Netherlands and Europol, Prevention of organised crime:

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Company Law regulation is the most essential factor in the transparency of a financial system.¹⁶ This is because Company Law contributes to the level of transparency/opacity of a financial system, thereby influencing other sectors of regulation, e.g. the due diligence of customers in the banking sector, and the effectiveness of police and judicial co-operation (the 'domino effect').¹⁷

The abuse of corporate vehicles, in particular for money laundering and tax evasion, has been an issue for more than two decades.¹⁸ Since the atrocities of September 11, 2001 it has become clear that front and shell companies are also increasingly used for the financing of terrorism.¹⁹

The registration of legal persons and their directors and the international exchange of information (The report recommended, inter alia, the need: 'To take measures to make legal persons and the persons behind them [i.e. the natural persons who are behind the legal person, such as directors, shareholders, beneficiary owners] more transparent [and provide information about these natural persons].') at <http://www.fatf-gafi.org/pdf/Review40_en.pdf> visited on 10 April 2004.

- 16 *Euroshore Report*, page 75 - 76 (noting a great deviation in Company Law within Europe from Integrity Standards and concluding that 'Company Law is the point from which action to protect financial systems against exploitation by organised crime should begin, both in Europe and elsewhere').
- 17 *Euroshore Report*, page 76 (observing that if company law seeks to maximise anonymity in financial transactions, facilitating the creation of shell or shelf companies whose owners remain largely unknown - because other companies own them - , such anonymity could be transferred to other sectors of the law, such as criminal, banking, tax. Therefore, the names of the real beneficial owners or beneficiaries of financial transactions remain obscured, thwarting criminal investigation and prosecution).
- 18 Jean-Francois Thony, Assistant General Counsel IMF, *Money Laundering and Terrorism Financing: An Overview* [2002] IMF Working Paper at 1-2 at <<http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/thony.pdf>> visited on 10 April 2004; See also United Nations Office for Drug Control and Crime Prevention, 'Financial Havens, Banking Secrecy and Money Laundering' [1998] (observing that international business corporations are used in virtually all money-laundering schemes because they provide an impenetrable layer of protection around the ownership of the assets) at <<http://www.imolin.org/finhaeng.htm#V.%20Issues%20for%20consideration>> visited on 10 April 2004.
- 19 FATF, *Report on Money Laundering Typologies 2002 - 2003* at 3 <http://www1.oecd.org/fatf/pdf/TY2003_en.pdf> visited on 10 April 2004.

Transcrime ‘Transparency and Money Laundering’²⁰

The Transcrime Report seeks to answer the following questions:

- What regulation and/or implementation in the banking/financial and in the corporate/company regulative fields create obstacles to anti-money laundering international co-operation between EU Member States?
- What is the dimension of the obstacles in these fields?
- What remedies could be proposed and at what level, to reduce the obstacles to anti-money laundering international cooperation between the EU Member States?

*Susceptible Corporate Vehicles for Abuse (Money Laundering)*²¹

The results of the Transcrime Report showed that the public limited company was reported to be ‘often used’ in money laundering operations in 40% of EU Member States and the private limited company in 67% of EU Member States.²²

Areas of Company Law Relevant for Transparency/Opacity

Three thematic areas of Company Law relevant for the level of transparency/opacity of the national financial systems were identified: Incorporation, Company Activity, and Identification of the real beneficial owner.²³ With the help of Company Law experts (and drawing on the results of the Euroshore Report, the FATF Reports on Money Laundering Typologies, and the OECD Report on the Misuse of Corporate Vehicles for Illicit Purposes)²⁴ so-called ‘indicators of transparency’ in each of the three thematic areas were identified and questionnaires were sent to company law experts (professors, auditors and members of the IOSCO).²⁵

Company Law Providing for Opacity – Summary of Results

20 Transcrime, Research Centre on Transnational Crime – University of Trento, Italy, ‘Transparency and Money Laundering’, Study of the Regulation and its Member States, that obstruct Anti-Money Laundering International Co-operation (Banking/Financial and Corporate/Company Regulative Fields), Final Report October 2001, Financed by the European Commission (hereinafter the ‘Transcrime Report’) at <<http://www.transcrime.unitn.it/aree/progetti.dhtml?id=6>> visited 10 April, 2004.

21 The Transcrime Report, page 70 (A Questionnaire was drafted and send to a maximum of three experts from the financial police units and Financial Intelligence Unit, with the co-operation of Europol. These expert panels were asked to select those corporate vehicles susceptible in being used for money laundering).

22 The Transcrime Report, page 73 [graphic on page 72].

23 The Transcrime Report, page 74.

24 The Transcrime Report, page 75-85.

25 The Transcrime Report, page 75.

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The results illustrate that the greatest obstacles of Company Law concerning anti-money laundering international co-operation are to be found in the thematic area 'Identification of the real beneficial owner' (of a public or private limited company, especially when a legal entity is a shareholder or director, or when the issuance of bearer shares is permitted)²⁶ and – to a lesser degree – the lack of control and information during the 'incorporation phase'.²⁷

- a) Incorporation phase:
With regards to the public limited company only in three countries background checks on founders and on legal origin of incorporation capital required²⁸ [private limited company: four countries].²⁹ No country requires a minimum incorporation period [same for private limited company].³⁰ Only two countries prohibit shelf companies³¹ [same for private limited company].³² Only three countries prohibit issuance of bearer shares³³ [private limited company: thirteen countries].³⁴ Only four countries prohibit nominee shareholder and nominee directors.³⁵ [private limited company: six countries, respectively five].³⁶
- b) Identification of Beneficial Owner
With regards to the public limited company – in case of legal entity as shareholder – three countries require information on the final beneficial owner of a corporate vehicle and five countries require disclosure of a beneficial owner of a company to the authorities on request.^{37 38}

26 The Transcrime Report, page 125 (Furthermore, some problems seem to arise from the fact that, in some EU countries, the regulation allows for nominee shareholders and directors).

27 The Transcrime Report, page 125 (Lack of regulation in this area makes it more difficult to acquire information of physical persons party to the creation of legal structures, also shelf companies prevent a check on the real beneficial owner).

28 The Transcrime Report, page 181, 181.

29 The Transcrime Report, page 191, 192.

30 The Transcrime Report, page 192.

31 The Transcrime Report, page 182.

32 The Transcrime Report, page 193.

33 The Transcrime Report, page 188.

34 The Transcrime Report, page 198.

35 The Transcrime Report, page 189.

36 For private limited companies see The Transcrime Report, page 199.

37 The Transcrime Report, page 189-90.

38 The Transcrime Report, page 199.

Recommendations concerning Company Law

With regard to the 'identification of the real beneficial owner' it was recommended that the EU Member States require complete information on the identity of the real beneficial owner (shareholdings and companies), prohibit bearer shares, nominee directors and nominee shareholders [Recommendation 1].³⁹ Concerning the 'incorporation phase' it was recommended to execute background investigations on the founders of a company (minimum period for the incorporation), to prohibit shelf companies, and to check on the origin of the incorporation capital [Recommendation 2].⁴⁰

Transparency in the Financial Sector

The Transcrime Report assesses four thematic areas: identification of customers and record-keeping rules; reporting of suspicious transactions; co-operation with law enforcement authorities; and international payment systems.⁴¹ Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering required the identification of beneficial ownership by financial institutions.⁴² The report shows that in the area of customer identification requirements concerning legal entities (verification of existence and identity of real beneficial owner) only two countries (Greece and Italy, which use self-regulation) have not implemented corresponding legislation.⁴³

General Conclusions: Policy Implications 'Gatekeeper Issues'

The Report states: 'Positive results in combining transparency and efficiency, achieved in the banking/financial regulative field, should be intensified in relation to legal professionals, accountants and financial consultants (the 'Gatekeepers').. Due to the increasing complexity of money laundering operations, these professionals play an essential role in establishing corporate mechanisms and performing financial transactions. The threshold between their advocacy function and their role as active, though often unwitting, consultants in money laundering operations should be clearly established and consequently regulated.'⁴⁴

39 The Transcrime Report, page 128.

40 The Transcrime Report, page 129; but see also page 131 (The issue of the trade-off between increased transparency and reduced efficiency of the corporate structure is recognized and a cost-benefit analysis is recommended).

41 The Transcrime Report, page 30.

42 Council Directive 91/308/EEC on prevention of the use of the use of the financial system for the purpose of money laundering, June 1991 at <http://www.uic.it/en/antiriciclaggio-en/altro_en/UE_1991_06_10.htm> visited on 10 April, 2004.

43 The Transcrime Report, page 151.

44 The Transcrime Report, page 133.

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*Behind the Corporate Veil – Using Corporate Entities for Illicit Purposes*⁴⁵

This report of the OECD came out in 2001. It resulted from a request by the Financial Stability Forum Working Group on Offshore Financial Centres in 2000. The matter was referred to the Steering Group on Corporate Governance and this was supported by the G-7 Finance Ministers.

The report stipulated three fundamental objectives to prevent corporate entities being used for illicit purposes. These were:

- (1) beneficial ownership and control data must be maintained or be available to the authorities;
- (2) there must be proper oversight and integrity in this process; and
- (3) non public information must be able to be shared by regulators and law enforcement authorities, both domestic and international.

The recommended alternative mechanisms also fell into three categories:

- (1) primary reliance on up front disclosure to the authorities;
- (2) primary reliance on intermediaries such as company formation agents, trust companies, lawyers, trustees, directors and officers involved as corporate service providers to maintain the ownership and control data; and
- (3) primary reliance on an investigative system.

The first requires extensive disclosure at the formation stage and an obligation to update it. This is probably best suited to jurisdictions with weak investigative systems and a large number of non resident ownership of companies.

The second requires a changed profile for the company service providers. This is only suited to those jurisdictions with responsible service providers and a sound investigative system.

The third rests more on powers of compulsion. This is suitable for those jurisdictions with reliable investigative functions and legal system.

The three mechanisms are not mutually exclusive.

45 OECD, November 2001.

The Work of FATF

The FATF is an intergovernmental body entrusted with the development of domestic and international policies against money laundering and terrorist financing.

The FATF experts continue to find that there is little difference in the methods used by terrorist groups or criminal organisations in attempting to hide or obscure the link between the source of the funds and their eventual destination or purpose. The following series of techniques and mechanisms were identified in relation to terrorist financial activity:

- Front companies – companies which actually carry on business where illegal profits can be mingled with revenues from legitimate undertakings.
- Shell companies – businesses without substance or commercial purpose which have been incorporated to conceal the true beneficial ownership of business accounts and assets owned.
- Nominees – use of family, friends or associates who are trusted within the community, and who will not attract attention, to conduct transactions on their behalf to disguise the source and ownership of funds.⁴⁶

The misuse of non-profit or charitable organisations in support of terrorist fundraising and channelling of terrorist funds is highlighted.⁴⁷

Review of the FATF Forty Recommendations – Consultation Paper

The FATF has been concerned for several years about the availability of information on the persons that are the true owners and controllers of assets derived from criminal activity, and more recently, various types of ‘corporate vehicles’ were found to have been used as part of the financing of terrorist activity.⁴⁸ Criminals have increasingly used various types of legal entities to conceal their ill-gotten wealth, as part of the money laundering process.⁴⁹ The FATF has consistently found that the lack of transparency concerning the ownership and control of corporate vehicles is a problem for money laundering investigations.⁵⁰

46 FATF, *Report on Money Laundering Typologies 2002 – 2003* at 3
<http://www1.oecd.org/fatf/pdf/TY2003_en.pdf> visited on 10 April 2004.

47 FATF, *Report on Money Laundering Typologies 2002 – 2003* at 4
<http://www1.oecd.org/fatf/pdf/TY2003_en.pdf> visited on 10 April 2004.

48 FATF, *Review of the Forty Recommendations – Consultation Paper, 30 May 2002*, ii, at
<http://www.fatf-gafi.org/pdf/Review40_en.pdf> visited on 10 April 2004.

49 FATF, *Review of the Forty Recommendations – Consultation Paper, 30 May 2002*, 52 at
<http://www.fatf-gafi.org/pdf/Review40_en.pdf> visited on 10 April 2004.

50 FATF, *Review of the Forty Recommendations – Consultation Paper, 30 May 2002*, 52

Summary

Information on the beneficial ownership of corporate vehicles is required for a wide range of purposes, namely the prevention and control of money laundering, suppressing the financing of terrorism, terrorist acts and terrorist organisations, the effective investigation/prosecution of criminal and civil cases, the effective exchange of information between regulatory and law enforcement authorities and FIU, the freezing and seizing of funds and other assets, and to enable financial institutions and non-financial entities to undertake proper customer due diligence.⁵¹ In 2002, the European Commission issued a report that noted that increased corporate transparency and better integrated supervisory systems are seen as necessary conditions to prevent the misuse of corporate vehicles for illicit purposes.⁵² It has become apparent that apart from financial institutions, financial service providers, such as lawyers, will now be targeted in the quest for obtaining information on the beneficial ownership and with regard to reporting requirements for suspicious transactions.

Measures against the Abuse of Corporate Vehicles in the Context of Terrorism Financing

UN Convention for the Suppression of the Financing of Terrorism 1999

An Overview

The adoption of the International Convention for the Suppression of the Financing of Terrorism on December 9, 1999 (the 'Convention') forms the cornerstone of the struggle against the financing of terrorism.⁵³ The Convention has been signed by

51 FATF, *Review of the Forty Recommendations – Consultation Paper, 30 May 2002*, 54 at <http://www.fatf-gafi.org/pdf/Review40_en.pdf> visited on 10 April 2004; see also The G7, *Actions Against Abuse of the Global System*, 21 July 2000 (stressing that 'corporations are sometimes established simply in order to gain access to the financial system. If there is obscurity about their ownership, banks and other financial institutions may not be able to discover the identity of the beneficiary of the account and will be unable to meet their "know your customer" obligation. The combination of market access and obscurity of ownership can facilitate money laundering and market abuse.') at <http://www.g7-2001.org/en/washington2/frames_a.htm> visited 10 April 2004.

52 Communication from the Commission to the Council, the European Parliament, The Economic and Social Committee and the Committee of the Regions, *Responses to the Challenges of Globalisation: A Study on the International Monetary and Financial System and on Financing for Development*, 13 February, 2002, page 5 at http://europa.eu.int/eur-lex/en/com/cnc/2002/com2002_0081en01.pdf.

53 UN, *International Convention for the Suppression of the Financing of Terrorism* at <<http://www.un.org/law/cod/finterr.htm>> visited on 10 April 2004.

132 states and is in force in 80 states.⁵⁴ Australia ratified the Convention on 27 September 2002.⁵⁵

The Convention establishes a distinct offence of terrorist financing (the 'offence') and obliges states to hold legal persons liable 'when a person responsible for the management or control of that legal entity, has in that capacity, committed the offence.'⁵⁶ Most importantly, Article 18 (b) of the Convention obliges states parties to require 'financial institutions and other professions involved in financial transactions to utilize the most efficient measures available for the identification of their customers, as well as customers in whose interest accounts are opened, and to pay special attention to unusual or suspicious transactions and report transactions suspected of stemming from a criminal activity.'⁵⁷

Customer Due Diligence and Suspicious Transactions Reporting

a) Customer Due Diligence

The so-called Know-Your-Client (the 'KYC') principle, which was derived from counter-money laundering, requires with respect to legal entities that financial institutions 'take measures to verify the legal existence and the structure of the customer by obtaining proof of incorporation, including information concerning the customers name, legal form, address, directors and provisions regulating the

54 Legal Department IMF, *Suppressing the Financing of Terrorism – A Handbook for Legislative Drafting* (2003 International Monetary Fund) page 5 at <<http://www.imf.org/external/pubs/nft/2003/SFTH/pdf/SFTH.pdf>> visited on 20 April 2004.

55 Media Release, Australian Minister for Foreign Affairs, 27 September 2002 at <http://www.foreignminister.gov.au/releases/2002/fa137_02.html> visited on 10 April 2004.

56 Art 2(1)(a),(b) and Art 5 Convention.

57 Art 18 (b) (i) –(iv) of the Convention reads:
'States Parties shall consider:

- (i) Adopting regulations prohibiting the opening of accounts the holders or beneficiaries of which are unidentified or unidentifiable, and measures to ensure that such institutions verify the identity of the real owners of such transactions;
- (ii) With respect to the identification of legal entities, requiring financial institutions, when necessary, to take measures to verify the legal existence and the structure of the customer by obtaining, either from a public register or from the customer or both, proof of incorporation, including information concerning the customers name, legal form, address, directors and provisions regulating the power to bind the entity;
- (iii) Adopting regulations imposing on financial institutions the obligation to report promptly to the competent authorities all complex, unusual large transactions and unusual patterns of transactions, which have no apparent economic or obviously lawful purpose, without fear of assuming criminal or civil liability for breach of any restriction on disclosure of information if they report their suspicions in good faith;
- (iv) Requiring financial institutions to maintain, for at least five years, all necessary records on transactions, both domestic or international.'

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power to bind the entity.⁵⁸ In elaboration of the Convention and in line with the OECD Report of 2001,⁵⁹ the World's twelve largest Banks issued the 'Wolfsberg Principles' which prescribe in detail that 'beneficial ownership must be established for all accounts [and where] the client is a company the private banker will understand the structure of the company sufficiently to determine the provider of funds, principal owner(s) of the shares and those who have control over the funds, e.g. the directors and those with the power to give direction to the directors of the company.'⁶⁰ Thus the abuse of corporate vehicles in providing a 'veil' for money launderers and terrorist financiers was targeted.

b) Suspicious Transactions Reporting

The Convention requires financial institutions to 'report promptly to the competent authorities all complex, unusual large transactions and unusual patterns of transactions, which have no apparent economic or obviously lawful purpose.'⁶¹ Suspicious transaction reporting has internationally proven to be one of the most effective measures against money laundering and terrorism financing.⁶² In Australia, the suspicious transaction reporting system for financial institutions has been implemented under the *Suppression of the Financing of Terrorism Act 2002* which amended the *Financial Transaction Reports Act 1988*.⁶³

58 Art 18 (b)(ii) of the Convention.

59 OECD, *Behind the Corporate Veil – Using Corporate Entities for Illicit Purposes* (November 2001 OECD) page 41-72.

60 The Wolfsberg Anti-Money Laundering Principles on Private Banking of 2002, at <<http://www.wolfsberg-principles.com/privat-banking.html>> visited on 20 April 2004; See also Homepage Deloitte, Bank Fined for Breaching Anti-Money Laundering Rules, 5 March 2003 (reporting that The United Kingdom Financial Services Authority fined the Royal Bank of Scotland with GBP£750,000 because it had failed to adequately establish the identity of their customers) at <http://www.deloitte.com/dtt/press_release/0,2309,sid%253D5527%2526cid%253D12992,00.html> visited on 3 May 2004.

61 Art 18 (b)(iii) Convention.

62 FATF, *Report on Money Laundering Typologies 2001 – 2002*, page 23 (reporting that within FATF member jurisdictions where suspicious transaction reports (the "STRs") serve as the direct source of investigated or prosecuted money laundering cases, the proportion of non-STR related cases seems small, ranging from 5-10%) <http://www1.oecd.org/fatf/pdf/TY2002_en.pdf> visited on 10 April 2004.

63 s 16(1A) *Financial Transaction Reports Act 1988* reads:

'Where:

(a) a cash dealer is a party to a transaction; and

(b) either:

(i) the cash dealer has reasonable grounds to suspect that the transaction is preparatory to the commission of a financing of terrorism offence; or

(ii) the cash dealer has reasonable grounds to suspect that information that the cash dealer has concerning the transaction may be relevant to investigation of, or prosecution of a person for, a financing of terrorism offence; the cash dealer, whether

Non-Financial Professions and Businesses Targeted

The tightening of controls in the financial sector prompted money launderers (and terrorists) to seek alternative methods for concealing the origin of proceeds of crime resulting in a trend towards the increased use of non-financial professions.⁶⁴ Therefore, in 2001, the EU Directive 2001/97/EC (the 'EU Directive') extended customer due diligence and suspicious reporting requirements to auditors, notaries and independent legal professionals.⁶⁵ In 2003, the Financial Action Task Force's Revised Forty Recommendations encompassed this approach *de facto* requiring all member states to implement corresponding legislation.

FATF's Forty Recommendations

The Financial Action Task Force's original recommendations

Since 1990, the FATF issued the Forty Recommendations against money laundering and terrorism financing, which though not a binding international convention, set the international standard.⁶⁶ In the aftermath of September 11, 2001 the FATF adopted the Eight Special Recommendations aimed at combating the financing of terrorism which prescribe Suspicious Transaction Reports for all businesses subject to anti-money laundering obligations (Special Recommendation IV) and require a review of the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism, particularly non-profit organizations (Special Recommendation VIII).⁶⁷ The FATF's Forty and Eight

or not required to report the transaction under Division 1 or 3, must, as soon as practicable after forming the suspicion [...] prepare a report of the transaction.'

64 Preamble No. 14, 15 of the EU Directive 2001/97/EC of the European Parliament and the Council of 4 December, 2001 (observing that 'there is evidence that the tightening of controls in the financial sector has prompted money launderers to seek alternative methods for concealing the origin of proceeds of crime. [...] There is a trend towards the increased use of non-financial businesses [...] The obligations [...] concerning customer identification, record keeping and the reporting of suspicious transactions should be extended to [legal professionals]') at <http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/l_344/l_34420011228en00760081.pdf> visited on 10 April 2004; See also FATF, Report on Money Laundering Typologies 2003 – 2004, page 23 (reporting a trend toward the involvement of various legal and financial experts in money laundering schemes) <http://www1.oecd.org/fatf/pdf/TY2004_en.pdf> visited on 10 April 2004.

65 Article 2a Nr 3, 5 EU Directive.

66 FATF Members are committed to a self-assessment exercise and a mutual evaluation procedure which are the primary instruments by which the FATF monitors progress made by member governments in implementing the FATF Recommendations at <http://www1.oecd.org/fatf/AboutFATF_en.htm#Forty> visited on 10 April 2004; The FATF also provides a list of Non-Cooperative Countries and Territories at <http://www1.oecd.org/fatf/NCCT_en.htm> visited on 10 April 2004.

67 The FATF Eight Special Recommendations at <http://www1.oecd.org/fatf/SRecsTF_en.htm> visited on 10 April 2004.

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Special Recommendations have been recognised by the International Monetary Fund and the World Bank as the international standards for combating money laundering and the financing of terrorism.

The Revised Forty Recommendations – 2003

On April 2003, the FATF completed an exhaustive revision of the Forty Recommendations (the 'Revised Forty Recommendations').⁶⁸ Members are required to 'ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities.'⁶⁹ This transparency of legal persons is promoted through enhanced Customer Due Diligence (the 'CDD') and Suspicious Transaction Report (the 'STR') requirements. Because of the increased use of professionals to provide advice and assistance in laundering criminal funds and for terrorist financing⁷⁰ designated non-financial businesses and professions, such as (business) lawyers, are for the first time subjected to the complex anti-money laundering regime applying to financial institutions.⁷¹ Adequate sanctions will be imposed for non-compliance with the anti-money laundering or terrorist financing requirements.⁷²

68 The Revised Forty Recommendations 2003 at
<http://www1.oecd.org/fatf/40Recs_en.htm> visited on 10 April 2004.

69 Revised Recommendation 33.

70 FATF, Report on Money Laundering Typologies 2001 – 2002 at 25
<http://www1.oecd.org/fatf/pdf/TY2002_en.pdf> visited on 10 April 2004; FATF, Report on Money Laundering Typologies 2003 – 2004 at 23
<http://www1.oecd.org/fatf/pdf/TY2004_en.pdf> visited on 10 April 2004.

71 Revised Recommendation 12, 16: 'The Customer Due Diligence [and Suspicious Transaction Reporting requirements] apply to designated non-financial businesses and professions in the following situations:

Lawyers, notaries, other independent legal professionals and accountants when they prepare for or carry out transactions for their client concerning the following activities:

- buying and selling of real estate;
- managing of client money, securities or other assets;
- management of bank, savings or securities accounts;
- organisation of contributions for the creation, operation or management of companies;
- creation, operation or management of legal persons or arrangements, and buying and selling of business entities.

Trust and company service providers [...]

Lawyers, notaries, [and] other independent legal professionals [...] are not required to report their suspicions if the relevant information was obtained in circumstances where they are subject to professional secrecy or legal professional privilege.'

72 Revised Recommendation 17.

a) Impact on the Legal Profession

Customer Due Diligence

Lawyers working in the real estate and the corporate law area are required to identify the beneficial owner and the control structure of a legal person, obtain information on the purpose of the business, conduct ongoing due diligence on the business relationship and scrutinize business transactions.⁷³ Concerning the beneficial ownership of a legal person – and following the OECD Report of 2001⁷⁴ - such lawyers must determine who the natural persons are that ultimately own or effectively control the customer thus requiring the identification of ‘the natural persons with a controlling interest and the natural persons who comprise the mind and management of company.’⁷⁵ Where lawyers are unable to comply with

73 Revised Recommendation 5: ‘The customer due diligence measures to be taken are as follows:

- a) Identifying the customer and verifying that customer’s identity using reliable, independent source documents, data or information.
- b) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the [designated professional] is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include [the designated professional] taking reasonable measures to understand the ownership and control structure of the customer.
- c) Obtaining information on the purpose and intended nature of the business relationship.
- d) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with [the designated professional’s] knowledge of the customer, their business and risk profile, including, where necessary, the source of funds.’

74 OECD, *Behind the Corporate Veil – Using Corporate Entities for Illicit Purposes* (November 2001 OECD) page 81-83 (Option 2: Imposing an obligation on corporate service providers to maintain beneficial ownership information – ‘Intermediary Option’).

75 FATF, *Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 8 Special Recommendations*, 27 February 2004, page 13: ‘5.5.2 For customers that are legal persons or legal arrangements, the [designated professional] should be required to take reasonable measures to:

- (a) understand the ownership and control structure of the customer;
- (b) determine who are the natural persons that ultimately own or control the customer. This includes those persons who exercise ultimate effective control over a legal person or arrangement.

Examples of the types of measures that would be normally needed to satisfactorily perform this function include: For companies - identifying the natural persons with a controlling interest and the natural persons who comprise the mind and management of company.’

at <http://www1.oecd.org/fatf/pdf/Meth-2004_en.PDF> visited 10 April 2004.

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these requirements they should refrain from advising the customer and consider filing a STR.⁷⁶

Suspicious Transaction Reports

Designated lawyers will be obliged to report suspicious transactions to the Financial Intelligence Unit, such as AUSTRAC in Australia,⁷⁷ if they suspect (the 'subjective standard') or have reasonable grounds to suspect (the 'objective standard') that funds are the proceeds of a criminal activity, or are related to terrorist financing.⁷⁸ To detect suspicious transactions anti-money laundering and anti-terrorism internal control programs, an ongoing employee training program and an audit function to test the system have to be implemented.⁷⁹ Lawyers are protected from any form of liability for breach of any restriction on disclosure of (confidential) information but are prohibited from 'tipping-off' the client about the filing of a suspicious transaction report.⁸⁰

Disclosure of Confidential Information?

Recommendation 16 affirms that, lawyers 'are not required to report their suspicions if the relevant information was obtained in circumstances where they are subject to professional secrecy or legal professional privilege.' In Common Law countries, such as Australia, this exemption is thus from the outset narrowly

76 Revised Recommendation 5:
'[Where the designated professional] is unable to comply with [Revised Recommendation 5] (a) to (c) above, it should not open the account, commence business relations, or perform the transaction; or should terminate the business relationship; and should consider making a suspicious transactions report.'

77 AUSTRAC is Australia's anti-money laundering regulator and specialist financial intelligence unit overseeing compliance with the reporting requirements of the *Financial Transaction Reports Act 1988*.

78 Revised Recommendation 13:
'If [the designated professional] suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity, or are related to terrorist financing, it should be required, directly by law or regulation, to report promptly its suspicions to the financial intelligence unit (FIU).'

79 Revised Recommendation 15: '[The designated professional] should develop programs against money laundering and terrorist financing. These programs should include:
a) The development of internal policies, procedures and controls, including appropriate compliance management arrangements, and adequate screening procedures to ensure high standards when hiring employees.
b) An ongoing employee training program.
c) An audit function to test the system.'

80 Revised Recommendation 14.

confined to legal advice because the legal professional privilege does not apply to communications relating to business or financial advice.⁸¹

Moreover, the Interpretative Note to the STR requirements states that legal professional privilege or professional secrecy would normally only cover information lawyers receive from their clients either 'in the course of ascertaining the legal position of their client' or 'in performing their task of defending or representing that client in judicial proceedings.'⁸² It is not clear whether this wording will be narrowly interpreted to exclude the giving of general legal advice and to cover only the ascertainment of the legal position before actual legal proceedings.⁸³

b) Assessment

Compliance costs for internal money laundering control programmes can be expected to be significant.⁸⁴ The identification of the beneficial owner and the control structure of a corporation may be difficult to ascertain, resulting in a situation where the lawyer must terminate the relationship with the client. The potential damage to the client-lawyer relationship seems immense.

It comes as no surprise that the Bar Associations and Law Societies worldwide have protested against the STR-'whistle blowing' provisions because of a potential threat to the traditional independence of the bar and the client-lawyer relationship.⁸⁵ Clearly, lawyers working in the designated profession may have

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- 81 Attorney-General's Department, *Anti-Money Laundering Reform*, Consultation Issues Paper 5: Legal Practitioners, Accountants, Company & Trust Service Providers 2004, page 11 at <[http://www.ag.gov.au/www/rwpattach.nsf/viewasattachmentPersonal/49C783AF10B8CEE5CA256E30000409D0/\\$file/04-IssuesPaper5-LegAccTrustCompanyServiceProviders.pdf](http://www.ag.gov.au/www/rwpattach.nsf/viewasattachmentPersonal/49C783AF10B8CEE5CA256E30000409D0/$file/04-IssuesPaper5-LegAccTrustCompanyServiceProviders.pdf)> visited 10 April 2004; See also Law Council of Australia, Draft Submission on Issues Paper 5 to the Attorney General's Department, 19 March 2004, No. 55 (noting that the 'communications must be referable to the professional relationship, and privilege will not apply to communications between a lawyer and client which relate to non-legal activities') at <www.lawcouncil.asn.au/get/submissions/2393173489> visited on 30 April 2004.
- 82 Interpretative Note to Recommendation 16 at <http://www1.oecd.org/fatf/Interpnotes_en.htm#16> visited on 30 April 2004.
- 83 Council of the Bars and Law Societies of the European Union, Action Points For EU Bars and Law Societies on the Implementation of the Money Laundering Directive, January 2002, page 4 (advocating the inclusion of general legal advice) at <http://www.ccbe.org/doc/En/action_points_220102_en.pdf> visited on 30 April 2004.
- 84 The UK Treasury (Financial Services), Full Regulatory Impact Assessment – Money Laundering Regulations 2003, page 14 (reporting an estimated impact in compliance costs of at least AUS \$100 million for the qualified legal profession in the UK alone) at <http://www.hm-treasury.gov.uk/media//4ADBC/fullriamlr03_80.pdf> visited on 10 April 2004.
- 85 Council of the Bars and Law Societies of the European Union, Joint Statement by the

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difficulties in deciding when the legal professional privilege applies. This might explain why suspicious transaction reporting by lawyers has been historically very low in countries that already have mandatory STR provisions.⁸⁶ On the other hand, where enforcement regarding the failure to file STRs can be expected to be strict and effective, lawyers might even resort to 'over-reporting' because of the fear of potential liability, in particular under an objective standard.⁸⁷ This, in turn would come at the expense of the quality and reliability of the reported information.

Implementation of the Revised Forty Recommendations

CDD and STR requirements for lawyers have been implemented in nearly all European Member States in the form of the EU Directive due to the deadline of 15 June 2003.⁸⁸ On the other hand, in Canada, STR requirements for lawyers have been successfully constitutionally challenged and have been repealed. The implementation of the Revised Forty Recommendations in the USA and Australia is under discussion. In the following part recent developments in the United Kingdom, Canada, the USA and Australia concerning the new role of the investigative and whistle-blowing business lawyer will be highlighted.

international legal profession on the fight against money-laundering (signed also by the Bars of the US and Japan):

'(5) We are seriously concerned that, in the effort to stamp out money laundering, the values recognised in international and constitutional laws of professional confidentiality and trust and independence of the bar are not receiving adequate consideration. On behalf of our clients, we can accept neither inroads into professional confidentiality and our duty of loyalty to clients, nor obstacles in access to justice. We believe that efforts to undermine these values will be subject, in a number of countries, to successful constitutional challenge.'

at <http://www.ccbe.org/doc/En/signed_statement_030403_en.pdf> visited 10 April 2004.

86 FATF, *Report on Money Laundering and Terrorist Financing Typologies 2003-2004*, page 24 (reporting that in jurisdictions, which have extended the obligation to report suspicious transactions to independent legal and financial professionals, it found that less than two percent of reports dealing with solicitor or notary involvement were made by the professions themselves) at <http://www1.oecd.org/fatf/pdf/TY2004_en.PDF> visited 10 April 2004.

87 Patricia Shaughnessy, 'The New EU Money-Laundering Directive: Lawyers as Gatekeepers and Whistle-Blowers' [2002] *34 Law & Policy in International Business* 25, 33.

88 Council of the Bars and Law Societies of the European Union, *Implementation of the EU Money Laundering Directive 2001/97/EC in the Member States* at <http://www.ccbe.org/doc/En/mld_implementation.pdf> visited on 10 April 2004.

Impact on the Role of the Business Lawyer and Emergence of the Lawyer as Gatekeeper and Whistleblower

United Kingdom

The New Anti-Money Laundering and Anti-Terrorism Provisions

The United Kingdom has enacted the Revised Forty Recommendations in the form of the EU Directive through changes to the *Proceeds of Crime Act 2002* (the 'POCA') and the new *Money Laundering Regulations 2003*, which came into force on 1 March 2004 (the 'MLR').⁸⁹ In particular the new and extensive CDD and STR requirements for lawyers have caused the Law Society to issue a 100 page Money Laundering Guidance Note for Solicitors.⁹⁰

Focus on CDD, Internal Reporting and STR

a) Money Laundering Regulations 2003

The MLR apply to notaries and legal professionals participating in financial (or real estate) transactions which are identified as 'high-risk', such as buying and selling of business entities, opening or managing bank or securities accounts, and creating or operating companies or similar structures (the 'regulated sector').⁹¹ The UK Treasury estimates that more than 70% of all qualified solicitors in the United Kingdom will be subject to the MLR.⁹² Failure to comply with the MLR is

89 HM Treasury – Financial Services, Transposition Note: Implementing Amendments to the Money Laundering Directive 2001/97/EC at <http://www.hm-treasury.gov.uk/media//7DDFB/Transnotemlr03_16.pdf> visited on 10 April 2004.

90 The Law Society, *Money Laundering: Guidance for Solicitors – Pilot*, January 2004 at <<http://www.lawsociety.org.uk/dcs/pdf/mlguidance2.pdf>> visited on 10 April 2004.

91 s 2(2)(l),(m) MLR; see The Law Society, *Money Laundering: Guidance for Solicitors – Pilot*, January 2004, page 26 (observing that the Government has indicated that the MLR are intended to reflect the identification of high-risk activities in the EU Directive) at <<http://www.lawsociety.org.uk/dcs/pdf/mlguidance2.pdf>> visited on 10 April 2004; see also The UK Treasury, Official Letter to the British Bankers' Association, 19 January 2004 (stating that s 2(2)(m) MLR was intended to cover corporate service providers to address the 'problem of front and shell companies' used in money laundering schemes) at <http://www.hm-treasury.gov.uk/media//52ED7/money_letter_to_BBA_190104.pdf> visited on 30 April 2004.

92 The UK Treasury (Financial Services), Full Regulatory Impact Assessment – Money Laundering Regulations 2003, page 13-4 (observing that of the more than 100,000 qualified solicitors in the United Kingdom between 70,000-80,000 will be brought within the MLR) at <http://www.hm-treasury.gov.uk/media//4ADBC/fullriamlr03_80.pdf> visited on 10 April 2004; see also The UK Treasury, Official Letter to the British Bankers'

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an offence punishable on conviction by a maximum of 2 years' imprisonment and/or a fine, irrespective of whether money laundering has actually taken place.⁹³
Identification of Corporate Clients

The customer identification procedures under the MLR require 'that where a person acts or appears to act for another person, reasonable measures must be taken for the purpose of establishing the identity of that person.'⁹⁴ In this context, the Law Society of England and Wales advises that 'it may be necessary for checks to be made about beneficial ownership if the initial information obtained is of the identity of mere nominees.'⁹⁵ However, this seems to fall short of the Revised Forty Recommendations which always compulsorily require information on the beneficial ownership.⁹⁶

Internal Reporting Procedures

A law firm's internal STR procedure requires the nomination of a person (the 'nominated officer') to receive STRs, and that the nominated officer determines whether to make an external report to the United Kingdom's Financial Intelligence Unit (the 'NCIS').⁹⁷ However, there is no (internal or external) reporting obligation on professional legal advisers where the information is received in privileged circumstances.⁹⁸ That said, the mere fact that the information comes from a client is not the test because situations where a client mentions a matter other than for legal advice or in relation to legal proceedings fall outside privileged circumstances.⁹⁹

The new legislation is specifically designed to target the traditional low level of STRs made by lawyers.¹⁰⁰ The extension of the MLR to non-financial professions,

Association, 19 January 2004 (responding to a clarifying that s 2(2)(m) MLR was intended to cover corporate service providers to address the 'problem of front and shell companies' used in money laundering schemes, but does not cover

93 s 3(2) MLR; see The Law Society, *Money Laundering: Guidance for Solicitors – Pilot*, January 2004, page 29 at <<http://www.lawsociety.org.uk/dcs/pdf/mlguidance2.pdf>> visited on 10 April 2004.

94 s 4(3)(d) MLR.

95 The Law Society, *Money Laundering: Guidance for Solicitors – Pilot*, January 2004, page 52 at <<http://www.lawsociety.org.uk/dcs/pdf/mlguidance2.pdf>> visited on 10 April 2004.

96 Revised Recommendation 5 and 33.

97 s 7(1) MLR.

98 s 7(3) MLR.

99 The Law Society, *Money Laundering: Guidance for Solicitors – Pilot*, January 2004, page 61 at <<http://www.lawsociety.org.uk/dcs/pdf/mlguidance2.pdf>> visited on 10 April 2004. The UK Treasury (Financial Services), Full Regulatory Impact Assessment – Money Laundering Regulations 2003, page 3, 11 (citing statistics of the NCIS 2000-2002 which show that only 1-2% of all STRs are filed by lawyers) at <[85](http://www.hm-</p></div><div data-bbox=)

such as lawyers, is aimed to result in a significant increase in the intelligence available to law enforcement.¹⁰¹ Therefore, all regulated lawyers will need to ensure that they have a detailed understanding of legal professional privilege and the duty of confidentiality.

Compliance Costs

All lawyers in the regulated sector are required to comply with the prescribed CDD and STR by establishing appropriate procedures of internal control and ongoing training of employees.¹⁰² The 'relevant staff' (covering the law firm's administrative, secretarial and clerical staff who may encounter evidence of money laundering) must receive appropriate training concerning the applicable law and the detection of money laundering in form of guidance notes, internal money laundering handbooks, face to face training and/or e-learning.¹⁰³ The UK Treasury estimates that the regulatory impact of the MLR will result in compliance costs of at least GB£ 80 million to GB£ 100 for the legal (and accountancy) profession in the United Kingdom.¹⁰⁴

treasury.gov.uk/media//4ADBC/fullriamlr03_80.pdf> visited on 10 April 2004; See also The United Kingdom Parliament, Select Committee on International Development, Fourth Report, 22 March 2001, Section 6, No 135 ('We are concerned at the under-reporting of suspicious transactions by certain professional groups, in particular lawyers and accountants') at <<http://www.parliament.the-stationery-office.co.uk/pa/cm200001/cmselect/cmintdev/39/3911.htm>> visited on 20 April 2004.

The UK Treasury (Financial Services), Full Regulatory Impact Assessment – Money Laundering Regulations 2003, page 12 at

<http://www.hm-treasury.gov.uk/media//4ADBC/fullriamlr03_80.pdf> visited on 10 April 2004.

102 s 3 MLR - Systems and training etc. to prevent money laundering:

(1) Every [lawyer in the regulated sector] must

- (a) comply with the requirements of regulations 4 (identification procedures), 6 (record-keeping procedures) and 7 (internal reporting procedures);
- (b) establish such other procedures of internal control and communication as may be appropriate for the purposes of forestalling and preventing money laundering; and
- (c) take appropriate measures so that relevant employees are -
 - (i) made aware of the provisions of these Regulations, Part 7 of the *Proceeds of Crime Act 2002* (money laundering) and sections 18 and 21A of the *Terrorism Act 2000*[24]; and
 - (ii) given training in how to recognise and deal with transactions which may be related to money laundering.'

103 The Law Society, *Money Laundering: Guidance for Solicitors – Pilot*, January 2004, page 30, 78-88 (providing detailed advice regarding 'procedures to forestall and prevent money laundering, risk assessment and suspicion') at

<<http://www.lawsociety.org.uk/dcs/pdf/mlguidance2.pdf>> visited on 10 April 2004.

104 The UK Treasury (Financial Services), Full Regulatory Impact Assessment – Money

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b) Proceeds of Crime Act 2002: Failure to Disclose” Offence

Chapter 7 POCA introduces a failure to disclose a knowledge or suspicion of money laundering” offence which applies to persons within the regulated sector and the nominated officer.¹⁰⁵ In addition to the previous subjective test in form of actual knowledge or suspicion there is now an objective test, i.e. reasonable grounds” for knowledge or suspicion. A higher, ‘should have known or suspected’ standard of compliance is expected because lawyers in the regulated sector must receive anti-money laundering training and law firms must have anti-money laundering systems in place to detect and prevent money laundering.¹⁰⁶ No offence is committed if there is a reasonable excuse or if the information comes to a professional legal adviser in privileged circumstances, i.e. in connection with rendering legal advice or with (contemplated) legal proceedings.¹⁰⁷

The Controversial Issue of ‘Tipping-off’

A ‘tipping-off’ offence bars the lawyer from disclosing to the client that a STR has been made or that a money laundering investigation is being or will be carried out.¹⁰⁸ Although ‘tipping-off’ the client is allowed where to do so would fall within the ambit of being in connection with the giving of legal advice or with legal proceedings actual or contemplated this exemption does not apply where it is made with the intention of furthering a criminal purpose.”¹⁰⁹

The NCIS argued that every time a party who is suspected of holding a criminal purpose is given notice that a STR has been or will be made to the NCIS he will be ‘tipped off’.¹¹⁰ However, on 8 October 2003 the High Court held that the solicitor should be free to communicate [the disclosure to NCIS] to his/her client or opponent [...] in connection with the giving of legal advice or acting in connection with actual or contemplated legal proceedings [regardless of criminal intent on behalf of the client].”¹¹¹ The NCIS subsequently amended its more onerous guidelines following the suggestions of the High Court.¹¹²

Laundering Regulations 2003, page 13-4 (observing that about 70,000-80,000 qualified solicitors and 32,725-37,400 accountants as well as 43,000 firms of unqualified practitioners will be covered) at

<http://www.hm-treasury.gov.uk/media//4ADBC/fullriamlr03_80.pdf> visited on 10 April 2004.

105 s 330, 331 POCA.

106 The Law Society, *Money Laundering: Guidance for Solicitors* [Pilot – January 2004] page 7 at

<<http://www.lawsociety.org.uk/dcs/pdf/mlguidance2.pdf>> visited on 10 April 2004.

107 s 330(6) POCA.

108 s 333, 342 POCA.

109 s 333(3), (4) and 342(4), (5) POCA.

110 *P v P* (2003) EWHC Fam 2260, No 62 at <<http://www.ncis.co.uk/downloads/P-v-Pperfected710.pdf>> visited on 30 April 2004.

111 *P v P* (2003) EWHC Fam 2260, No 64-65 at <<http://www.ncis.co.uk/downloads/P-v-Pperfected710.pdf>> visited on 30 April 2004.

Assessment

There are now significant new obligations on business lawyers and law firms in the form of money laundering control systems and lawyer/employee training procedures. Compliance costs are significant. Furthermore, even though there are reporting exemptions for legal advisers, the difficulty to distinguish between business and mere legal advice will be likely to cause confusion for lawyers. In this context, the threat of the 'failure to disclose' offence and the 'tipping-off' offence make it imperative for business lawyers to clarify their position as legal advisers and the scope of legal professional privilege. Finally, new extended CDD requirements concerning the mandatory ascertainment of the beneficial ownership of corporate clients can be expected in the wake of the implementation of the Revised Forty Recommendations.

Canada

Anti-Money Laundering Legislation: CDD and STR

The *Proceeds of Crime (Money Laundering) and Terrorist Financing Act 2000* (the 'PCTFA') and the corresponding Regulations required business lawyers receiving or paying funds, purchasing or selling securities, real property or business entities, to identify clients, to keep certain records and to report suspicious transactions.¹¹³ The threshold for STR was objective and s 11 PCTFA provided a defence for non-disclosure of communication subject to the solicitor-client privilege without further defining the privilege (the 'solicitor-client privilege').

Constitutional Challenges Lead to Repeal of STR for Lawyers

The Federation of Law Societies of Canada (the "Federation") strongly opposed the STR requirement's potential infringement upon the solicitor-client relationship and the professional independence of the legal profession and challenged its validity in the courts.¹¹⁴

a) The Court Decisions

On November 20, 2001, the British Columbia Supreme Court ruled in favour of the Federation and granted lawyers a (temporary) exemption from all obligations

Pperfected710.pdf> visited on 30 April 2004.

112 NCIS, Part 7 *Proceeds of Crime Act 2002*, National Criminal Intelligence Service guidance in relation to disclosures by the legal profession, No 10-15 at <<http://www.ncis.co.uk/legaldisclosures.asp>> visited on 30 April 2004.

113 s 5-9 PCTFA in connection with s 5 Regulations.

114 Homepage of the Federation of Law Societies of Canada, Money Laundering – Chronology of Events, July 2003 at <http://www.flsc.ca/en/pdf/ml_chronology.pdf> visited 10 April 2004.

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under the PCTFA, most notably the STR requirements.¹¹⁵ Justice Allan concluded that the PCTFA ‘authorizes an unprecedented intrusion into the traditional solicitor-client relationship [and threatens the independence of the bar].’¹¹⁶ The Court followed the Federation’s submission that ‘the impugned legislation places all lawyers in a profound conflict of interest between their duty of solicitor-client confidentiality owed to a client and their duty to report that client to the government [enforced by serious penalties for non-compliance].’¹¹⁷ Justice Allan dismissed the submission of the Attorney General of Canada that lawyers were fully protected by the solicitor-client privilege stating that ‘clearly the protection provided by that privilege falls far short of the traditional confidential nature of the solicitor-client relationship that the petitioners seek to preserve.’¹¹⁸

b) Repeal of PCTFA with Regards to Lawyers

When the decision of Justice Allan was upheld upon Appeal – and Courts in all States granted exemptions for lawyers from the STR requirements¹¹⁹ – the Parties agreed to adjourn the constitutional challenge of the PCTFA in the Supreme Court of Canada to November 2004.¹²⁰ Accordingly, in March 2003 the Government repealed the PCTFA’s provisions applying to legal firms and legal practitioners.

Assessment

The court decisions highlight the difficulty of striking a balance between the traditional independence of the bar and the new changing role of the business lawyer as a whistleblower to the authorities. Despite the repeal of the STR provisions concerning lawyers it appears that it is only a matter of time for new legislation to be introduced by the Canadian Government to comply with the obligations under the Revised Forty Recommendations. That said, there is little leeway to alter the repealed legislation more favourable to lawyers. It will be

115 *The Law Society of B.C. v. A.G. Canada; Federation of Law Societies v. A.G. Canada* (2001) BCSC 1593 at <<http://www.courts.gov.bc.ca/jdb-txt/SC/01/15/2001BCSC1593.htm>> visited on 10 April 2004.

116 *The Law Society of B.C. v. A.G. Canada; Federation of Law Societies v. A.G. Canada* (2001) BCSC 1593 [108].

117 *The Law Society of B.C. v. A.G. Canada; Federation of Law Societies v. A.G. Canada* (2001) BCSC 1593 [76].

118 *The Law Society of B.C. v. A.G. Canada; Federation of Law Societies v. A.G. Canada* (2001) BCSC 1593 [80].

119 See Homepage of the Federation of Law Societies of Canada, Money Laundering – Chronology of Events, July 2003 at <http://www.flsc.ca/en/pdf/ml_chronology.pdf> visited 10 April 2004.

120 Homepage of the Federation of Law Societies of Canada, Money Laundering – Chronology of Events [July 2003] page 17 at <http://www.flsc.ca/en/pdf/ml_chronology.pdf> visited 10 April 2004.

interesting to see how the Canadian Supreme Court will rule on the issue of STR for lawyers.

USA¹²¹

Introduction – The ABA’s Struggle against Gatekeeper Initiatives

Despite the fact that the USA is a Member to the FATF there has been little development on the implementation of the Revised Forty Recommendations to date. However, it is anticipated that the US government will begin to do so in the near future in light of the FATF’s announced timetable.¹²²

The American Bar Association (the ‘ABA’) has founded a Task Force on Gatekeeper Regulation and the Profession which fiercely opposes any STR and extensive due diligence compliance programs, because of the ‘unprecedented impact on client-confidentiality, the attorney-client relationship, the independence of the bar, and the compliance-counselling role of lawyers in [the] society.’¹²³

The USA Patriot Act of 2001

a) Lawyers Working in the Real Estate Profession

The *USA Patriot Act of 2001*¹²⁴ deals with the establishment of anti-money laundering programs for financial institutions, requiring due diligence on their client’s identity and source of funds, the appointment of a compliance officer, the training of employees, and the independent auditing of the anti-money laundering program.¹²⁵ The term ‘financial institution’ covers ‘persons involved in real estate

121 See Jill E Fisch and Kenneth Rosen, ‘Is There a Role for Lawyers in Preventing Future Enron?’ (2003) 48 *Vill L Rev* 1097; Robert Gordon, ‘A New Role for Lawyers? The Corporate Counsellor After Enron’ (2003) 35 *Conn L Rev* 1185; Michael Fox, ‘To Tell or Not To Tell: Legal Ethics and Disclosure After Enron’ (2002) *Columbia Bus L Rev* 867; John C Coffee Jr, ‘the Attorney as Gatekeeper: An Agenda for the SEC’ (2003) 103 *Columbia L Rev* 1293; ‘Developments in the Law – Corporations and Society’ (2004) 117 *Harv. L Rev* 2169 at 2227 et seq.

122 FATF, Media Release, New Anti-Money Laundering Standards Released, Berlin, 20 June 2003 (stating that FATF members will have to “immediately” implement the Revised Forty Recommendations and mutual evaluations will start before the end of 2004) at <http://www1.oecd.org/fatf/pdf/PR-20030620_en.pdf> visited on 20 April 2004.

123 Homepage ABA, Task Force on Gatekeeper Regulation and the Profession, 2004 Legislative Priorities at <<http://www.abanet.org/poladv/priorities/gatekeeper.html>> visited 10 April 2004.

124 *The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA Patriot Act) Act of 2001*, Pub. L. No. 107-56, 115 Stat. 252 (2001).

125 § 352 USA Patriot Act; See also Department of the Treasury & Department of Justice,

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closings and settlements.¹²⁶ On April 10, 2003, the USA's Financial Intelligence Unit (the 'FinCEN') issued an 'advance notice of proposed rulemaking' indicating that lawyers involved in real estate transactions could be required to establish anti-money laundering programs (the 'Proposed Rule').¹²⁷

b) Resistance of the American Bar Association

The Proposed Rule has caused strong opposition by law firms, the ABA and other institutions, because the anti-money laundering programs require an audit of the client's affairs which would undermine the attorney-client relationship at the outset and pit the attorney against the client into a de facto adversarial position.¹²⁸

Particularly STR requirements for real estate lawyers, which are at least expected to be necessary under best practice standards, are vehemently opposed because of the threat to the client-lawyer privilege and the duty of confidentiality.¹²⁹ In this context, it seems noteworthy that the Securities and Exchange Commission (seemingly) failed to establish a similar, mandatory STR provision (the so-called 'noisy withdrawal' provision) which would have required securities lawyers to report suspected financial fraud of their corporate clients to the SEC under an objective standard.¹³⁰

National Money Laundering Strategy [2003] Appendix G – Summary of the Anti-Money Laundering Provisions of the USA Patriot Act and the Steps Taken to Implement Them, page 49, 51 at
<<http://www.treas.gov/offices/eotffc/publications/ml2003.pdf>> visited 10 April 2004.

126 See 31 U.S.C. § 5312(a)(2)(U).

127 68 Fed. Reg. 17569, 17570 (Apr. 10, 2003).

128 See Comments of the ABA, Section Real Property, Probate and Trust Law, June 9, 2003, page 8 (also observing that the prospect of an independent audit function 'would necessarily have to review and investigate a client's files including the attorney's work product, thereby exposing the attorney to a breach of the attorney-client privilege') at <<http://www.fincen.gov/belcher.pdf>> visited on 30 April 2004.

129 See Comments of The Real Property, Probate and Trust Law Section of The Florida Bar, June 9, 2003, page 9 (observing that while neither Section 352 nor the Proposed Rule makes any mention of a STR requirement, some type of suspicious transaction reporting procedure can be expected to be built into a real estate attorney's anti-money laundering program as a best practice because 'simply sitting on information of a possibly suspect transaction produced in the course of the Know Your Customer process – without doing more – would emasculate the effectiveness of any AML program') at <<http://www.fincen.gov/guttmann.pdf>> visited on 10 April 2004.

130 Proposed s 205.3(d) SEC Rules, Implementation of Standards of Professional Conduct for Attorneys, January 29, 2003 at <<http://www.sec.gov/rules/final/33-8185.htm>> visited on 10 April 2004; See Legal Week, Congress attacks SEC's whistle blowing reforms: 'Noisy withdrawal' proposals look dead in the water after Oxley's SEC attack, 8 March 2004 (reporting that the joint-sponsor of *the Sarbanes-Oxley Act*, Michael G. Oxley stated that the SEC clearly went beyond Congressional intent in proposing the

Assessment

There has been no progress for over a year and the Proposed Rule has yet to be implemented. However, given the fact that real estate lawyers are just one (small) part of the legal profession targeted by the Revised Forty Recommendations future conflicts between the ABA and the government seem inevitable. Surprisingly, the annual 'National Money Laundering Strategy Report', issued by the Department of Justice and the Treasury on November 2003, does not mention any implementation effort of the Revised Forty Recommendations with regards to the non-financial profession.¹³¹

Australia

The new Anti-Money Laundering Bill 2004

The forthcoming Anti-Money Laundering Bill 2004 will implement the Revised Forty Recommendations in Australia.¹³² In accordance with the OECD Report of 2001 and the Revised Forty Recommendations, legal practitioners will be subject to the anti-money laundering regime where they are instructed in, provide advice on, prepare or carry out a range of activities that involve real estate, financial and corporate transactions.¹³³

noisy withdrawal mandate) at <www.legalweek.net/ViewItem.asp?id=18341> visited 10 April 2004.

131 Department of the Treasury & Department of Justice, *National Money Laundering Strategy, November 2003*, page 26-32 (the Revised Forty Recommendations are only briefly cited on page 8) at <<http://www.treas.gov/offices/eotffc/publications/ml2003.pdf>> visited 10 April 2004.

132 Homepage of the Attorney-General's Department, *Anti-Money Laundering Reform* (noting that 'implementing the revised Forty Recommendations in Australia will require a significant review of Australia's anti-money laundering system and include some new measures intended to counter terrorist financing') at <<http://www.ag.gov.au/aml>> visited 10 April 2004.

133 The Attorney-General's Department, *Anti-Money Laundering Reform, Consultation Issues Paper 5: Legal Practitioners, Accountants, Company & Trust Service Providers 2004*, page 6:

'[CDD and STR requirements apply] where a legal practitioner or accountant is instructed in the planning or execution of financial transactions for their client concerning:

- a. buying and selling of real property;
- b. buying and selling of business entities;
- c. managing of client money, financial products or other assets;
- d. opening or management of accounts with a financial institution; or
- e. creation, operation or management of corporations, trusts, partnerships or similar structures.'

at<[http://www.ag.gov.au/www/rwpattach.nsf/viewasattachmentPersonal/49C783AF10B8CEE5CA256E30000409D0/\\$file/04-IssuesPaper5-LegAccTrustCompanyServiceProviders.pdf](http://www.ag.gov.au/www/rwpattach.nsf/viewasattachmentPersonal/49C783AF10B8CEE5CA256E30000409D0/$file/04-IssuesPaper5-LegAccTrustCompanyServiceProviders.pdf)> visited on 10 April 2004.

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a) Customer Due Diligence and Suspicious Transactions Reporting

Ongoing CDD includes identification of the beneficial owner and verification of nature and the purpose of the business relationship.¹³⁴ Anti-money laundering programs, including staff training, internal policies and compliance programs and an independent audit procedure of such programs have to be implemented.¹³⁵ Suspicious transactions reporting to AUSTRAC,¹³⁶ until now reserved for financial institutions under the *Financial Transactions Reporting Act 1988*, will be extended to business lawyers.¹³⁷ Professional advisers will have an ongoing obligation to monitor suspicious transactional activity.¹³⁸ The client-lawyer privilege will be narrowly confined to legal advice and will not apply to communications relating to business or financial advice.¹³⁹

b) Criticism by the Law Council of Australia

The Law Council of Australia predicts a serious conflict of duties on the side of the practitioner because a practitioner will be forced to choose between either risking a contravention of the reporting obligations or making a disclosure about their client which may be unjustified.¹⁴⁰ Such an approach will come at a 'cost to the

134 The Attorney-General's Department, *Anti-Money Laundering Reform*, Consultation Issues Paper 5: Legal Practitioners, Accountants, Company & Trust Service Providers 2004, page 8-9.

135 The Attorney-General's Department, *Anti-Money Laundering Reform*, Consultation Issues Paper 5: Legal Practitioners, Accountants, Company & Trust Service Providers 2004, page 12.

136 AUSTRAC is Australia's anti-money laundering regulator and specialist financial intelligence unit which receives all suspicious transaction reports at <<http://www.austrac.gov.au/about/index.htm>> visited on 10 April 2004.

137 The Attorney-General's Department, *Anti-Money Laundering Reform*, Consultation Issues Paper 5: Legal Practitioners, Accountants, Company & Trust Service Providers 2004, page 9.

138 The Attorney-General's Department, *Anti-Money Laundering Reform*, Consultation Issues Paper 5: Legal Practitioners, Accountants, Company & Trust Service Providers 2004, page 9 (stating that 'suspicious activity reporting relies on the professional adviser having sufficient knowledge of the client to be able to judge when a financial transaction is suspicious, [so that] professional advisers need to be able to detect unusual patterns in instructions and inconsistency of purpose and objective').

139 The Attorney-General's Department, *Anti-Money Laundering Reform*, Consultation Issues Paper 5: Legal Practitioners, Accountants, Company & Trust Service Providers 2004, page 10.

140 Law Council of Australia, Draft Submission on Issues Paper 5 to the Attorney General's Department, 19 March 2004, No. 39.-40. at <www.lawcouncil.asn.au/get/submissions/2393173489> visited on 10 April 2004.

frankness of the relationship between lawyer and client, and also at a physical cost to the practitioner and the firm.¹⁴¹

Assessment

Increased compliance costs, the potential for actions of lawyers to attract criminal liability and the need to conduct lengthy education programs can be expected to have a significant impact on the legal profession.¹⁴² The Law Council of Australia suggests that because of the 'unique nature of legal professional privilege and client confidentiality' anti-money laundering reforms for the legal profession should be dealt with separately from other business relationships.¹⁴³ It is clear that there is a need for more detailed guidance for legal practitioners in how to comply with the new legislation.

Conclusion

Piercing the corporate veil in cases of crime and civil fraud looks to the substance not the form and seeks to combat criminal and terrorist behaviour.

The abuse of corporate vehicles for money laundering and terrorist financing purposes has led to increased responsibilities for business lawyers. However, the potential implications for the unique position of lawyers have not been thoroughly addressed.

First, burdensome CDD requirements may threaten the client-lawyer relationship, apart from significant compliance costs. Second, STR requirements potentially impact on the traditional legal professional privilege and the duty of confidentiality. Third, the potential danger of tipping-off the client when advising on suspected contraventions of the anti-money laundering legislations may inhibit lawyers and result in an impairment of the client's right to legal advice.

141 Law Council of Australia, Draft Submission on Issues Paper 5 to the Attorney General's Department, 19 March 2004, No. 54.

142 Law Council of Australia, Draft Submission on Issues Paper 5 to the Attorney General's Department, 19 March 2004, No. 81.

143 Law Council of Australia, Draft Submission on Issues Paper 5 to the Attorney General's Department, 19 March 2004, No. 59, 80.

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Business lawyers will not only be required to act as whistleblowers, but even as investigators because of the CDD requirements and the ongoing obligation to monitor the client. The traditional role of the lawyer as advocate of the client is changing in the face of the global threats of money laundering and terrorism financing. The 'knockout-argument' of fighting terrorism does not warrant a hastily 'one-size-fits-all' approach towards the legal profession whose distinctiveness from the other non-financial professions and importance for the administration of justice cannot be disputed. Nevertheless Corporate Law Practice is arguably a public calling¹⁴⁴ and every corporate lawyer should be acutely cognizant of his responsibilities to the public.¹⁴⁵

144 See Robert W Gordon, 'Corporate Law as a Public Calling' (1990) 49 *Md L Rev* 255.

145 AA Sommer Jr. 'The Emerging Responsibilities of the Securities Lawyer' Jan 1974 in [1973-4] *Transfer CCH Fed. Sec. L. Rep* 79, 631 at 83, 689-90 cited by Coffee op cit. Footnote 121 supra at 1298-9 footnote 123). Also cited in 'Developments in the Law – Corporations and Society' (2004) 117 *Harv. L. Rev.* 2169 at 2202. Footnote 121 supra at 1298-9 footnote 123). Also cited in 'Developments in the Law – Corporations and Society' (2004) 117 *Harv. L. Rev.* 2169 at 2202.