2012

JALAP

JOURNAL OF APPLIED LAW AND POLICY

2012

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Proofread by Anne Kallies
Typeset by David Brennan
ISSN 1836-6953 (Online)

TABLE OF CONTENTS

FOREWORD
Professor Dale Pinto iv

COMMUNITIES OF TAXATION AND JUSTICE
A Communitarian Approach To Inequality And Taxation
Jonathan Barrett 1

LONG SERVICE LEAVE IN AUSTRALIA
An Examination of the Options For a National Long Service Leave Minimum Standard
Rebecca Casey, John McLaren and John Passant 17

GLOBAL LAW FIRMS AS PROFESSIONAL GATEKEEPERS IN CORPORATE GOVERNANCE AND FINANCIAL SYSTEM STABILITY
Magdalene D'Silva 39

THE FINANCIAL ADVISER AS FIDUCIARY
A Brave New World?
Kristy Richardson and Jenny Butler 57

ADOPTION IN VANUATU
Sofia Shah 67

FOREWORD

It is my pleasure to welcome readers to the 2012 issue of the Journal of Applied Law and Policy (JALAP). JALAP is a double-blind refereed journal that publishes scholarly works on all aspects of law.

JALAP was established by the Applied Law and Policy (ALAP) Area of Research Focus and it represents an important initiative which is central to the research endeavours of ALAP. All submissions have undergone a rigorous double-blind peer review and I am confident that readers will find the articles not only interesting and topical, but scholarly as well.

Finally, and most importantly, I need to extend my sincere thanks to a number of people whose collective efforts have made this journal possible. First, in addition to all members of the ALAP Executive, I would like to thank my Editorial Board colleagues for their counsel and support. Second, I must thank all referees who assisted us with the double-blind refereeing process. I would also like to offer my thanks to Anne Kallies for her exceptional work in proofreading and to David Brennan for his efforts in typesetting. Lastly, I need to record a special thanks to Deepa Sharma who is ALAP's Administrative-Coordinator whose efforts in bringing this issue to fruition are very much appreciated.

I commend this issue of JALAP to all readers and ALAP looks forward to continuing to contribute to legal scholarship through this journal.

Professor Dale Pinto
Editor-in-Chief
JALAP

COMMUNITIES OF TAXATION AND JUSTICE
A COMMUNITARIAN APPROACH TO INEQUALITY AND TAXATION

JONATHAN BARRETT[*]

ABSTRACT

In the light of increasing inequality in contemporary society and a crisis of confidence in the neoliberal policies that have principally informed Western governance in the past 30 years, this article proposes and considers a communitarian approach to taxation. First, broad concepts of community and communitarianism, and basic policy considerations are outlined. Second, specific egalitarian proposals are sketched. Third, more radical communitarian proposals are floated. It is concluded that a shift in tax policy focus from the individual to the community could have significant social and economic benefits.

I. INTRODUCTION

When Alasdair MacIntyre, Michael Sandel and Michael Walzer published their seminal communitarian theses in the early 1980s,[1] communitarianism constituted one of a triad of plausible philosophical underpinnings for democratic government.[2] Narrowing the gap between economic outcomes was widely considered both desirable and attainable,[3] and programmes of wealth redistribution that today might be considered chimerical constituted normal policy for post-war, Western governments across the political spectrum.[4] As Tony Judt observes, '[b]y the early '70s it would have appeared unthinkable to contemplate unravelling the social services, welfare provisions, state-funded cultural and educational resources and much else that people had come to take for granted'.[5] However, in the 30 year period beginning roughly in 1980,[6] neoliberalism,[7] which has since normalised

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1 See Alasdair MacIntyre, *After Virtue* (Duckworth, 1981); Michael Sandel, *Liberalism and the Limits of Justice* (Cambridge University Press, 1982) and Michael Walzer, *Spheres of Justice* (Basic Books, 1983). (Other leading communitarians include Michael Oakeshott and Charles Taylor.) The authors do not identify themselves as 'communitarian'; this is a description typically applied by critics. However, they have in common a rejection of 'liberalism's devaluation of community'. See Daniel Bell, 'Communitarianism' in Edward N Zalta (ed), *The Stanford Encyclopedia of Philosophy* (2012) <http://plato.stanford.edu/archives/spr2012/entries/communitarianism/>.

2 Communitarians tended to critique the progressive liberalism expounded in John Rawls, *A Theory of Justice* (Harvard University Press, 1971) from one flank, while Robert Nozick, *Anarchy, State, and Utopia* (Blackwell, 1974) attacked from the other, libertarian flank.

3 Different strains of communitarianism may be progressive or conservative, even totalitarian; thus Walzer is a 'democratic socialist' and Michael Oakeshott, a 'traditional conservative' (Michael J Sandel, 'Introduction' in Michael J Sandel (ed), *Liberalism and Its Critics* (Basil Blackwell, 1984) 1, 10). Conservative communitarianism may be socially inclusive inasmuch as everyone has a place in society, but anti-egalitarian, see Andrew Vincent, *Modern Political Ideologies* (Blackwell, 1992) 64-5. Modern communitarianism is, however, most likely to coincide with social democratic policies, because, as Gordon Graham, *Contemporary Social Philosophy* (Basil Blackwell, 1988) 54 notes, 'individualists stress the importance of individual liberty and communitarians stress the importance of social justice'. In this article, reference to communitarianism connotes the progressivism typified by Sandel and Walzer.

4 Tony Judt, *Ill Fares the Land* (Penguin Books, 2011) 91 notes that 'Conservatism – not to mention the ideological Right – was a minority preference in the decades following World War II'.

5 Ibid, 79.

6 Margaret Thatcher became the United Kingdom's Prime Minister in 1979 and Ronald Reagan was elected United States President in 1980. Thatcher famously claimed, 'there is no alternative' to neoliberalism. See generally, Claire Berlinksi, *There Is No Alternative: Why Margaret Thatcher Matters* (Basic Books, 2008).

7 Colin Gordon identifies neoliberalism as a totalising ideology that claims all rational conduct as a concern of economics: see Colin Gordon, 'Government Rationality: an Introduction' in Graham Burchell, Colin

economic individualism in everyday life, became the 'dominant discourse'.[8] And now, after three decades of ascendency, the consequences of neoliberal policies, including egregiously unequal wealth distributions and the collapse of the deregulated financial system,[9] have intimated fracture of the neoliberal consensus.[10]

Three inequality considerations that transcend ideological preference are of particular contemporary relevance. The effects inequality has on society and all members of that society are becoming better understood. Furthermore, sustained inequality has deleterious macro-economic and structural consequences.[11] Finally, inequality has become the subject of increasing popular anger that democratic governments cannot ignore.[12] In this context, equality must be brought back to the policy agenda and, it is submitted, a communitarian conception of taxation has much to offer the ensuing debate.

Unlike liberalism, for which equality of opportunity is the pertinent concern,[13] communitarianism values a tendency towards equality of outcomes.[14] And, whereas traditional tax theory focuses on the aggregate welfare of individuals,[15] a communitarian approach to taxation starts from a rejection of 'a mistaken prioritization of individuals over their communities'.[16] Since, in the communitarian view, 'the individual only becomes an individual or person by being part of and taking part in communal life',[17] the solidarity and sustainability of the taxpaying community is a principal concern.[18] Furthermore, social justice within that community demands an egalitarian approach to outcomes. This article proposes and considers the idea of communities of taxation and justice. First the idea of 'community' is explained and the basic communitarian tax principles established. Second, the contemporary significance of inequality is outlined. Third, specific tax policy measures consistent with communitarianism are sketched and conclusions drawn.

Gordon and Peter Miller (eds), *The Foucault Effect* (Harvester, 1991) 1, 43. According to Jonathan Boston et al, *Public Management: the New Zealand Model* (Oxford University Press, 1996) 17, neoliberalism is founded on the presumptions that human behaviour is dominated by self-interest and social interactions are value maximising exchanges.

8 See David Hudson and Mary Martin, 'Narratives of Neoliberalism: The Role of Everyday Media Practices and the Reproduction of Dominant Ideas' in Andreas Gofas and Colin Hay (eds), *The Role of Ideas in Political Analysis: A Portrait of Contemporary Debates* (Routledge, 2010) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2033221>.

9 See generally, Richard A Posner, *A Failure of Capitalism: The Crises of '08 and the Descent into Depression* (Harvard University Press, 2009).

10 See Nancy Birdsall and Francis Fukuyama, 'The Post-Washington Consensus Development after the Crisis' (2011) 90(2) *Foreign Affairs* 45, 45-53.

11 See generally, James K Galbraith, *Inequality and Instability: A Study of the World Economy Just Before the Great Crisis* (Oxford University Press, 2012) 148.

12 On protest movements, including the 99%, Los Indignados and Occupy, see Geoffrey Pleyers, *Alter-Globalization: Becoming Actors in the Global Age* (Polity Press, 2010).

13 See Rawls, above n 2, 61.

14 Stephen Mulhall and Adam Swift, *Liberals and Communitarians* (Blackwell, 1995) 147 note, regarding Walzer's idea of complex equality, 'what is unjust about capitalist society is not so much the unequal distribution of money as the fact that money is able to bring its possessor goods, such as health care or education, that properly belong to different distributive spheres.' Critically, then, opportunity is greatly determined by pre-existing and unequal patterns of distribution.

15 See, for example, J A Mirrlees, 'An Exploration in the Theory of Optimal Income Taxation' (1971) 38(2) *Review of Economic Studies* 175, 176.

16 Mulhall and Swift, above n 14, xi.

17 Johan van der Walt, 'The Relation between Law and Politics: A Communitarian Perspective' (1993) 110 *South African Law Journal* 757, 761.

18 Emile Durkheim described social solidarity as 'a wholly moral phenomenon' of which law is its 'visible symbol'. See Emile Durkheim, *The Division of Labour in Society* (W D Halls trans, Macmillan, 1984) 24 [trans of: *De la Division du Travail Social* (first published 1893)].

II. COMMUNITY AND COMMUNITARIAN TAX PRINCIPLES

Communitarians reject the liberal principle that the wishes of individuals should be prioritised ahead of the flourishing of the community in which they live. As Gordon Graham explains, 'on the liberal individualist view society is necessarily and essentially a plurality, a mere association of different views an interests … [whereas communitarianism] regards society as a community, and this, as the very word implies, means that society is in some way a *unity*, a single thing in which individual members are bound together'.[19] In this part, the idea of community is discussed and basic principles for taxation from a communitarian perspective established.

A. *Community*

In the communitarian view, the political community precedes individual rights. Thus for Walzer, the welfare state is derived from membership, rather than rights, as Rawls proposes.[20] But, if it is to be accorded priority over the individual, what is a 'community'?

Ferdinand Tönnies first distinguished the traditional community (*Gemeinschaft*) from an association (*Gesellschaft*),[21] for which the principal underpinning is 'the rational pursuit of individual self-interest'.[22] In contrast, as Talcott Parsons explains, the *Gemeinschaft*:

> … is a community of fate (*Schicksal*). One may say that within the area of the relationship the parties act and are treated as a unit of solidarity. They share benefits and misfortunes in common, not necessarily equally, because *Gemeinschaft* relations perfectly well admit both of functional and of hierarchical differentiation. But it is the specific field of application of the communistic principle, to each according to his needs, from each according to his abilities. [23]

The national political community cannot plausibly be likened to a church congregation or family (typical *Gemeinschaft* examples) but nor can it be considered a voluntarily associative *Gesellschaft*, which people may join and leave at will, or pick and choose which of its rules they will comply with.[24] Indeed, elements of both *Gemeinschaft* and *Gesellschaft* are manifest in the nation, and so strict categorisation does not ensure understanding of the real nature of a particular social group. Sandel says:

> … to ask whether a particular society is a community is not simply to ask whether a large number of its members happen to have among their various desires the desire to associate with others or to promote communitarian aims – although this may be one feature of a community – but whether the society is itself a society of a certain kind, ordered in a certain way, such that community describes its basic structure and not merely the dispositions of persons within the structure. For a society to be a community in this strong sense, community must be constitutive of the shared self-understandings of the participants

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19 Graham, above n 3, 12.

20 Sandel, above n 1, 10.

21 See generally, Ferdinand Tönnies, *Community & Society* (Charles P Loomis, trans, Michigan State University Press, 1957) [trans of: *Gemeinschaft und Gesellschaft* (first published 1887)].

22 See Talcott Parsons, 'Notes on *Gemeinschaft* and *Gesellschaft*', in Max Weber, *Theory of Social and Economic Organization* (A R Henderson and Talcott Parsons trans, William Hodge, 1947) 687 [trans of: *Grundriss der Sozialoekonomik* (first published 1911-20)].

23 Ibid, 688-9.

24 Tönnies stressed the involuntary nature of the *Gemeinschaft*, typified by the parent-child relationship, and compared this with the voluntary nature of the *Gesellschaft*, which may be exemplified by the choice of becoming a shareholder (or, in older terminology, a member) of a joint stock company. One may join a political community by immigrating or conversely leave by emigrating and renouncing citizenship. However, provided the host agrees, one may voluntarily take residency of another country, but, having done so, is bound by the rules, and, to some extent, the traditions and customs of the new country. See Parsons, above n 22, 689.

> and embodied in their institutional arrangements, not simply an attribute of certain of the participants' plans of life. [25]

If, then, two societies are compared, one may manifest more of the community features Sandel identifies, but both may, nevertheless, be properly considered communities.[26]

For Sandel, '[Rawlsian] justice as fairness fails to take seriously our commonality'[27] and, indeed, devalues it. And so, in one sense, community is about holding feelings in common with others.[28] However, since all human beings share many experiences and feelings in common,[29] the expression of community lies greatly in valorising those aspects of our lives which we do not hold in common with others, such as a shared history and the practice of particular traditions. For people to positively imagine themselves members of a certain political community, and no other, is critical for nationhood,[30] but constructing differences from those outside the community is equally important.[31]

Eugene Kamenka and Alice Erh-Soon Tay are plausible when they argue that crises of 'liberalism and individualism, of *Gesellschaft* law and of the *Gesellschaft* concept of liberty under law … point not backward to the *Gemeinschaft*, or forward to the traditional communist utopia, but to a new and much more complex paradigm'.[32] Nevertheless, citizens do need to think of the national political community as having some features of the *Gemeinschaft* (broadly, a discrete community of mutual support) if tax-benefit systems are to be sustainable. As Walzer observes, 'distributive justice presupposes a bounded world within which distribution takes place … whose members distribute power to one another and avoid, if they possibly can, sharing it with anyone else'.[33] However, the strength of community feeling and the sense of shared fate inevitably influences the degree of mutuality expected and practised in a particular society. A degree of mutual trust, which is, of course, challenging in spatially dispersed, multicultural societies, is also necessary. As Judt observes, 'we cannot do without *trust*. If we truly did not trust one another, we would not pay taxes for our mutual support'.[34] Again, the degree of mutual trust present in the community influences the extent of mutual provision.

Individualism may have impacted on local community cohesion and, indeed, local communities themselves.[35] Whether or not government actively set out to attack communities,[36] a weakening of community-based opposition has benefitted the neoliberal

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25 Sandel, above n 1, 173.

26 While less obviously communitarian than, say, Finland, the United States is nevertheless a distinct political community. Crucially, notwithstanding regional differences, particular cultural allegiances and a strong sentiment for individual liberty, US Americans overwhelmingly think of themselves as citizens of the United States. They do not think of themselves as members, for the time being, of a voluntary association of millions of individuals.

27 Sandel, above n 1, 174.

28 J A Simpson and E S C Weiner, *The Oxford English Dictionary* (2nd, Clarendon Press, 1989) vol II, 581.

29 See, for example, Abraham H Maslow, *Motivation and Personality* (first published 1954, Harper & Row, 1970 ed) 24, 54, respectively, on the commonality of human physiological and psychological experiences, and the alikeness of cultures.

30 See generally, Benedict Anderson, *Imagined Communities: Reflections on the Origin and Spread of Nationalism* (Verso, 1991) on the role of imagination in forming and sustaining political communities.

31 For a universalist critique of this form of 'parochialism', see Terry Eagleton, *The Illusions of Postmodernism* (Blackwell, 1996) 114-16.

32 Eugene Kamenka and Alice Erh-Soon Tay, 'Socialism, Anarchism and Law' in Eugene Kamenka, Robert Brown and Alice Erh-Soon Tay (eds), *Law and Society: The Crisis in Legal Ideas* (St Martin's Press, 1978) 48, 55.

33 Walzer, above n 1, 31.

34 Judt, above n 4, 32 (emphasis in original).

35 Pierre Bourdieu asked: 'What is neoliberalism?' and answered: 'A programme for destroying collective structures which may impede the pure market logic.' See Pierre Bourdieu, 'The Essence of Neoliberalism', *Le Monde Diplomatique* (online English edition), 8 December 1998 <http://mondediplo.com/1998/12/08bourdieu>.

36 Neoliberal government certainly sought to weaken trade unions, which are typically a manifestation of communitarian fraternity: see, for example, the *Employment Contracts Act 1991* (NZ). Thatcher's

project.[37] However, even in the face of globalisation, it is not plausible to argue that the national community does not or should not exist.[38] Indeed, Paul Hirst and Grahame Thompson observe that, as the body of international law necessary for globalisation has proliferated, nation states have become increasingly important as 'agencies that create and abide by the law'.[39] And so, the national community remains intact, if only as a 'hollow state',[40] but sentiments of community are less obvious. Through, inter alia, the promotion of equality, communitarian taxation may contribute to a resurgence of a sentiment of commonality and community.

B. *Communitarian Tax Principles*

Gesellschaft-oriented taxation would aim to maximise aggregate utility of individuals, whereas *Gemeinschaft*-oriented taxation would expect everyone to contribute according to their means and receive according to their needs. The resulting taxes could be similar,[41] although this seems improbable.[42] While practicable communitarian tax policy would tend toward *Gemeinschaft* taxation, focus would lie with how the community of taxation and justice might be sustained. The sustainability and solidarity of the tax community would be a pre-eminent concern, rather than, say, individuals' expectations to amass wealth, because, without a political community, individual flourishing cannot be realised.[43] Since the political community is one of shared fate, every member of that community should be included in the tax contribution system. As Warren Buffett, the billionaire supporter of fairer taxes argues, government needs 'to get serious about shared sacrifice'.[44] At the social extremes, neither the 'dole bludger' nor the 'billionaire rentier' should be permitted to free ride.[45] However, in the context of increasing inequality, particular attention must be paid to full inclusion of the wealthy in the tax community. These basic principles are applied in the discussion of policy in part IV.

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aphorism – there is no such thing as society – demonstrated disdain for social groups other than the *Gesellschaft*. See generally, John Kingdom, *No Such Things as Society?: Individualism and Community* (Open University Press, 1992).

37 See, for example, Bruce Jesson, *Only Their Purpose Is Mad* (Dunmore Press, 1999) on the impact of neoliberal policies on local communities in New Zealand.

38 For a counter argument, see Kenichi Ohmae, *The End of the Nation State: The Rise of Regional Economies* (Free Press, 1995).

39 Paul Hirst and Grahame Thompson, *Globalization in Question: The International Economy and the Possibilities of Governance* (Polity, 1996) 194.

40 See Christopher Pollitt, *New Perspectives on Public Services: Place and Technology* (Oxford University Press, 2012) 3.

41 In accordance with traditional marginal utility theory, progressive income taxes are justifiable because the higher earner suffers less 'pain' when taxed at higher rates on higher slices of income: see, for example, Martin Daunton, *Trusting Leviathan: The Politics of Taxation in Britain, 1799-1914* (Cambridge University Press, 2001) 30. This scheme not only maximises aggregate utility (or, at least, minimises aggregate disutility) but also ensures taxpayers contribute according to their ability to pay – a communitarian expectation.

42 Richard Epstein argues that, in a Lockean scheme, progressive income tax is morally indefensible because it interferes with individuals' entitlements to property and their preferences, whereas consumption or benefit-based taxes, which do not disrupt choices, are justifiable notwithstanding their regression. See Richard A Epstein, 'Taxation in a Lockean World' in Jules Coleman and Ellen Frankel Paul (eds), *Philosophy and Law* (Basil Blackwell, 1987) 49, 49-74.

43 Walzer, above n 1, 63.

44 Warren E Buffett, 'Stop Coddling the Super-Rich', *The New York Times* (New York), 15 August 2011, A21.

45 Gareth Morgan and Susan Guthrie, *Tax and Welfare: The Big Kahuna* (Public Interest Publishing, 2011) 123 observe: 'We hear a heap about the abuse of the welfare system by "bludgers": we don't hear quite so much about tax dodging by the wealthiest in our society, and you certainly don't see politicians rushing in to jump on it.'

III. EQUALITY

Equality is a critical concern for communitarian taxation, and, to some extent, contemporary inequality justifies a shift from liberal to communitarian taxation. In short, if neoliberal policies were in fact 'raising all boats' and social injustice were not rampant or the financial system not imperilled,[46] beyond ideology, the grounds for preferring communitarian taxation would be diminished. In this part, a history of attitudes to equality of outcomes is outlined and then the major consequences of contemporary inequality are identified.

A. *A Brief History of Egalitarianism*

Plato, whose *Republic* is generally considered to be the first expression of communitarianism,[47] proposed minimum and maximum levels of wealth so that the most affluent class in society should own no more than four times the wealth of the poorest class.[48] Aristotle argued that all features of the social product should be allocated proportionately,[49] and Christian teaching has, at times, condemned inequality of wealth.[50] The Levellers sought material equality in 17th century England,[51] and the French revolutionary, François-Noël 'Gracchus' Babeuf argued there should be 'neither rich nor poor' and 'every individual has an equal right to property'.[52] However, Samuel Fleischacker concludes that these ideas were anomalous and a belief in wealth redistribution, as opposed to the alleviation of absolute poverty,[53] only became commonly held – and not without strong opposition – in the 19th century.[54]

For almost a century after the introduction of the United Kingdom's progressive estate duty in the mid-1890s,[55] the principle of wealth redistribution informed tax-benefit systems around the world.[56] In the period of unprecedented economic growth following the Second World War, ideologically diverse governments pursued highly progressive tax policies.[57] Whereas left-wing governments sought material equality as a matter of

46 Galbraith, above n 11, 148, observes: 'A rising tide may lift all boats, but recent business cycles have been more like waves, whereby certain sectors and areas ride the peals before crashing to the shore. This is a sign, surely not of the social evil of inequality per se but of the instability of bubble economies, closely associated with inequality of money, wealth and power, for which we now pay a fearsome price.'

47 Graham, above n 3, 12. For an argument on the malignity of Plato's influence, see Karl Popper, *The Open Society and Its Enemies: The Spell of Plato* (Princeton University Press, 1971).

48 Plato, 'Laws' in John M Cooper and D S Hutchinson (eds), *Complete Works* (Hackett Publishing, 1997) 1318, 1425.

49 Aristotle, *The Nicomachean Ethics* (David Ross trans, Oxford University Press, 2009) 85.

50 See generally, Richard Harries, *Is There a Gospel for the Rich? The Christian in a Capitalist World* (Mowbray, 1993). Despite the Catholic Church's consistent promotion of the idea of human dignity, Michael Rosen demonstrates how a sea-change occurred in Catholic thinking between the end of the 19th century and the second half of the 20th century, from anti-egalitarianism to support for the fullest political, social and economic equality. See Michael Rosen, *Dignity: Its History and Meaning* (Harvard University Press, 2012) 47-54.

51 See J F C Harrison, *The Common People: A History from the Norman Conquest to the Present* (Flamingo, 1984) 195.

52 John Hall Stewart, *A Documentary Survey of the French Revolution* (Macmillan, 1951) 656-7.

53 See, for example, the *Poor Law Act 1601*, 43 Eliz I, c 2.

54 Samuel Fleischacker, *A Short History of Distributive Justice* (Harvard University Press, 2004) 54.

55 See *Finance Act 1894*, 57 & 58 Vict, c 30. Cf the *Death Duties Act 1909* (NZ) and *Estate Duty Act 1914* (Cth).

56 Friedrich Hayek cites a narrowly defeated 1956 proposal of India's National Planning Commission to limit all personal income to a ceiling equivalent to US$6 300 per annum and salary income to US$4 300 per annum. See F A Hayek, *The Constitution of Liberty: The Definitive Edition* (first published 1960, University of Chicago Press, 2011 ed) 449.

57 J K Galbraith, *The Affluent Society* (first published 1958, Pelican Books, 1968 ed) 76-7 argues that despite high nominal rates, progressive income tax was undermined by loopholes and inequities. He considered the turn of the twentieth century to be the peak period for political concerns about inequality. Ibid, 77.

principle,[58] the same motivation cannot be imputed to conservative governments. Equalisation of wealth could not possibly be maintained, and nor would it have obvious social value,[59] but the consensus held that the *consequences* of inequality were sufficient (for governments that did not necessarily support equality of outcomes) to outweigh other considerations.[60] Reflected in 'cuts in benefits, tighter eligibility rules and a shift away from progressive income tax',[61] in the past 30 years, governments have tended to show less concern for equality of outcomes, which have, indeed, diverged.[62]

B. *Consequences*

Ricardo Tejada observes that inequality is an economic issue 'because sustained inequality hinders growth'.[63] Furthermore, '[r]estoring equality by redistributing income from the rich to the poor … could also help save the global economy from another major crisis'.[64] However, in the communitarian view, it is the ethical and social issues arising from inequality that matter most. A socio-economic system that perpetuates grossly unequal outcomes seems incompatible with the fundamental and universal ethical principle of

58 It should be noted, however, that the Fourth Labour government (1984-1990), under the premiership of David Lange for the greatest period, introduced controversial neoliberal reforms to New Zealand. See Michael King, *The Penguin History of New Zealand* (Penguin Books, 2003) 495.

59 See, for example, G W F Hegel, *Outlines of the Philosophy of Right* (T M Knox trans, Oxford University Press, 2008) 165 [trans of: *Grundlinien der Philosophie des Rechts* (first published 1820)] and David Hume, *Enquiries Concerning Human Understanding and Concerns for the Principles of Morals* (Clarendon Press, 3rd ed, 1974) 194. As John Kenneth Galbraith, *The Good Society: The Humane Agenda* (Sinclair-Stevenson, 1996) 59 observes, equalisation of wealth is simply 'not consistent with either human nature or the character and motivation of the modern economic system'.

60 For right-wing governments, a feared consequence of gross material inequality might be the poor voting for extremist parties or revolting. The neoliberal revolution coincided with the fall of the Soviet bloc: afterwards there was no more communist threat to buy off. See generally, Francis Fukuyama, *The End of History and the Last Man* (Simon and Schuster, 1992).

61 Angel Gurría, 'Tackling Inequality' (2011) 287(Q4) *OECD Observer* 3. Top marginal statutory rates of personal tax have been cut substantially in the past 30 years. The OECD average top marginal statutory rate of personal income tax was 66.8 per cent in 1981, and 41.7 per cent in 2010. See Alan Carter and Stephen Matthews 'How Tax Can Reduce Inequality' (2012) 290-291(Q1-Q2) *OECD Observer* (online)<http://www.oecdobserver.org/news/fullstory.php/aid/3782/How_tax_can_reduce_inequality.html>.

A preference for regressive consumption taxes during this period should also be noted.

62 Ricardo Tejada, 'Inequality: Why the Struggle Matters' (2011) 287 (Q4) *OECD Observer* 7, 7 records that, in the United States, CEO salaries are 183 times the average salary, and, even in the traditionally egalitarian Netherlands, the ratio is 85:1. In 2008, the top 0.1 per cent accounted for close to 3 per cent of total pre-tax incomes in Australia and New Zealand. New Zealand's Gini coefficient moved from 0.27 in 1985 to 0.33 in 2008. See OECD, *An Overview of Growing Income Inequalities in OECD Countries: Main Findings* (2011) <http://www.oecd.org/dataoecd/40/12/49499779.pdf>.
(The Gini index is between 0 and 100. A value of 0 represents absolute equality and 100 absolute inequality. See Tatyana B Soubbotina, *Beyond Economic Growth: an Introduction to Economic Development* (The World Bank, 2nd ed, 2004) 30).

New Zealanders elected a National-led government in 2008, which has introduced regressive tax policies, notably lowering income tax rates and increasing the goods and services tax (GST) rate. Inequality can, therefore, be expected to have become more pronounced. However, it should be noted that the highest marginal income tax rate for individuals of 38 per cent introduced by the previous Labour-led government, by inviting high income professionals to channel their incomes through lower taxed trusts, may have vitiated the equality goal of the top rate. Cf Galbraith, above n 59, 76-7.

63 Tejada, above n 62, 7.

64 Michael Kumhof and Romain Rancière, 'Leveraging Inequality' (2010) 47 (4) *Finance & Development* 28, 31. While it may appear unlikely that World Bank researchers, such as Kumhof and Rancière, should be giving such pre-neoliberal prescriptions, the global financial crisis has led to a resurgence in collectivist thinking. As Brendan Edgeworth notes, the United Kingdom 'which paradoxically avoided nationalising banks even when in the post-war period it embarked on a policy of nationalisation of most of the other commanding heights of the economy, has now done so with unprecedented and unimaginable vigour'. See Brendan Edgeworth, '"New Property", the Contracting State and the Global Financial Crisis' in Lyria Bennett Moses, Brendan Edgeworth and Cathy Sherry (eds), *Property and Security: Selected Essays* (Law Book Co, 2010) 49, 64.

respect for human dignity.[65] Furthermore, sustained disparities in economic outcomes among individuals have significant social consequences.[66] Angel Gurría, Secretary-General of the Organisation of Economic Co-operation and Development (OECD), observes, '[w]idening disparities weaken the structures that hold our societies together and threaten our ability to move forward'.[67] This lack of social cohesion affects rich and poor alike. The more equal a society, the greater the trust,[68] and vice versa. In more equal societies, 'people are more likely to trust each other, measures of social capital and social cohesion show that community life is stronger, and homicide rates and levels of violence are consistently lower'.[69]

Democracy, which is founded on the general parity of human attributes among citizens,[70] implies some guarantee of a share in the social product if only to ensure participation.[71] When people are engaged in a struggle for day-to-day survival, they cannot meaningfully participate in community decision-making, and democracy becomes an abstraction for them, rather than a lived experience. Conversely, if particular individuals are able to corner a disproportionate share of the common wealth,[72] and, thereby, unduly influence democratic decision-making,[73] democracy itself may be imperilled. Decisions about taxation and spending and 'the kind of society which we want as citizens and as a community, and how the resources available to us are spent to achieve this' are critical

65 See the *International Covenant on Economic, Social and Cultural Rights*, opened for signature 16 December 1966, 993 UNTS 3 (entered into force 3 November 1976) at 49; the *International Covenant on Civil and Political Rights*, opened for signature 16 December 1966, 999 UNTS 171(entered into force 23 March 1976) at 52. Australia and New Zealand have signed both covenants, along with the *Universal Declaration of Human Rights*, GA Res 217A (III), UN GAOR, 3rd sess, 183rd plen mtg, UN Doc A/810 (10 December 1948).

66 See generally, Richard Wilkinson and Kate Pickett, *The Spirit Level: Why More Equal Societies Almost Always Do Better* (Allen Lane, 2009).

67 Gurría, above n 61, 3.

68 Judt, above n 4, 66. See also Francis Fukuyama, *Trust: Social Virtues and the Creation of Prosperity* (Hamish Hamilton, 1995).

69 The World Bank, *World Development Report 2003: Dynamic Development in a Sustainable World* (The World Bank, 2003) 184. For a fuller discussion of the grounds for countering inequality through taxation, see Jonathan Barrett, 'Progressive Income Taxation Revisited' (2008) 14(4) *New Zealand Journal of Tax Law and Policy* 457, 467-9.

70 See, for example, Robert Dahl, *Democracy and Its Critics* (Yale University Press, 1989) 97.

71 On the social element of citizenship, as proposed by Thomas Marshall, see Robert Pinker, 'Introduction' in T H Marshall, *The Right to Welfare and Other Essays* (Heinemann Educational Books, 1981) 1, 10.

72 John Locke argued that a person gains property rights in things held in common by applying labour, but added the proviso 'at least where there is enough, and as good left in common for others'. See John Locke, *Two Treatises of Government* (J M Dent & Sons, first published 1690, 1990 ed) 129. As Graham, above n 3, 71 notes, this proviso greatly undermines Nozick's theory of justice in relation to historical property holdings.

73 See generally, The Leveson Inquiry, *Leveson Inquiry: Culture, Practice and Ethics of the Press* (ongoing) <http://www.levesoninquiry.org.uk/about/>.

Mining magnate Gina Rinehart's increased share in Fairfax Media has raised concerns about the influence of the wealthy on political discourse. See, for example, 'Richest Aussie Stuns Media as She Buys Big Stake in Fairfax', *The New Zealand Herald* (Auckland), 2 February 2012, B3.

Michael Rafferty reportedly argues that 'the moguls' efforts to sway public opinion are a disturbing development that has led to the country's greatest alliance of political and economic power 'in 70 or 80 years' … 'They are very interested in advancing and protecting their interests by political power, whether it is investing in the media or being involved in the political parties.' See Jonathan Pearlman, 'The Australian Mining Magnate at the Top of the Rich List', *The Telegraph* (online), 23 May 2012 <http://www.telegraph.co.uk/finance/newsbysector/industry/9285055/The-Australian-mining-magnate-at-the-top-of-the-rich-list.html>. Looking back to the early 20th century, Galbraith, above n 57, 81 observes: 'When the rich were not only rich but had the power that went with active direction of corporate enterprise, it is obvious that wealth had more perquisites than now. For the same reasons, it stirred more antagonism.'

democratic choices:[74] no members of the community should be excluded or, conversely, over-represented in this debate.

IV. POLICY RESPONSES

If arguments for greater equality of wealth outcomes are plausible, how can tax policy contribute to more equal outcomes? In this part, certain tax policy responses consistent with communitarian aspirations are considered. It is argued that tax policy based on the idea of community solidarity and sustainability may be more effective in delivering equality than approaches that focus on individuals in aggregate.

A. *Inclusion*

Inclusion of those marginalised in society by improving their socio-economic conditions and thereby helping to level opportunities is a progressive imperative. As elements of a comprehensive egalitarian programme,[75] progressive tax and benefit policies are a proven way of countering inequality.[76] Practical challenges arise when, say, negative income taxes are introduced. Discussing the particular New Zealand tax-transfer system, but, it seems likely, making generalisable observations,[77] Gareth Morgan and Susan Guthrie argue that barriers are put 'in the way of people properly contributing to the redistributive system … the targeted transfer system applying to those of working age imposes significant financial costs on those who attempt to cross the divide between a transfer and low-paid work'.[78] However, these are remediable technical problems that do not present grounds for opposing measures that have proven effective in promoting social inclusion. Sight must not be lost of the conditions of the needy, but society has two margins, and attention is increasingly being paid to the upper margin, popularly identified as the '1%'.[79] If a community is to enjoy egalitarian tax-benefits, then, the wealthy will need to pay more tax, willingly or not.[80] However, they too may be practically excluded since the 'tax system permits tax "minimisation" for those with wealth so, for these people, self-interest dictates putting resources out of the reach of the tax net as much as possible'.[81]

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74 Fabian Society, *Paying for Progress: A New Politics of Tax for Public Spending* (Fabian Society, 2000) 150.

75 Wilkinson and Pickett, above n 66, 271 include: 'minimum wage legislation, education policies, the management of the national economy, whether unemployment is kept to low levels, whether different rates of VAT [GST] and sales tax are applied to necessaries and luxuries, provision of public services, pension policies, inheritance taxes, negative income tax, basic income policies, child support, progressive consumption taxes, industrial policy, retraining schemes'.

76 Galbraith, above n 57, 65. However, for examples of tax policies having unpredicted or nil effects, see Joseph E Stiglitz, *Economics of the Public Sector* (W W Norton & Co, 3rd ed, 2000) 701-2.

77 See, for example, Mike Brewer, Tom Clark and Michal Myck, 'Credit Where It's Due? An Assessment of the New Tax Credits' (Commentary 86, The Institute for Fiscal Studies, 2001) 39 on the 'clash of benefits' problems the United Kingdom's Working Families Tax Credit scheme faced, despite using taper rates.

78 Morgan and Guthrie, above n 45, 131. Although, with a GST rate of 15 per cent and no merit good concessions, the poor make a disproportionate consumption tax contribution in New Zealand, whatever their income tax contribution.

79 See, for example, Joseph E Stiglitz, 'Of the 1%, by the 1%, for the 1%', *Vanity Fair* (New York), 1 May 2011, 126.

80 £4.5-£7 billion is thought to be lost annually from the United Kingdom treasury as a consequence of individual tax avoidance. See Hannah Furness, 'Comedian Jimmy Carr Has £3.3 million in Jersey Tax Avoidance Scheme', *The Telegraph* (online), 19 June 2012 <http://www.telegraph.co.uk/finance/9341117/Comedian-Jimmy-Carr-has-3.3m-in-Jersey-tax-avoidance-scheme.html>.

81 Morgan and Guthrie, above n 45, 131.

B. *Including the Wealthy*

François Hollande, France's socialist president, is said to despise the rich.[82] Political advantage may, no doubt, be gained from castigating the wealthy in times of economic hardship, but it is, perhaps, the great weakness and danger of communitarianism that social solidarity may be bolstered by demonising minorities, whether they are distinguishable on the grounds of their gender, ethnic origin, religious persuasion or economic standing.[83] But envy of the wealthy cannot inform justifiable tax policy.[84] Indeed, in a growth-oriented economic system, the lawful amassing of individual wealth through productive enterprise may be socially valuable, particularly if new jobs are created.[85] Erecting tax barriers to the pursuit of individual wealth may disadvantage the community as a whole – although not all wealthy people are job-creating entrepreneurs.[86] And so, while individual wealth cannot be considered inherently 'bad',[87] conversely, there is no reason to view individual wealth as an inherent social 'good', and no plausible reasons exist to privilege the accumulation of individual wealth through tax concessions.[88] Furthermore, because even the most imaginative individual is reliant on others and society in general (by, inter alia, granting patents and other intellectual property rights) to accumulate wealth from invention and enterprise, 'a *general* system of redistribution' should be established 'which will ensure that everyone gets a reasonably fair share of the rewards that living in society brings'.[89] This consideration becomes particularly pressing when wealth creators are not willing to share the fruits of their good fortune with those who most obviously contribute to generating that wealth, such as employees,[90] and less with the community as a whole.[91]

Taxation of the wealthy raises particular tax policy issues.[92] To illustrate these issues, it is useful to construct the crude categories of 'mobile wealthy' and 'situated wealthy'.

1. *Mobile Wealthy*

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82 Emma Rowley, Anna White and Helia Ebrahimi, 'High Earners Say Au Revoir to France' *The Telegraph* (online), 13 May 2012 <http://www.telegraph.co.uk/finance/globalbusiness/9261905/High-earners-say-au-revoir-to-France.html>.

83 Kamenka and Tay, above n 32, 53 cite the Salem witch trials and Hester Prynne's victimisation in Nathaniel Hawthorne's *The Scarlet Letter* as examples of communitarian oppression of women. However, such oppression may be challenged in a human rights state: see above n 65 on the basic human rights commitments of Australia and New Zealand.

84 See Nozick, above n 2, 239-46 for an argument that egalitarianism springs from envy.

85 Research shows that, in the United States, new firms, as a class, add an average of three million jobs in their first year. See Tim Kane, 'The Importance of Startups in Job Creation and Job Destruction' (Kauffman Foundation Research Series: Firm Formation and Economic Growth, 2010) 2 <www.kauffman.org/uploadedFiles/firm_formation_importance_of_startups.pdf>.

86 See Pearlman, above n 73 for Rafferty's characterisation of Rinehart and other mining magnates as 'rentiers'.

87 Judt, above n 4, 39 reports: 'Relative indifference to wealth for its own sake was widespread in the postwar decades.'

88 Capital gains, which disproportionately accrue to the wealthy, are typically taxed at lower rates than other manifestations of comprehensive income under the Haig-Simon model. See R M Haig, 'The Concept of Income', in R M Haig, T S Adams and T R Powell (eds), *The Federal Income Tax* (first published 1921, BiblioBazaar, 2009 ed) 7 and H C Simons, P*ersonal Income Taxation: The Definition of Income as a Problem of Fiscal Polic*y (University of Chicago Press, 1938) 50.

89 Graham, above n 3, 76 (emphasis in original).

90 For example, the revenue of Apple Stores divided by the number of sales staff is US$473 000. In 2011, Tim Cook, Apple's CEO received stock grants worth more than US$570 million, whereas the average sales clerk's annual salary was US$25 000. See David Segal, 'Apple's Retail Army, Long on Loyalty but Short on Pay', *The New York Times* (New York), 23 June 2012, A1.

91 See, for example, Charles Duhigg and David Kochieniewski, 'How Apple Sidesteps Billions in Taxes', *The New York Times* (New York), 29 April 2012, A1.

92 For example, typical optimal tax analysis models support regression for the highest earning taxpayers. See, Lawrence Zelanak and Kemper Moreland, 'Can the Graduated Income Tax Survive Optimal Tax Analysis?' (1999) 53 *Tax Law Review* 51, 54-5.

The Rolling Stones were neither the first nor last artistes to prefer living abroad to the obligations of tax residency, but their decampment for France in 1971 remains a *cause célèbre*. Mark Blake records that because 'high earners were required to pay 83 per cent tax on earned income and 98 per cent on income yet to be earned … the band moved to France, where they could live for more than a year without paying taxes'.[93] In a move widely interpreted as an attempt to avoid tax once Facebook was listed,[94] Eduardo Saverin, a co-founder of the firm, renounced his United States citizenship.[95] (The United States is the only OECD member to base tax liability principally on citizenship.) After the election of the Hollande government, which, during its electoral campaign, promised to implement a 75 per cent marginal income tax rate on earnings over €1 million, many bankers are said to have left Paris for London.[96] These examples indicate that some of the mobile wealthy will simply become tax exiles if nominal income tax rates are too high.[97]

Tax exile not only generates considerable rhetoric, it may also mask other reasons for leaving a political community. Since the Rolling Stones had entered into notoriously disadvantageous record deals,[98] it is possible that they received proportionately little unearned income but were simply 'weary from the pressure of English authorities'.[99] Saverin, a Brazilian native, has denied he was motivated by tax concerns and besides would have been subject to an exit tax on his unrealised capital gains.[100] Likewise, French bankers may not be simply reacting to a higher marginal tax rate (which they might easily mitigate) but rather fulfilling the Tiebout hypothesis.[101] Being a far larger and more sophisticated financial centre than Paris, London offers better career opportunities for bankers, but also has a sizeable French expatriate community, as well as francophone schools and professional services.[102]

People should in principle be free to move between political communities, although, due to immigration restrictions, it is typically easier to leave a political community than it is to join another one. However, emigrants may be expected to account for the wealth they have accumulated as a consequence of their membership of the particular community, such as unrealised capital gains, before they leave. Furthermore, their exit from the political community must be genuine: for example, despite being knighted and maintaining

93 Mark Blake, 'Soul Survivors', *Mojo* (United Kingdom), January 2012, 71, 75. Guitarist Keith Richard has said '[w]e left England because we'd be paying 98 cents on the dollar (sic)': see Andy Serwer, Julia Boorstin and Ann Harrington, 'Inside the Rolling Stones Inc.', *Fortune* (New York), 30 September 2002, 58. In fact the highest rate of United Kingdom income tax in 1971 was 75 per cent, with a 15 per cent surcharge applying to unearned (investment income): see Tom Clark and Andrew Dilnot, 'Long-Term Trends in British Taxation and Spending' (Briefing Note No 25,The Institute for Fiscal Studies, London, 2002) 7-8. The highest income tax rate was increased to 83 per cent by a Labour government elected in 1974. The investment surcharge was not abolished until 1984, despite a radical Conservative government being elected in 1979. Ibid.

94 See Quentin Hardy, 'A Facebook Founder Renounces His U.S. Citizenship', *The New York Times* (online), 11 May 2012 <http://bits.blogs.nytimes.com/2012/05/11/a-facebook-founder-renounces-his-u-s-citizenship/?pagemode=print>.

95 United States Government, *Quarterly Publication of Individuals, Who Have Chosen to Expatriate* (2012) <https://www.federalregister.gov/articles/2012/04/30/2012-10274/quarterly-publication-of-individuals-who-have-chosen-to-expatriate>.
For a morality tale about a Singapore-resident lawyer renouncing his United States citizenship to gain tax benefits, see Paul Theroux, 'Bottom Feeders' in *The Collected Short Novels* (Penguin, 1998) 335, 335-82.

96 Rowley et al, above n 82.

97 Of course, for every prominent tax exile, countless other examples of tax residents can be adduced. Thus, whereas the Rolling Stones decamped, the far wealthier Beatle, Paul McCartney, did not.

98 Blake, above n 93, 75.

99 Bill Janovitz, *Exile on Main Street* (Continuum, 2005) 12.

100 Hardy, above n 94. Presumably sophisticated legislation and practice would enable the revenue service to take into account the net present value of shares in a soon to be listed company.

101 C M Tiebout, 'A Pure Theory of Local Expenditures' (1956) 64 *Journal of Political Economy* 416, 424 proposed that, under conditions of full 'consumer-voter' mobility, people will select areas to live, based on their preferences for local government revenue-expenditure patterns.

102 Rowley et al, above n 82.

significant property in England, singer Mick Jagger has not been a British tax resident since 1971.[103]

Morgan and Guthrie cite an 1891 pamphlet that claimed New Zealand's progressive land tax was causing capitalists to leave the country in droves.[104] Such scare mongering seems both perennial and implausible, and, as Richard Wilkinson and Kate Pickett observe, we should not 'allow ourselves to be cowed by the idea that higher taxes on the rich will lead to their mass emigration and economic catastrophe. We know that more egalitarian countries live well, with high living standards and much better social environments.'[105]

2. *Situated Wealthy*

Once issues of exit and exile from the community are dealt with, mobility is not in itself a significant concern. Almost everyone has, at a particular point in time, a place they think of as home, often expressed in the passport they hold,[106] and, rather than technical rules about days spent in a place, that allegiance is likely to provide a reliable indicator of tax nexus to a particular taxing jurisdiction. Political communities invariably have a physical locus and so extraterritoriality – floating above the situated community but taking its benefits – cannot be sanctioned. Zygmunt Bauman cautions that it is 'the progressive breakdown in communication' between elites within countries and the rest that really matters.[107] The increasing cosmopolitanism of major cities indubitably challenges sentiments of commonality and community,[108] but it is inequality, disproportionate political power at the disposal of the wealthy, and the increasingly different ontologies of those at the opposite margins of society that tear at the fabric of the political community. In short, the very rich may be 'different from you and me',[109] and may require special attention if they are to be fully included in the tax community.

C. *Specific Policy Responses*

In order to optimise tax policy and law in promoting equality, government should, first, strictly enforce existing tax laws, particularly general avoidance and anti-evasion provisions, and optimise international cooperation to eliminate tax havens. Individual revenue services have achieved significant successes in combating evasion and avoidance schemes,[110] but, despite cooperative measures to share information,[111] James Henry of the

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103 These facts were highlighted when Jagger was revealed to have been one of the many wealthy Britons whose private residencies were owned by offshore companies, an arrangement that had the effect of avoiding substantial stamp duty. See Nicholas Hellen, 'UK Chancellery to Clamp Down on Properties Held in Offshore Companies', *The Australian* (online), 18 March 2012 <http://www.theaustralian.com.au/news/world/uk-chancellery-to-clamp-down-on-properties-held-in-offshore-companies/story-fnb64oi6-1226303010710>.

104 Morgan and Guthrie, above n 45, 69.

105 Wilkinson and Pickett, above n 66, 269.

106 Blake, above n 93, 73 observes that 'the Stones drifted across the globe, cocooned by fame, drugs and flattery', but they still carried British passports. Taxation based on citizenship, as practised in the United States, presents itself as a sensible policy choice.

107 Zygmunt Bauman, *Globalization: the Human Consequences* (Columbia University Press, 1998) 3.

108 For a discussion of the distinction between the *demos*, with its common political goals, and the globalised *cosmopolis*, see Daniele Archibugi, 'Demos and Cosmopolis' (2002) 13 *New Left Review* 24, 24-38.

109 F Scott Fitzgerald wrote: 'Let me tell you about the very rich. They are different from you and me.' See F Scott Fitzgerald, 'The Rich Boy' in *The Short Stories of F. Scott Fitzgerald, Volume 1: The Diamond as Big as the Ritz and Other Stories* (first published 1926, Penguin, 1980 ed) 139, 139.

110 See, for example, Australian Tax Office, *Project Wickenby* (2012) <http://www.ato.gov.au/corporate/content.aspx?doc=/content/00220075.htm&alias=wickenby>. But see Rob O'Neill, 'Aussie Taxman Targets NZ Trusts', *Sunday Star-Times* (New Zealand), 20 May 2012, D5 on how a lack of co-ordination between Australian and New Zealand law has allowed New Zealand to become a tax haven for certain wealthy Australians.

111 For a summary of measures adopted by the OECD, see OECD, *The Global Forum on Transparency and Exchange of Information for Tax Purposes* (2012) <http://wwww.oecd.org/ctp/harmfultaxpractices/43757434.pdf>.

Tax Justice Network concludes that between US$21 and 32 trillion remains invested 'virtually tax-free' in offshore centres.[112] Second, existing taxes may be made fairer by closing loopholes, removing concessions and raising marginal rates.[113] Third, changes may be made to the mix of taxes within the overall tax system, for example, placing greater reliance on progressive income tax, rather than regressive goods and services tax (GST). Fourth, new taxes, notably on wealth or capital transfers might be introduced.[114] Finally, radical shifts in taxation could be considered.

Before considering radical alternatives, the issue of higher marginal income tax rates deserves comment. Gurría notes '[t]ax rates on high earners have declined in recent years, so raising marginal tax rates on high incomes would help restore fairness and generate some extra revenue as well'.[115] The highest rate of marginal tax may have symbolic value,[116] but is not necessarily indicative of tax actually paid. A tax base without loopholes and concessions may be more effective in promoting equality than a porous base coupled with high nominal rates.[117] Furthermore, conventional arguments against high marginal rates on the grounds of behavioural responses may be adduced.[118] Hence the increasing interest in minimum income tax rates for those with high incomes,[119] and asset taxes.[120]

Alan Carter and Stephen Matthews argue that 'the most growth-friendly approach would be to reduce tax-induced distortions that harm growth … raising more revenues from recurrent taxes on residential property … while setting taxes to reduce environmental damage and correct other externalities'.[121] This proposal signals a move from taxing people's activities (income earning and consumption) to taxing the things in the community that people own. Intimating a still more radical shift in policy from taxing individual effort and enterprise (income tax) to property (capital taxes),[122] Morgan and Guthrie propose taxing capital itself – land, buildings, plant and equipment and so forth, 'given how easy the income generated by capital can be hidden and shifted offshore'.[123] This proposal is squarely in the communitarian field and echoes earlier progressivism that privileged the community over the individual. As commentators have observed, in *Progress and Poverty*,[124] Henry George, 'a great progressive of the late nineteenth century',[125] argued for a single land tax on 'unearned increment' because 'the value of the

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112 James S Henry, *The Price of Offshore Revisited: New Estimates for "Missing" Global Private Wealth, Income, Inequality and Lost Taxes* (Tax Justice Network, 2012) 5. Henry critically notes that funds held secretly offshore are 'large enough to have a major impact on estimates of inequality of wealth and income'. Ibid.

113 Gurría, above n 61, 3.

114 See, for example, Commonwealth of Australia, *Australia's Future Tax System: Report to the Treasurer* (2010) ('Henry Report') vol 1, [A3] on a potential bequests tax.

115 Gurría, above n 61, 3.

116 Cf Jean-Jacques Rousseau's preference for taxing conspicuous luxury goods: see Jean-Jacques Rousseau, 'A Discourse on Political Economy' in *The Social Contract and Discourses* (G D H Cole, trans, J M Dent, 1992) 128, 166 [trans of: *Du Contrat Social* et al (first published 1762)].

117 See Galbraith, above n 57, 76-7.

118 See, for example, Stiglitz, above n 76, 477.

119 For example, Nick Clegg, the United Kingdom Deputy Prime Minister, has proposed a minimum 'tycoon tax rate' of between 20 and 30 per cent. This would be a trade off for a reduction in the current marginal income tax rate of 50 per cent, which many high income earners do not pay. See Robert Winnett and James Kirkup, 'Nick Clegg Goes after the Ultra-Rich', *The Telegraph* (online), 10 March 2012 <http://www.telegraph.co.uk/news/politics/nick-clegg/9135243/Nick-Clegg-goes-after-the-ultra-rich.html>.

120 See Morgan and Guthrie, above n 45, 183.

121 Carter and Matthews, above n 61.

122 Cf Richard W Lindholm, 'Twenty-One Land Value Taxation Questions and Answers' (1972) 31(2) *American Journal of Economics and Sociology* 153, 153 who argues that a land value tax would shift the tax burden from 'individual effort' to the surplus 'value created by society' inherent in land value.

123 Morgan and Guthrie, above n 45, 139.

124 See generally, Henry George, *Progress and Poverty* (first published 1879, Hogarth Press, 1953 ed).

125 Joseph E Stiglitz, 'Principles and Guidelines for Deficit Reduction' (Working Paper No 6, The Roosevelt Institute, 2010) 5.

land is determined by community rather than individual efforts'.[126] Any 'increase in land values would be due to increased productivity which was closely related to increases in population and wealth. The rental income gave land its value and as such could be collected in taxes without decreasing incentives for efficient production.'[127]

D. *Radical Responses*

By putting the community first, communitarian thought allows us to think beyond the self (our immediate material ambitions and, indeed, longevity) and to consider our actions, both individual and collective, in the longer term context of those community members who came before and those who will come after us. Contemplating the philosophy of Baruch Spinoza, Bertrand Russell observed '[t]he wise man, so far as human finitude allows, endeavours to see the world … under the aspect of eternity'.[128] No conception of the longest term can ignore the environment in which people and communities exist, and certainly, it seems likely that individual accumulation of wealth would not be privileged in that perspective.[129] A consideration of what really matters for the community, is likely to generate radical responses: for example, based on G K Chesterton's idea of Distributism, MacIntyre proposes an alternative economic system, which links virtue to contemporary society, by repudiating 'usury, communism and capitalism in equal measure for an economy based on guilds, specialist associations, self-sufficiency and barter'.[130] This proposal indicates the irrelevance of economic growth to many communitarians.

'Growth is a substitute for equality of income. So long as there is growth there is hope, and that makes large income differentials tolerable.'[131] That hope appears to have dissipated for many people. One of the most commonly encountered arguments against heavily taxing the very wealth is that a country's economic growth will be negatively affected.[132] However, empirical evidence indicates that there is no straightforward connection between high growth and low tax rates.[133] Furthermore, equality and growth are not mutually exclusive policy goals that must balanced against each other.[134] '[G]reater equality makes growth much less necessary',[135] but economic growth is not the most important community goal. Thus Martha Nussbaum observes, the political community 'is held together by a wide range of attachments and concerns, only some of which concern productivity. Productivity is necessary, and even good; but it is not the main end of social life.'[136] Others go further and argue that we need 'a historical shift in the sources of human

126 Richard F Dye and Richard W England, 'The Principles and Promises of Land Value Taxation' in Richard F Dye and Richard W England (eds), *Land Value Taxation: Theory, Evidence, and Practice* (Lincoln Land Institute of Land Policy, 2009) 1, 4.

127 William J McCluskey and Riël C D Franzsen, *Land Value Taxation: An Applied Analysis* (Ashgate, 2005) 3.

128 Bertrand Russell, *History of Western Philosophy and Its Connection with Political and Social Circumstances from the Earliest Times to the Present* (Routledge, 2nd ed, 1961) 556.

129 Cf the death bed test for how one would wish to have spent one's life that Daniel Bell employs in Daniel A Bell, *Communitarianism and Its Critics* (Clarendon Press, 1993) 188.

130 See John Cornwell, 'MacIntyre on Money' (2010) 176 *Prospect* 58, 61.

131 Henry Wallich, former governor of the Federal Reserve, quoted by Wilkinson and Pickett, above n 66, 226.

132 Walzer, above n 1, 120 observes, 'if the constraints and limits are too severe, productivity may fall, and then there will be less room for the social recognition of needs. But at some level of taxation … the political community can't be said to invade the sphere of money; it merely claims its own.'

133 See Eric Toder and Daniel Baneman, 'Distributional Effects of Individual Income Tax Expenditures: An Update' (Urban-Brookings Tax Policy Center, 2012) <http://www.taxpolicycenter.org/UploadedPDF/412495-Distribution-of-Tax-Expenditures.pdf>; Emmanuel Saez, Joel B Slemrod, Seth H Giertz, 'The Elasticity of Taxable Income with respect to Marginal Tax Rates: A Critical Review' (NBER Working Paper 15012, National Bureau of Economic Research, 2009) <http://www.nber.org/papers/w15012>.

134 Joseph E Stiglitz, *Globalization and Its Discontents* (Allen Lane, 2002) 79.

135 See Wilkinson and Pickett, above n 66, 221.

136 Martha C Nussbaum, *Frontiers of Justice: Disability, Nationality, Species Membership* (The Belknap Press of Harvard University Press, 2006) 160.

satisfaction from economic growth to a more sociable society'.[137] For Tim Jackson, 'prosperity has to do with our ability to flourish: physically, psychologically and socially',[138] and the New Zealand Treasury, long a bastion of neoliberal economics,[139] has recently argued that happiness, rather than gross domestic product, is a more appropriate measure of national prosperity.[140] Following Richard Layard, above a certain level of wealth, happiness is determined by factors other than material wealth,[141] and 'prosperity hangs on our ability to participate meaningfully in the life of society'.[142]

V. CONCLUSION

This article has presented arguments for the potential role of communitarian tax policy in combating inequality and its deleterious impacts on individuals and society. A community of taxation and justice would manifest fairer outcomes and higher levels of mutual trust than contemporary neoliberal-informed societies. Increased trust in society benefits everyone, rich and poor alike. Greater equality may be compatible with economic growth, but thinking about what really matters for the community in the long-term is likely to lead to increased concerns for sustainability. Tax policy should therefore be oriented to sustaining the environment in which community members live, and promoting real prosperity, not short-term economic growth and the accumulation of individual wealth.

137 Wilkinson and Pickett, above n 66, 231.

138 Tim Jackson, *Prosperity without Growth? The Transition to a Sustainable Economy*. Sustainable Development Commission (2009) 86 <http://www.sd-commission.org.uk/data/files/publications/prosperity_without_growth_report.pdf>.

139 See generally, Malcolm McKinnon, *Treasury: The New Zealand Treasury 1840 – 2000* (Auckland University Press, 2003).

140 See Ben Gleisner, Mary Llewellyn-Fowler and Fiona McAlister, *Working Towards Higher Living Standards for New Zealanders* (New Zealand Treasury, 2011).

141 Richard Layard, *Happiness: Lessons from a New Science* (Penguin, 2005). Layard may be read as reconfiguring marginal utility theory, but he also intimates a concern for the community within which individual happiness may be realised.

142 Jackson, above n 138, 86.

LONG SERVICE LEAVE IN AUSTRALIA
AN EXAMINATION OF THE OPTIONS FOR A NATIONAL LONG SERVICE LEAVE MINIMUM STANDARD

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ABSTRACT

Long service leave is an employment condition that provides paid leave to employees who serve an employer over a long period of time without a break in service. A common feature of long service leave is continuous service with an employer, which then entitles an employee to paid leave as a reward for their service. This means that in most jurisdictions the leave is generally not portable and is lost when transferring between employers. This paper will explore the long service leave entitlements for national system employees that currently exist in state and territory long service leave legislation in Australia and in selected key pre-reform instruments that have broad application in the various jurisdictions. The paper will not examine the situation relating to non-national system employees. In particular, it will not discuss the non-national system employees in Western Australia as a result of the Western Australian government not referring the relevant powers to the Commonwealth government. The current long service leave entitlements vary in Australia because there are eight legislative frameworks relating to long service leave operating across the various states and territories. This makes the existing long service leave provisions in Australia highly complex and prescriptive for non-lawyers such as employers and employees. This paper will contend that a nationally consistent long service leave minimum standard would be a desirable outcome in Australia as it will ensure that all employees are rewarded for long term service with an employer and will provide employees with a paid break from work while maintaining job tenure. The various options for the national standard are examined in detail within the current long service leave environment.

I. INTRODUCTION

Long service leave is an employment condition that provides paid leave to employees who serve an employer over a long period of time without a break in service.[1] A common feature of long service leave is continuous service with an employer, which then entitles an employee to paid leave as a reward for their service.[2] This means that in most jurisdictions the leave is generally not portable and is lost when transferring between employers.[3] Long service leave is recognised in all Australian jurisdictions through relevant state or territory legislation that outlines the entitlement. In addition to the legislation, some employers or industries provide long service leave benefits to their employees through private agreements or specific statutes.[4]

This paper will explore the long service leave entitlements that currently exist in state and territory long service leave legislation in Australia and in selected key pre-reform

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1 K R Handley and V Watson, 'Australian Long Service Leave Legislation' (1960) 3(2) *Sydney Law Review* 260; *Kennedy v Board of Fire Commissioners* (1967) AR 455.

2 B Creighton and A Stewart, *Labour Law: An Introduction* (The Federation Press, 3rd ed, 2000) 259.

3 Ibid. Note that continuous service is not lost through a transmission of business transaction as held in Cf *Crosilla v Challenge Property Services* (1982) 2 IR 448.

4 Creighton and Stewart, above n 2, 258.

instruments[5] that have broad application in the various jurisdictions. The paper will not examine the situation relating to non-national system employees. In particular, it will not discuss the non-national system employees in Western Australia as a result of the Western Australian government not referring the relevant powers to the Commonwealth government. The current long service leave entitlements vary in Australia because there are eight legislative frameworks relating to long service leave operating across the various states and territories.[6] This makes the existing long service leave provisions in Australia highly complex and prescriptive for non-lawyers such as employers and employees. For example, the qualifying period can range from 7 years[7] to 15[8] years; the accrual rates differ and the actual amount of long service leave paid to an employee ranges from approximately 8 weeks to 13 weeks paid leave after 10 years' service. The main focus of the paper is to find a way to ensure the equitable application of long service leave provisions across states for organisations operating in those states and employees working within those organisations.

The *Fair Work Act 2009* (Cth) ('*Fair Work Act')* contains a commitment to develop a nationally consistent long service leave entitlement as part of the National Employment Standards and provides a safety net for employees.[9] The *Fair Work Act* currently contains a transitional long service leave National Employment Standard.[10] Moreover, a uniform national long service leave standard is currently a topic of discussion between the Commonwealth and state and territory governments.[11] However, to date there is no uniform standard across all jurisdictions. It is contended that a national minimum standard would provide a safety net for employees and, with correct legal drafting in the *Fair Work Act*, the states and territories could supplement employee long service leave entitlements across jurisdictions. This would provide greater flexibility for employers and employees given the fact that the growth in full-time casual employment is becoming the norm in Australia.[12]

The following passage by Senior Deputy President Lacy of the Australian Industrial Relations Commission outlines the rationale for long service leave in Australia:

> …the entitlement to long service leave generally originated in the colonial service administration of the colonies of South Australia and Victoria. It gained statutory recognition throughout the several States of Australia commencing with New South Wales in 1951. Since that time there has been little change to the structure of long service leave. It is generally regarded now as an opportunity for an employee to take some respite from a long period of service in the one business.[13]

Australia's standard long service leave entitlement regime has its origins in a 1964 decision of the then Commonwealth Conciliation and Arbitration Commission.[14] This decision took place after NSW legislation provided three months long service leave at full pay after 15 years of service in 1964.[15] The first arbitrated federal long service leave award provided 13 weeks leave after 15 years service, with pro rata payment in lieu of

5 Instruments mean an award, an enterprise agreement, a public sector industrial agreement, a former industrial agreement, a contract determination or a contract agreement.
6 Rohan Price, *Employment Law in Principle* (Thomson Reuters, 3rd ed, 2009) 205.
7 *Long Service Leave Act 1976* (ACT).
8 *Long Service Leave Act 1976* (Tas) s 8(2)(a)(i).
9 Explanatory Memorandum, Fair Work Bill 2008 (Cth) 39.
10 *Fair Work Act 2009* (Cth) ss 113, 113A.
11 Anthony Forsyth et al, *Navigating the Fair Work Laws* (Thomson Reuters, 2010) 51.
12 Creighton and Stewart, above n 2, 259.
13 *Re. Office of the Chief Electrical Inspector Enterprise Agreement 2003* (AIRC) PR942414 (5 January 2004) para 8.
14 Department of Parliamentary Services (Cth), *Bills Digest*, No. 38 of 2009–10, 15 October 2009.
15 Symposium, State Systems of Industrial Relations: Greg Patmore, 'Setting the pace - The NSW jurisdiction before 1981' (19 September 2005) *Australian Review of Public Affairs*, University of Sydney. <http://www.australianreview.net/digest/2005/09/patmore.html>

termination after 10 years service in the metal trades and graphic arts.[16] New South Wales (NSW),[17] Queensland (Qld) and South Australia (SA),[18] the Australian Capital Territory (ACT),[19] and the Northern Territory (NT)[20] have since adopted qualifying periods of 10 years or less. At a federal level, the *Fair Work Act* currently preserves state and territory legislation for national system[21] employees.[22]

The existing long service leave provisions in Australia are complex and highly prescriptive, differing considerably in operation and level of entitlement across jurisdictions.[23] Differing state or territory long service leave provisions within one organisation that operates across jurisdictions can lead to inequities between employees.[24] A new long service leave National Employment Standard could alleviate confusion, inequity and administrative complexities for employers and employees because there would be a single system in place, rather than many.[25]

In Australia, long service leave is primarily regulated at a state and territory level, either through legislation or state awards.[26] Long service leave is an entitlement that is fairly unique to Australia, although there are other countries that reward continuity of service.[27] In Greece and Britain there is a link between continuity of service and the length of annual leave.[28] In Canada, some provinces have legislated for extended annual leave after set periods of continuous service. New Zealand has long service leave provisions in some employment contracts but the required length of service is generally longer and the entitlement is typically shorter than in Australia.[29]

This paper will contend that the introduction of a national long service leave minimum standard would be an appropriate outcome in Australia. An analysis of the *Fair Work Act* and the current long service leave frameworks in Australia at both the federal level and the state and territory level will provide a solid basis for determining how a national long service leave minimum standard should be developed. The paper will also consider the legal issues arising in developing a national standard for long service leave, including the referral of workplace relations powers to the Commonwealth; the potential amendments of the *Fair Work Act* and state and territory long service leave legislation; and any constitutional issues surrounding the options for developing a nationally consistent long service leave framework in Australia. This will be followed with an examination of the various options for the development of a nationally consistent long service leave framework in Australia, including an analysis of other national systems that have been either attempted or successfully introduced. In conclusion, this paper will recommend the best model for a national long service leave minimum standard.

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16 Ibid.

17 *Long Service Leave Act 1955* (NSW) s 4.

18 *Long Service Leave Act 1987* (SA) s 5.

19 *Long Service Leave Act 1976* (ACT) s 3.

20 *Long Service Leave Act 1981* (NT) s 8.

21 *Fair Work Act 2009* (Cth) s 13 provides that 'a national system employee is an individual so far as he or she is employed, or usually employed, as described in the definition of national system employer in s 14.

22 Department of Parliamentary Services (Cth), *Bills Digest*, No. 38 of 2009–10, 15 October 2009.

23 Forsyth et al, above n 11, 51.

24 I O'Donovan, *'How Secure Are Employees' Rights to Long Service Leave?' (1977) 8(2)* Sydney Law Review *429, 458.*

25 Ibid 437.

26 Explanatory Memorandum, Fair Work Bill 2008 (Cth), 73. Note: entitlements to long service leave under a pre-reform award became legislative entitlements on 1 January 2010.

27 John Burgess, Anne Sullivan and Glenda Strachan, 'Long service leave in Australia: rationale, application and policy issues' (2002) 13 *Labour and Industry* 21, 38.

28 Ibid.

29 Commonwealth, 'Flexibility in Long Service Leave' (Research paper, the Labour Ministers Council, May 1999).

II. THE LONG SERVICE LEAVE FRAMEWORK IN AUSTRALIAN JURISDICTIONS

Prior to examining the various options for a long service leave national standard, it is important to first demonstrate the different treatment of long service leave among the states and territories.

A. *The Operation of the Fair Work Act 2009*

The industrial relations laws in Australia have undergone significant change over the past six years with the introduction of the *Workplace Relations Amendment (Work Choices) Act* 2005 (Cth) being arguably the most significant.[30] The Work Choices amendments of 2005 rewrote the *Workplace Relations Act* 1996 (Cth), which had been substantially unchanged since 1996.[31] A key change in this legislation was the way agreements were made in the workplace. Work Choices moved away from collective bargaining arrangements and towards individual bargaining arrangements through the use of Australian Workplace Agreements.[32] In addition, Work Choices set minimum employment conditions for employees nationally.[33] To honour its election promise, the incoming Labor Government replaced the Work Choices legislation with the *Fair Work Act 2009* (Cth) in 2009.[34]

The *Fair Work Act* outlines the transitional entitlement to long service leave for employees who had certain long service leave entitlements before 1 January 2010. The transitional arrangements were put in place pending the development of a uniform national long service leave standard. The *Fair Work Act* amended many of the provisions contained in the Work Choices legislation.[35] The key changes were the transition to a national industrial relations system with the exclusion of state laws. Other key inclusions were the establishment of a safety net of 10 National Employment Standards, the implementation of modern awards, new dispute resolution procedures, and new unfair dismissal rules.[36] The National Employment Standards set out the minimum employment conditions in Australian workplaces. The current National Employment Standard relating to long service leave preserves long service leave entitlements in pre-modernised awards from 1 January 2010.[37] Prior to the introduction of modern awards, pre-modern awards covered terms and conditions of employment. These included pre-reform (federal) awards, notional agreements preserving state awards, and state reference transitional awards.[38] An employee's entitlement to long service leave in a pre- reform award[39] might apply rather than the state and territory legislation because it contains a more beneficial long service leave provision.[40] If an employee did not have applicable award-derived long service leave term, any entitlement to long service leave was derived from state or territory long service leave legislation.[41]

30 Forsyth et al, above n 11, 3.
31 Ibid 5.
32 Ibid.
33 *Workplace Relations Amendment (Work Choices) Act 2005* (Cth) s 3.
34 *Fair Work Act 2009* (Cth) s 2.
35 Forsyth et al, above n 11, 5.
36 Ibid.
37 Peta Tumpey, 'Government releases new National Employment Standards' (August 2008) 60(7) *Keeping Good Companies,* 424-7.
38 Fair Work Australia, *Pre-modern awards* (11 January 2011) < http://www.fairwork.gov.au/awards/pre-modern-awards/pages/default.aspx>. Note: Pre-modern awards do not include transitional (federal) awards in Western Australia, Division 2B State awards and enterprise awards; Fair Work Ombudsman , *Long Service Leave* (25 October 2010)<http://www.fairwork.gov.au/leave/long-service-leave/pages/default.aspx>.
39 Explanatory Memorandum, Fair Work Bill 2008 (Cth) 73.
40 *Fair Work Act 2009* (Cth) s 29 and Forsyth et al, above n 11, 51; and *Fair Work Act 2009* (Cth) s 113.
41 Price, above n 6*,* 205.

The *Fair Work Act* does not exclude state and territory laws that deal with long service leave, except in relation to employees who are entitled to long service leave under the *Fair Work Act*.[42] The Act also states that state and territory laws that deal with long service leave prevail over an award or agreement,[43] noting that there are eight legislative frameworks operating across the various states and territories relating to long service leave.[44] The Act also prohibits a modern award from including terms dealing with long service leave.[45]

B. *The Long Service Leave Framework in Australia*

There are a number of long service leave entitlements that currently exist in state and territory long service leave legislation in Australia and in selected key pre-reform instruments that have broad application in the various jurisdictions.[46] The following analysis of the current framework in the states and territories will assist in the proposed development of a nationally consistent long service leave framework in Australia. There are eight legislative frameworks operating across the various states and territories relating to long service leave.[47] These frameworks are contained in the relevant legislation as follows:

Long Service Leave Act 1958	(Western Australia)
Long Service Leave Act 1955	(New South Wales)
Long Service Leave Act 1992	(Victoria)
Long Service Leave Act 1987	(South Australia)
Industrial Relations Act 1999	(Queensland)
Long Service Leave Act 1981	(Northern Territory)
Long Service Leave Act 1976	(Australian Capital Territory)
Long Service Leave Act 1976	(Tasmania)

It is important to conduct an analysis of the core attributes of long service leave across jurisdictions in order to ascertain the differences between the long service leave entitlements across the states and territories. This analysis will reinforce the recommendations within this paper and support the argument that a national long service leave framework is needed for Australian employees.

Not only do the states and territories have different legislative long service leave provisions, these can be exceeded in awards and agreements.[48] Providing a uniform national standard for long service leave provides a number of challenges as any standardisation may result in an improvement in long service leave conditions for some employees but not for others, depending on the jurisdiction. For example, applying the lowest qualifying period and the highest accrual rate across-the-board would mean an increase in the long service leave entitlement for employees in some jurisdictions, whereas, employees in jurisdictions that already have the lowest qualifying period and the highest accrual rates would receive no additional benefit. This is a controversial issue for employers and employees as unions do not want to see a reduction in long service leave entitlements [49]and employers do not want to see an increase in long service leave entitlements which will give rise to additional costs.[50] A key challenge in standardising

42 *St Marys Rugby League Club Ltd* [2010] FWA 8300 (12 November 2010).
43 *Fair Work Act 2009* (Cth) s 29.
44 *The Australian Road Transport Industrial Organisation (ARTIO),* Road Transport (Long Distance Operations) 2010 (LDO Award): Modern Award Handbook *(2010)* <http://www.artio.org.au/index.php?option=com_content&view=article&id=42&Itemid=68>.
45 *Fair Work Act 2009* (Cth) s 155.
46 Forsyth et al, above n 11, 51.
47 Price, above n 6, 205.
48 Forsyth et al, above n 11, 51.
49 Interview with Kim Sattler, Secretary, Unions ACT (Canberra, 16 August 2011).
50 C Grealy, URBIS, 'Portable long service leave for the ACT community services sector' (Research Discussion Paper, Department for Disability, Housing and Community Services ACT, March 2009) 8.

long service leave is that state and territory long service leave laws not only provide for different amounts of leave and qualifying periods, but also a range of entitlements relating to termination of employment and other matters, such as the cashing out of leave.

Tasmania has the longest qualifying period of 15 years,[51] whereas the ACT has the shortest qualifying period of 7 years, pro-rata basis.[52] As is shown from the comparison below, all other states and territories provide a long service leave qualifying period of 10 years. Data obtained from the Australian Bureau of Statistics ('ABS') relating to qualifying periods and accrual of long service leave is discussed in the next section of this paper.

An accrual rate of 1.3 weeks per annum can be applied to employees in SA[53] and NT[54] and mining employees in Tasmania.[55] The other states and territories provide an accrual rate of 0.86667 weeks per annum. All employees in each of the states and territories are entitled to subsequent long service leave after the initial entitlement. All subsequent entitlements to long service leave have an accrual rate identical to that of the initial entitlement. Employees in SA[56] and the ACT[57] are entitled to subsequent long service leave on a yearly basis, whereas employees in Tasmania are entitled to subsequent long service leave on a 10 year interval.[58] The other states and territories provide subsequent long service leave in 5 year intervals.

All employees are also entitled to long service leave on a pro rata basis. All states and territories, except Victoria, have specified qualification criteria for pro rata entitlement to long service leave. Examples of qualification criteria for gaining the entitlement to pro rata long service leave are termination of employment for any reason other than serious misconduct; the death of the employee; or the termination of employment on account of illness, incapacity, domestic or other pressing necessity.[59] In NSW[60] and the ACT[61] access to pro rata entitlement to long service leave is after five years of continuous service and the other states and territories provide pro rata access after seven years of continuous service.

C. *Data Relating to Employees with an Entitlement to Long Service Leave*

The Australian Bureau of Statistics publishes regular data relating to 'Labour Mobility'[62] and 'Forms of Employment'.[63] The ABS reports that there were 11.4 million people working as at August 2012.[64] ABS data based on 'self report' show 62 per cent of employees, excluding owner managers of incorporated enterprises, report an entitlement to long service leave. This data strengthens the argument for a national long service leave framework given there are so many Australian employees reporting an entitlement to long service leave.

'Length of Service' data is provided in the most recent ABS 'Labour Mobility' survey.[65] There were 2.9 million people who were working as at February 2012 that had been with their current employer for 10 years or more. This represents 27 per cent of men

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This report found that employers concerns about changes to long service leave entitlements occur in areas such as expense to employers and increased administrative burden.

51 *Long Service Leave Act 1976* (Tas) s 8(2)(a)(i).
52 *Long Service Leave Act 1976* (ACT) s 3.
53 *Long Service Leave Act 1987* (SA) s 5.
54 *Long Service Leave Act 1981* (NT) s 8.
55 *Long Service Leave Act 1976* (Tas) s 8A(2)(a)(i).
56 *Long Service Leave Act 1987* (SA) s 5.
57 *Long Service Leave Act 1976* (ACT) s 3.
58 *Long Service Leave Act 1976* (Tas) s 8(2)(a)(ii).
59 Price, above n 6, 205.
60 *Long Service Leave Act 1955* (NSW), s 4 and Price, above n 6, 206.
61 *Long Service Leave Act 1976* (ACT), s 3.
62 Australian Bureau of Statistics, *ABS Labour Mobility (Cat. No.6202)* (August 2012).
63 Australian Bureau of Statistics, *ABS Forms of Employment (Cat. No.6359.0)* (November 2011).
64 ABS, *ABS Labour Mobility*, above n 62.
65 Ibid.

and 23 per cent of women who were working as at February 2012.[66] The industry groups with the highest proportion of people who had been with their current employer for 10 years or more were agriculture, forestry and fishing, 54 per cent; education and training, 35 per cent; public administration and safety, 34 per cent; and manufacturing, 30 per cent.[67]

These statistics show that 25 per cent of all employees, excluding owner managers of incorporated enterprises and owner managers and contributing family workers, have been with their current employer for 10 years or more. Ten years is the most common qualifying period for long service leave under state and territory legislation.

D. *Analysis of Instruments with Broad Application in the Jurisdictions*

As discussed earlier, employees may also have an entitlement to long service leave in a pre-modernised instrument such as pre-reform awards and agreements because a pre-modernised instrument may contain more beneficial long service leave provisions than those contained in state legislation.[68] This paper will analyse some key awards or agreements containing long service leave provisions that have broad application to a large number of employees within some of the jurisdictions. In formulating a national minimum long service leave standard, it is imperative that key awards and agreements are examined because of their broad application to employees across jurisdictions. The analysis below supports the argument that a national long service leave framework is needed for Australian employees. Long service leave entitlements in selected awards and agreements are discussed below to provide an overview of the common types of entitlements that are more beneficial to employees.

1. *New South Wales*

Long service leave applies to most NSW employees who are full-time, part-time or casual.[69]

Five state awards applying in NSW that contain long service leave provisions have been analysed.[70] They are the Aged Care General Services (State) Award, the Bread Industry (State) Award, the Broken Hill Commerce and Industry Agreement Consent Award, the Funeral Industries (State) Award and the Teachers (Independent Schools) (State) Award 2004. Some awards relied upon the *Long Service Leave Act 1955* (NSW), but others contained more generous entitlements than contained in the state legislation. With respect to the initial entitlement to long service leave, the NSW state legislation provides for two months long service leave (0.8667 weeks per annum) after 10 years service.[71] Two awards contained an entitlement to 13 weeks long service leave (1.3 weeks per annum) after 10 years. This was the highest accrual rate identified in NSW.

2. *Queensland*

Six state awards containing long service leave provisions in Queensland were examined.[72] Each of the awards relied upon the Queensland *Industrial Relations Act 1999* (Qld) for long service leave entitlement. Provisions in the legislation provide an initial entitlement to long service leave of two months long service leave (0.8667 weeks per annum) after 10 years service. Subsequent entitlement to long service leave under the state legislation is

66 Ibid.
67 Ibid.
68 Forsyth et al, above n 11, 51.
69 Price, above n 6, 206.
70 The Awards analysed are: Aged Care General Services (State) Award, Bread Industry (State) Award, Broken Hill Commerce and Industry Agreement Consent Award, Funeral Industries (State) Award, Teachers (Independent Schools) (State) Award 2004.
71 *Long Service Leave Act 1955* (NSW) s 4.
72 The awards analysed are: Building and Construction Industry Award – State 2003, Engineering Award – State 2002, Transport Distribution and Courier Industry Award – Southern Division 2003, Motor Vehicle Salespersons Award – State 2003, Anglican Community Services Commission Support Service and Personal Care Workers Certified Agreement – 2006, P&O Ports Limited Bulk Handling Agreement 2006.

four weeks after five years.[73] In Queensland, pro rata accessibility is available to employees after seven years.[74] Each of the awards analysed contained the provisions of the state legislation.

3. *Victoria*

Five state awards containing long service leave provisions were analysed from Victoria.[75] The majority of the awards relied upon the Victorian *Long Service Leave Act 1992* (Vic) or provided similar entitlements. However, the two awards that related to nurses contained differing qualifying provisions (as explained below) than those contained in the state legislation. With respect to the initial entitlement to long service leave, the state legislation provides for 13 weeks long service leave (1.3 weeks per annum) after 10 years service. Subsequent entitlement to long service leave under the state legislation is 45 calendar days for each additional five years. Pro rata accessibility is available to employees after seven years. Employees subject to the Nurses (Victorian Health Services) Award 2000 and the Nurses (Private Pathology Victoria) Award 2004, hold an initial entitlement to long service leave of six months and three months respectively after 15 years service. Subsequent entitlement to long service leave for these employees' is two months and one month respectively for each additional five years service.

3. *South Australia*

In South Australia, four state awards containing long service leave provisions were analysed for this thesis.[76] Each of the awards relied upon the *Long Service Leave Act 1987* (SA). With respect to the initial entitlement to long service leave, the state legislation provides for 13 weeks long service leave (1.3 weeks per annum) after 10 years service. Subsequent entitlement to long service leave under the state legislation is 1.3 weeks for each year of service. Pro rata accessibility is available to employees after seven years.

D. *Australian Portable Long Service Leave Schemes*

Another form of long service leave operating in Australia is referred to as a portable scheme. Portable long service leave allows an employee to accumulate their long service leave whilst working for different employers within an industry sector, and also across jurisdictions. [77]The accumulation of leave is therefore not limited to a single employer.[78] There are a number of industries in Australia that have developed portable long service leave schemes because it strengthens the capacity and sustainability of the sector. [79] This is particularly the case for the building and construction industry and all states and territories have schemes operating in this industry.[80] The ACT and Queensland have also extended portability of long service leave entitlements to the contract cleaning industry and the ACT

73 Price, above n 6, 206.

74 Ibid.

75 Nurses (Victorian Health Services) Award 2000, Victorian Independent Schools - Teachers - Award 1998, Nurses (Private Pathology Victoria) Award 2004, Food, Beverages and Tobacco Industry - Retail Dairies - Victoria - Award 2000, Victorian Electricity Industry (Mining & Energy Workers) Award 1998.

76 Coopers Brewery Limited Enterprise Agreement 2009, Utilities Management Pty Ltd Workplace Agreement 2008 (ETSA), University of Adelaide Enterprise Agreement 2010-2013, Drakes Supermarket Retail Agreement 2009.

77 *Long Service Leave (Portable Schemes) Act* 2009 (ACT). Pursuant to the Act, the 'Building and Construction Industry Long Service Leave Portable Scheme' allows eligible employees to work for different employers or as a subcontractor to accrue an entitlement within the scheme. This allows the worker to qualify for long service leave based on their recorded service with the Authority, rather than service from one employer. Employers are required to register with the Authority and declare wages and days worked for all employees via quarterly returns,

78 Chief Minister's Department (ACT), 'Towards a sustainable community services sector in the ACT' (Research paper, Community Sector Taskforce, March 2006) 39.

79 ACT Chief Minister Katy Gallagher, 'New scheme to strengthen community sector workforce' (Media Release, 10 September 2009).

80 Chief Minister's Department, above n 78, 39.

has a scheme for employees in the Community Services industry. The ACT government is the first Australian jurisdiction to implement a portable long service leave scheme to assist child care and community sector organisations.[81]

The ACT passed the legislation for a portable long service leave scheme in November 2009. The ACT Government noted that the scheme '…will strengthen the capacity and sustainability of the sector, and will also assist in developing more career options for community sector workers by facilitating movement between organisations and providing more variety in work with greater prospects for promotion'.[82] Further benefits of the scheme were identified as workforce retention and the protection of the basic entitlement of each worker to take long service leave.[83] The ACT government also found through their consultation process that there was strong support from unions and employees for the scheme.[84] The scheme was seen by these groups as an appropriate strengthening of employees' entitlements, supported by small to medium employers.[85]

The Australian Services Union argues that 'the advantage of a portable long service leave scheme is that where a worker decides to change jobs they might choose to stay within the sector rather than leaving for better wages and conditions in the public or private sector'.[86] High staff turnover rates and low unemployment rates raises concerns about retaining employees and portable long service leave provisions encourage employees to stay in a particular sector.[87]

It is uncertain how a national uniform long service leave provision might interact with portable long service leave schemes in each state or territory as there are many tensions associated with portability.[88] However, given the strength of the schemes currently in place, there is a strong argument to allow these schemes to continue to operate in the event that a national long service leave minimum standard was introduced. These schemes would, of course, need to ensure that the applicable legislation met the minimum national standard.

E. *The Commonwealth Long Service Leave Framework*

The Commonwealth public sector industry is a good example of how a well established long service leave scheme operates. The federal and state public sector industries have worked together as a whole over many years to establish employee benefits such as a portable long service leave scheme to create comprehensive long service leave entitlements that apply across the board to all public sector employees. For that reason, it makes a good model for a future national long service leave scheme as it makes the public sector industries competitive and gives them an advantage in the labour market.[89]

The *Long Service Leave (Commonwealth Employees) Act 1976* (Cth) provides an entitlement to long service leave for Australian public service employees.[90] The basic qualification for long service leave is that the employee has been continuously employed in qualifying service[91] for a period of service of at least 10 years.[92] An employee accrues

81 Chief Minister's Department, above n 78
82 Ibid.
83 Ibid**.**
84 Ibid**.**
85 Above n 78, 39.
86 Australian Government, Productivity Commission, 'Contribution of the Not-for-Profit Sector' (Research report, January 2010) 268.
87 Ibid.
88 Burgess, Sullivan and Strachan, above n 26, 34.
89 Sattler, above n 49**.**
90 *Long Service Leave (Commonwealth Employees) Act 1976* (Cth) s 5; Australian Public Service, *Foundations of Governance in the Australian Public Service* <http://www.apsc.gov.au/publications-and-media/current-publications/foundations-of-governance>.
91 Qualifying service is government service or recognised prior service in accordance with ss 11, 12, 14 of the *Long Service Leave (Commonwealth Employees) Act 1976* (Cth).
92 Ibid s 16(1).

three months long service leave after 10 years service and nine calendar days each year thereafter.[93] The continuity of service provisions under the Act allow for absences, or breaks in Commonwealth employment, for up to 12 months.[94] The Commonwealth's long service leave scheme is a portable scheme. It allows an employee to transfer from one Commonwealth agency to another without losing any entitlement to long service leave because the scheme recognises the Australian government as the employer, rather than an individual federal agency.[95] The legislation further accepts prior service from a range of other government authorities and non-Australian public service agencies, such as the public service of a territory, any service of a state, and members of the defence force.[96] The legislation also provides that Commonwealth agencies may recognise prior service with other bodies such as non-Australian public service authorities or state government agencies, other than for long service leave purposes consistent with the *Long Service Leave (Commonwealth Employees) Act 1976* (Cth).[97]

Essentially, the Commonwealth's long service leave framework is a generous and flexible scheme as it allows for portability of entitlements among individual agencies. A scheme such as this provides employees with stability and greater benefits in the workplace. The Commonwealth public service is a strong employer and is able to attract employees due to the employment benefits, terms and conditions it offers.[98]

III WHY A NATIONAL LONG SERVICE LEAVE MINIMUM STANDARD IS NEEDED

A nationally consistent long service leave minimum standard is a desirable outcome in Australia as it will ensure that all employees are rewarded for long term service with an employer and will provide employees with a paid break from work. Growth in non-standard forms of employment, such as casual, contract and other types of unstable employment is becoming the norm in Australia and is exceeding standard full-time employment.[99] While the casualisation of labour is an important issue in this discussion on long service leave, it is not intended to examine this feature in detail as it would greatly add to the length of this paper. However, it is an issue that warrants further examination. The greatest growth has been in casual jobs, which are defined as working by the hour or day and not attracting paid leave benefits.[100] The Australian Council of Trade Unions has found that approximately 40 per cent of the Australian workforce is employed in non-standard types of employment, which is the second highest rate of insecure workers of all OECD countries.[101]

The data supports the fact that employees are demanding flexible working arrangements from their employer in order to better balance their work and personal life.[102] Long service leave entitlements help employees to create a better work and life balance by rewarding employees with a break from work after long term service.[103] An entitlement to long service leave provides employers with the security of long term employees because

93 Ibid s 12.
94 Australian Public Service Commission, 'Long Service Leave' (Workplace Relations Advice 07 of 2009).
95 Burgess, Sullivan and Strachan, above n 27, 34.
96 *Long Service Leave (Commonwealth Employees) Act 1976* (Cth) s 11.
97 Ibid s 11 (2)(f).
98 Sattler, above n 49; Burgess, Sullivan and Strachan, above n 27, 34.
99 Mike Rafferty and Serena Yu, '*Shifting Risk - Work and Working Life in Australia' (Research paper, Workplace Research Centre, University of Sydney, September 2010).*
100 Australian Government, Fair Work Ombudsman, *Casual Employees* <http://www.fairwork.gov.au/employment/casual-employees/Pages/default.aspx>
101 Amy Corderoy, 'Job preservation a concern for nation of 'insecure' workers', *The Sydney Morning Herald* (Sydney), 28 September 2011, 6.
102 Creighton and Stewart, above n 2, 259; Burgess, Sullivan, and Strachan, above n 26, 35.
103 Sattler, above n 49.

employees are more likely to commit longer term.[104] An example of the benefit of long service leave to employees is for construction workers as they need a physical rest from their work and long service leave allows them to take a break.[105] Unions ACT argue that employers that offer long service leave entitlements to their employees are competitive in the labour market.[106] These factors strongly support the need for a national long service leave entitlement, which applies to employees in non-standard types of employment. Based on this evidence, it is argued that, without a national long service leave framework, there will be continued growth in non-standard employment types as employees are forced to work outside of industries with flexible work practices.

Flexible options for long service leave, including portable long service leave schemes, have been considered by Burgess et al,[107] who argue that a re-examination of long service leave is warranted in Australia. The need for more flexible options in long service leave is due to the growth in non-standard employment types.[108] It is argued that portable long service leave schemes operate well in industries where mobility within an industry is frequent, such as the construction and mining industries.[109] Burgess et al argue that long service leave entitlements need to be protected and that employers should encourage respite from work that is linked with other family friendly working arrangements.[110]

Casual employees are entitled to long service leave in most state and territory legislation. However, it should be noted that, in order for casuals to hold an entitlement to long service leave, certain conditions must be met, depending on the terms of the relevant legislation. Generally, casual employees are entitled to long service leave if they have completed the required years of 'continuous employment', for example 10 years service. Continuous employment means that the employee must have worked regularly for more than a certain number of hours, usually 32 hours, in each consecutive period of four weeks. A continuous period of service generally ends if the employment is broken by more than three months. However, the *Fair Work Act* does not mention casual or non-standard employment types when dealing with long service leave.[111]

The next part of the paper outlines the challenges associated with developing a national minimum long service leave standard; however, options for such a development are explored later in this paper.

IV. THE CHALLENGES OF DEVELOPING A NATIONAL LONG SERVICE LEAVE STANDARD

This part of the paper will examine the challenges facing the developing of a national long service leave standard and will argue that a nationally consistent long service leave minimum standard is a suitable outcome in Australia.

A. *Determining the Long Service Leave National Standard*

States and territories have different legislative long service leave provisions which can be exceeded in awards and agreements. Providing a uniform national standard for long service leave provides a number of challenges as any standardisation may result in an improvement in long service leave conditions for some employees but not for others, depending on the jurisdiction. For example, applying the lowest qualifying period and the highest accrual rate across-the-board would mean an increase in the long service leave entitlement for employees in the other jurisdictions, whereas employees in jurisdictions

104 Ibid.
105 Ibid.
106 Ibid.
107 Burgess, Sullivan and Strachan, above n 27, 35.
108 Ibid 25.
109 Ibid 34.
110 Ibid 35-7.
111 *Fair Work Act 2009* (Cth) s 113.

that already have the lowest qualifying period and the highest accrual rates would receive no additional benefit. This is an issue that poses a problem as it is unlikely that unions generally will want to see a reduction in long service leave entitlements and it is equally unlikely that employers will want to see an increase in long service leave entitlements due to the additional cost.[112] These are issues that will need consideration in formulating a recommendation for this paper.

Additionally, if such a model was adopted, there would be an increase in labour costs for employers in some jurisdictions. Conversely, adopting the more common provision in the other states and territories, ie three months after 10 years continuous service or equivalent, could mean a lowering of long service leave minimum entitlements for employees in some jurisdictions. The options for the development of a national long service leave framework are discussed in detail in Part VI.

B. *Relevant Fair Work Act 2009 Provisions*

The *Fair Work Act* prohibits a modern award from including terms dealing with long service leave because the current National Employment Standard provision preserves the effect of long service leave terms in pre-modernised awards from 1 January 2010. Section 113 of the *Fair Work Act* provides that if there are applicable award derived long service leave terms in relation to an employee, the employee is entitled to long service leave in accordance with those terms.[113]

To determine whether there are applicable award derived long service leave terms, it is necessary to consider the award that would have applied to the employee's current employment if the employee had been in that employment immediately before 1 January 2010.[114] The *Fair Work Act* does not exclude state and territory laws that deal with long service leave, except in relation to employees who are entitled to long service leave under the Act. The *Fair Work Act* also states that state and territory laws that deal with long service leave prevail over an award or agreement.[115]

C. *Commonality of Long Service Leave Entitlements in Legislation between Jurisdictions*

Currently, the standard period of service to qualify for long service leave is 10 years. The standard term of the entitlement is 13 weeks.[116] An analysis of the legislation applying in the state and territory legislation[117] has shown some threads of commonality across jurisdictions in long service leave entitlements. Although there are variations in the amount of entitlement provided to employees, common themes in long service leave arrangements across jurisdictions exist in topic areas such as:

- qualifying periods and access to pro-rata entitlement (for example, a 10 year qualifying period with a five year pro rata entitlement thereafter);
- quantum of entitlement to long service leave (for example, three months leave);
- pro-rata entitlement on termination;
- entitlement for casuals, apprentices and trainees, if applicable;
- what type of service counts for long service leave (for example, whether maternity leave counts as service for long service leave purposes);
- treatment on transmission of business (for example, whether the new company accepts the previous entitlement);

112 Sattler, above n 49.
113 Forsyth et al, above n 11, 51.
114 *Fair Work Act 2009* (Cth) s 113.
115 *Fair Work Act 2009* (Cth) s 113.
116 Burgess, Sullivan and Strachan, above n 27, 23.
117 *Long Service Leave Act 1958* (WA), *Long Service Leave Act 1955* (NSW), *Long Service Leave Act 1992* (Vic), *Long Service Leave Act 1987* (SA), *Industrial Relations Act 1999* (Qld), *Long Service Leave Act 1981* (NT), *Long Service Leave Act 1976* (ACT), *Long Service Leave Act 1976* (Tas).

- rate of payment during long service leave (for example, full pay at the employee's current salary, or an average over the past 10 years);
- method of payment during long service leave (for example, on a weekly basis or an upfront payment);
- taking of long service leave in advance (for example, prior to the qualifying period of 10 years);
- treatment of public holidays during periods of long service leave (for example, whether the public holiday is deducted from the long service leave balance);
- undertaking employment during long service leave; and
- record keeping and penalties.

Building on these commonalities it would then be possible to add in the minimum or negotiated standards in areas such as qualifying periods, pro-rata entitlement and the amount of entitlement to leave. These common entitlements to long service leave could then be standardised across the various schemes and be narrowed to form the basis of a minimum national standard. Table 1 outlines the areas of commonality across Australian jurisdictions with respect to long service leave.

Table 1: Areas of commonality in state and territory legislation

Long service leave entitlement	Areas of commonality (state and territory legislation)
Qualifying periods and pro-rata entitlement	The qualifying periods of long service leave vary between jurisdictions. The range is between 7 years and 15 years. However, 5 states contain provisions for a 10 year qualifying period. The most common pro rata entitlement period is after 7 years. All jurisdictions have a 7 year pro rata entitlement except NSW and the ACT where employees are entitled to pro rata entitlement after 5 years. The pro rata entitlement periods range from 5 years to 7 years.
Quantum of initial entitlement	Quantum of entitlement varies greatly between jurisdictions, although the most common entitlement is 13 weeks after 10 years. The minimum amount of initial entitlement is 6.07 weeks and the maximum is 13 weeks.
Quantum of subsequent entitlement	Quantum of entitlement varies greatly between jurisdictions. The minimum amount of initial entitlement is 4 weeks after a further 5 years and the maximum is 8 weeks.
Pro-rata entitlement on termination	The most common clause relating to pro rata entitlement upon termination only applies if the employee dies or the employment is terminated due to illness or incapacity and does not generally include termination for serious misconduct.
Entitlement for casuals, apprentices and trainees	Casuals, apprentices and trainees are entitled to long service leave in all jurisdictions provided they meet the service requirements.
What type of service counts for long service leave purposes	Continuous service is generally accepted in all jurisdictions to be all periods of paid leave and some unpaid leave types. Most jurisdictions did not allow industrial disputes to count as service, other clauses varied.
Treatment on transmission of business	In all jurisdictions, transmission of business did not interrupt continuity of service.

Long service leave entitlement	Areas of commonality (state and territory legislation)
Capacity to contract out	Some jurisdictions allowed for an employee to forgo their entitlement to long service leave if the agreement is in writing, and it usually would only occur at the termination of the employment relationship.
Rate of payment during long service leave	In general, employees are paid at their normal weekly rate of pay, excluding overtime and allowances.
Method of payment during long service leave	Many jurisdictions allowed for payment to be made to an employee in advance. Alternatively, the leave would be paid as though it was ordinary pay.
Taking of long service leave in advance	Some jurisdictions allowed an employee to take their long service leave before the entitlement crystallizes but, other jurisdictions were silent.
Treatment of public holidays during periods of long service leave	Most jurisdictions excluded public holidays during a period of long service leave.
Undertaking employment during long service leave	Not allowable in all jurisdictions.
Records and penalties	The most common period for keeping records was 7 years. The period varied between jurisdictions and ranges from 3 years to 7 years.

From this analysis it is clear that, although there is commonality of topic, however, the difference in treatment across jurisdictions requires the standardisation of entitlement to long service leave. This is evident from the simple topic of qualifying periods whereby the qualifying periods of long service leave varies between 7 years and 15 years between jurisdictions. To establish a standard qualifying period of 10 years for all employees would be beneficial because it would bring parity to Australian employee long service leave entitlements. The Commonwealth public sector industry is a good example of how a well established long service leave scheme operates. Because the federal and state public sector industries have worked together to establish employee benefits it gives them a competitive edge and places them in an advantageous position in the labour market because long service leave is an important employee entitlement.[118]

V. LEGAL ISSUES IN DEVELOPING A NATIONAL STANDARD FOR LONG SERVICE LEAVE

The introduction of a national long service leave system requires an analysis of state and territory laws as well as awards and agreements applying to employees in Australia. The following analysis raises issues surrounding constitutional law as well as industrial relations law in Australia.

A. *Referral of Workplace Relations Powers to the Commonwealth*

Section 51 (xxxvii) of the *Commonwealth of Australia Constitution Act 1900* (Imp) provides that the Commonwealth parliament has the power to legislate on matters referred to it by the states. The *Australian Constitution* gave the states the primary responsibility for regulating industrial relations upon its enactment and also gave the federal parliament a limited law-making power in this area. This meant that the federal industrial relations system has operated concurrently with state systems.[119]

118 Sattler, above n 49.
119 *Commonwealth of Australia Constitution Act 1900* (Imp) 63 & 64, Vict, c12, s51; Bede Harris, *Constitutional Law Guidebook* (Oxford University Press, 2009) 37.

In 2009, all jurisdictions, except Western Australia, signed an agreement to refer their powers to the Commonwealth for the purpose of creating a national system. As discussed above, this paper will not examine the position of non-national employees, especially in Western Australia. To do so would have resulted in a very lengthy paper. The agreement referring the state and territory industrial relations powers is heavily detailed and currently excludes long service leave entitlements as this remains a matter for the states and territories.[120] Depending upon the model selected to achieve uniformity on long service leave matters, the states and territories may need to refer their power to the Commonwealth to legislate on long service leave matters.

B. *The Potential Amendment of the Fair Work Act 2009 and State Long Service Leave Legislation*

In order for the government to meet its commitment to develop a uniform National Employment Standard for long service leave, the government will need to legislate to provide an ongoing long service leave entitlement for all national system employees. [121] A key issue is how a national long service leave standard will interact with existing state and territory laws about long service leave. As outlined earlier in this paper, most states and territories have specific legislation dealing with long service leave, with the exception of Queensland, which provides for long service leave in its industrial relations legislation.

C. *Constitutional Issues Surrounding the Options for Developing a Nationally Consistent Long Service Leave Framework in Australia*

Prior to making recommendations about a national long service leave standard, it is necessary to look at the constitutional issues, particularly under s 109, which states that 'when a law of a state is inconsistent with a law of the Commonwealth, the latter shall prevail, and the former shall, to the extent of the inconsistency, be invalid'.[122] A question to be considered is whether the states and territories could legislate aspects of long service leave not dealt with in a proposed new Commonwealth legislation.[123]

Ultimately, s 109 of the Constitution has the effect that state laws that are directly inconsistent with the *Fair Work Act* are invalid.[124] There is the potential for a state law concerning long service leave to be invalid for inconsistency with a long service leave National Employment Standard either on the basis that provisions of those laws are directly inconsistent, or because the National Employment Standard is intended to 'cover the field' in relation to long service leave.

In order to avoid this, the *Fair Work Act* would need to expressly state whether it is intended to 'cover the field' for long service leave or whether state laws are intended to operate concurrently. Through correct drafting of a new long service leave National Employment Standard under the Act, the states and territories could legislate aspects of long service leave not dealt with in the Commonwealth legislation. This will require the Commonwealth to allow states and territories to continue to legislate on some aspects of long service leave and would mean that the Commonwealth does not 'cover the field'. In *Victoria v Commonwealth*, Dixon J explained that:

> … if it appears from the terms, the nature or the subject matter of a Federal enactment that it was intended as a complete statement of the law governing a particular matter or set of rights and duties, then for a State law to regulate or apply to the same matter or relation is

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120 Harris, above n 119, 37.

121 *Fair Work Act 2009* (Cth) s 13 provides that 'a national system employee is an individual so far as he or she is employed, or usually employed, as described in the definition of national system employer in s 14.

122 *Commonwealth of Australia Constitution Act 1900* (Imp) 63 & 64 Vict. C 12, s 51 (xxxvii).

123 Price, above n 6, 205.

124 *R v Brisbane Licensing Court; Ex parte Daniell* (1920) 28 CLR 23.

> regarded as a detraction from the full operation of the Commonwealth law and so as inconsistent.[125]

The benefit of the constitutional terms for the government is that if a national minimum long service leave standard is set by the *Fair Work Act*, any state or territory law that provides for different minimum employment entitlements from a Commonwealth law will be directly inconsistent with the Commonwealth law and invalid. If a Commonwealth law provides a legal right or entitlement, a state law that claims to take away or reduce the legal right or entitlement will be inconsistent with s 109 of the Constitution. In *Victoria v Commonwealth*, Dixon J said:

> When a State law, if valid, would alter, impair or detract from the operation of a law of the Commonwealth Parliament, then to that extent it is invalid.[126]

This means that a Commonwealth law setting a minimum long service leave standard must ensure that employees under the national system are entitled to certain entitlements at a national level. Depending on the way in which the Commonwealth legislation is written, it would be possible for the *Fair Work Act* to set a minimum standard for long service leave and then allow the states and territories to provide entitlements over and above the minimum standard. This arrangement would be similar to the community service leave National Employment Standard, whereby the Act states that entitlements under state or territory laws are not intended to be excluded to the extent that those entitlements are more beneficial than the National Employment Standard.[127]

VI OPTIONS FOR THE DEVELOPMENT OF A NATIONAL LONG SERVICE LEAVE STANDARD

Five options are examined below with a recommendation on the preferred option discussed at Part VII of this paper.

A. *Option 1: Harmonisation of Long Service Leave Legislation*

A ‘harmonisation’ model would require the Commonwealth and the states and territories to come to an agreement in developing consistency in existing state and territory long service leave legislation.

Such a model would be similar to the recent harmonisation of work health and safety laws. In this case, the Council of Australian Governments formally committed to the harmonisation of work health and safety laws by signing an Intergovernmental Agreement for Regulatory and Operational Reform in OHS (‘IGA’) on 3 July 2008.[128] The IGA outlined the commitment of all states and territories and the Commonwealth to work together to develop and implement model work health and safety laws in Australia.[129] The model OHS Act aims to lead to better safety protections for employees and greater certainty for employers.[130] The Workplace Relations Ministers’ Council (‘WRMC’) considered and responded to the recommendations of the National Review into model OHS Laws . The WRMC decided on the most favourable structure and content of a model OHS Act to be adopted by the Commonwealth, state and territory governments.[131] All

125 (1937) 58 CLR 618, 630.
126 Ibid.
127 *Fair Work Act 2009* (Cth) s 112.
128 Council of Australian Governments, Intergovernmental Agreement for Regulatory and Operational Reform in Occupational Health and Safety (3 July 2008) <www.coag.gov.au/node/276>
129 Safe Work Australia , *Model WHS legislation* , <http://www.safeworkaustralia.gov.au/sites/SWA/Legislation/Pages/ModelWHSLegislation.aspx>..
130 Safe Work Australia, *Communiqué from Australian, State, Territory and New Zealand Workplace Relations Ministers' Council* (18 May 2009).
131 Ibid.

states and territories have different occupational health and safety legislation but all states and territories have committed to implementing uniform health and safety standards across Australia if they have not already done so.[132]

This model would require each state and territory to amend their current legislation to provide consistency across all components of long service leave, in each statute, across the jurisdictions.

This option is ideal as it will create certainty for employers and employees on the minimum entitlement to long service leave. However, a disadvantage of this model is that any increase in a state or territory's current arrangements in order to meet a national standard could be resisted from employers as this would be an added business cost.[133] In addition, a key issue associated with harmonisation is the difficulty in getting the various governments at all levels across Australia to agree to an outcome concerning long service leave and then that same government actually implementing the legislation due to electoral cycle.

B. *Option 2: Legislate a Long Service Leave Standard that Overrides State and Territory Legislation on Specific Components of Long Service Leave for National System Employers and Employees*

A further option is for the Commonwealth to legislate a long service leave standard that overrides state and territory legislation on specific components of long service leave for national system employers and employees.[134] The Commonwealth would legislate on specific aspects of long service leave based on the commonalities that can be identified across the relevant provisions of state and territory legislation. This would require the states and territories to repeal their provisions dealing with those aspects of long service leave that the Commonwealth would have legislated on, although state and territory legislation dealing with other aspects of long service leave could continue to operate. [135] This option would require careful drafting by the Commonwealth to avoid any inconsistency, as this may affect which 'components' are dealt with federally. Additionally, the states and territories will need to make complementary amendments of their relevant legislation to ensure that the state legislation fits with a federal Act.[136]

The benefit of this option is that it allows the current state and territory legislation to remain largely unchanged. However, this option would not achieve uniformity on all aspects of long service leave because the state and territory legislation would be prescriptive on many aspects of the entitlement. It could also be more difficult for employers and employees to understand because the obligations could come from both federal and state legislation and employers and industry groups are likely to be concerned about retaining elements of state-based long service leave regulation because of the complexity involved in deriving an employment entitlement from both federal and state legislation.[137]

As discussed earlier in the paper, it is likely that employers will feel disadvantaged if the level of legislated long service leave National Employment Standard is more generous than that which currently applies in a particular state because this will be an added cost to them.[138] A further difficulty with this option is that it would require legislative amendments at both the federal and state and territory levels, which means that the Commonwealth and state workplace relations referral legislation might also require amendment to ensure that long service leave is not an excluded subject matter. [139] The NES

132 NSW Government WorkCover Authority, *New Legislation 2012* (29 September 2011).

133 Sattler, above n 49; Burgess, Sullivan and Strachan, above n 27, 34.

134 Harris, above n 119, 37.

135 Ibid.

136 Ibid.

137 Burgess, Sullivan and Strachan, above n 27, 34.

138 Sattler, above n 49;Burgess, Sullivan and Strachan, above n 27, 34.

139 Harris, above n 119, 37.

would only stipulate a minimum standard. Industry sectors or employers have the option of providing more than the minimum standard. However, the aim of this option was to ensure that a minimum standard was introduced. Other states may want to exceed the minimum standard in order to attract employees or keep existing entitlements.

C. *Option 3: Legislate a Minimum Long Service Leave Entitlement at the Federal Level and Allow States and Territories to Legislate More Generous Entitlements*

This option would create a National Employment Standard for the very basic aspects of long service leave based on the least generous entitlements currently operating across the various jurisdictions. state and territory legislation could then supplement the long service leave standard by providing more generous entitlements. This option would operate similarly to the approach in the Fair Work Act in relation to the National Employment Standard that considers the entitlement to community service leave. The community service leave standard provisions contain a clause that explicitly states that state and territory laws are not excluded.[140] Again, the drafting of the Commonwealth legislation would need to be carefully undertaken to avoid inconsistency issues.

The benefit of this option is that the standard can be set at the lowest level currently applying in state and territory legislation and the states and territories will be able to maintain their current entitlements at a higher level. There is unlikely to be any resistance from employers as employees will not be disadvantaged. This option meets the government's policy that commits to developing a long service leave standard as it will provide a minimum standard. The disadvantage of this option is that it is not a true harmonisation of long service leave entitlements for national system employers and employees as only a basic safety net would be set, with an increased safety net applying on a state by state basis, which causes employees to continue to have differing entitlements depending on geographical location across Australia.

In order to implement this option, legislative amendments at both the federal and state and territory levels will be required. While states and territories would be able to continue legislating at or above any standard set in the long service leave National Employment Standard, amendments would still be required to ensure the state and territory legislation interacts appropriately with the Fair Work Act.[141] The Commonwealth and state workplace relations referral legislation would also require amendment to ensure that long service leave is not an excluded subject matter.[142]

D. *Option 4: Commonwealth to Exclusively Cover Long Service Leave through the National Employment Standard, with Appropriate Grandfathering or Transitional Arrangements for Employees in State and Territory Jurisdictions with Pre-existing Entitlements*

This option would involve the Commonwealth enacting a long service leave National Employment Standard that entirely covers the field of long service leave. This option would require comprehensive grandfathering or transitional arrangements for employees who are entitled to long service leave under state and territory legislation or pre-existing industrial instruments.[143] A grandfathering clause, over a period of time, would allow employers and employees time to adjust to the changes in long service leave entitlement.

An employee's entitlements to long service leave would be subject to the terms of the transitional provisions contained in the *Fair Work Act*, which may provide a transitional period to align all long service leave entitlements or grant grandfathering status to

140 *Fair Work Act 2009* (Cth) div 8.

141 Harris, above n 119, 37.

142 Ibid.

143 Peter Butt (ed), *Butterworths Concise Australian Legal Dictionary* (LexisNexis Butterworths, 3rd ed, 2004) 192. Grandfathering arrangements refer to arrangements that allow a previous entitlement to continue even though a subsequent change in legislation has occurred.

employees whose long service leave entitlements are derived from state and territory legislation or an applicable instrument. Transitional provisions could continue to apply until the employee's existing employment ends or the employee becomes covered by a different instrument. The benefit of this option is that it is the most comprehensive solution as it allows a more prescriptive long service leave standard to be created. It is in line with the intent of a true national system as it would provide a single minimum long service leave standard for employers and employees. This would remove the complexity in determining where the employee entitlements and obligations were derived following a transitional period or upon the exhaustion of the grandfathering provisions.

The disadvantage of this option is that grandfathering provisions and transitional periods are highly technical and it may be difficult for employers and employees to understand and implement. The complexity may arise due to the wide range of pre-existing long service leave entitlements and it will impose increased costs on employers over time. This would require very carefully drafted legislative provisions including a transitional Act. It would be complex and difficult for employers to administer in practice. While this would appear to be more of an administrative action or procedure, it is contended that it does provide an option.

E. *Option 5: Develop a Long Service Leave Insurance Scheme*

A further option for implementing a national long service leave scheme is to develop a mandatory insurance scheme, similar to the National Disability Insurance Scheme ('NDIS'). The NDIS provides insurance cover for all Australians in the event of significant disability. The Productivity Commission made a recommendation that the funding of the scheme should be a core function of government, similar to Medicare.[144]

Under this option, both the Commonwealth and the states and territories could come to an agreement about a national mandatory insurance scheme for long service leave entitlements. In order for this to occur, a set of standards would need to be developed by a committee comprising Commonwealth and state and territory government representatives, as well as employee and employer representatives. The standards would require wide consultation nationally to ensure the outcomes for employees are consistent with a set of agreed principles and objectives of Commonwealth and state and territory legislation. Given the consultation and agreement required, it would be impossible to reach an absolute conclusion as to the result. However, it is contended that it is still a viable option, albeit one that may be very difficult to achieve in practice.

While the NDIS is not yet complete, similar considerations could be made for the development of a long service leave insurance scheme. It is envisaged that the scheme would operate to the effect that all affected and concerned employers were mandated to make a certain contribution for each of their employees towards an eventual long service leave entitlement. The contribution would be made to the Commonwealth, who would oversee the scheme, and who would make the employee payments at the time their entitlement crystallised. This option would require the Commonwealth to legislate a minimum national long service leave entitlement and would operate in conjunction with the other options examined in this paper.

The disadvantage of this option is that it is likely that employers will be concerned about the possible added cost to them, although the Commonwealth will be able to consider possible funding options and it is arguable that a centralised scheme would reduce the long term costs to employers.[145] The advantage of this option is that long service leave would effectively become a 'portable' entitlement that employees can transfer to other employers and industries where there is not a break in service. This is advantageous to employers as it gives them an advantage in the labour market and increases competition in

144 Productivity Commission, *Inquiry Report: Disability Care and Support* (10 August 2011) 3.
145 Sattler, above n 49 and Burgess, Sullivan and Strachan, above n 27, 34.

the current economic climate.[146] While this option may appear to be simplistic, the government processes and consultation and the writing of new legislation would be quite involved, complex and time consuming.

VII. CONCLUSION

In conclusion, the five options can be summarised as follows. The first option is to harmonise long service leave legislation across jurisdictions, providing consistency across all components of long service leave including a common standard that is contained in each statute across the jurisdictions. This option is strong because a national minimum standard for long service leave can be set in the *Fair Work Act* and it would create certainty for employers and employees on the minimum entitlement to long service leave. The disadvantage to this model is that some employers may need to increase the existing minimum entitlement, but this is of course advantageous to employees. While this option is appealing, it is noted that a key issue associated with harmonisation is the difficulty in getting the various governments to agree to an outcome and then that same governments actually implementing the legislation due to electoral cycle.

The second and third options involve the Commonwealth parliament changing the *Fair Work Act* to legislate a national minimum standard that the states and territories could either completely supplement or supplement only some components. These options are seemingly simple; however, the disadvantages are that uniformity would not be achieved on all aspects of long service leave; it could be more difficult for employers and employees to understand; and the Commonwealth and state workplace relations referral legislation would also require amendment to ensure that long service leave is not an excluded subject matter, which is a complex process.

The fourth option involves the Commonwealth enacting a long service leave National Employment Standard that entirely covers the field of long service leave with comprehensive grandfathering or transitional arrangements. While this is a comprehensive solution that achieves uniformity on long service leave, grandfathering provisions are highly technical and would be difficult for employers and employees to understand and implement.

The fifth option is to develop a mandatory insurance scheme, whereby a scheme would operate to the effect that all employers were mandated to make a certain contribution for each of their employees towards an eventual long service leave entitlement. The contribution would be made to the Commonwealth, who would oversee the scheme, and who would make the employee payments at the time their entitlement crystallised. This option is advantageous to employers as it gives them an advantage in the labour market and increases competition.

In weighing up the advantages, the disadvantages and the need for a national minimum long service leave standard, the most preferable option is the option of a harmonisation model. Given the success of the recent harmonisation of work health and safety laws, the potential issue of the difficulty in getting the various governments at all levels across Australia to agree to an outcome concerning long service leave and then that same governments actually implementing the legislation due to electoral cycle, is significant.

This model would be developed through agreement of the Commonwealth and the states and territories. The representatives of the jurisdictions would need to build on the commonalities discussed in option 2 to create a national minimum standard for long service leave. For example, at the highest level, the most common entitlement is a qualifying period of 10 years, with 8.667 weeks entitlement and a further 4 ⅓ weeks after another 5 years service. For those employees in states and territories where an entitlement is higher, such as a qualifying period of 10 years with 13 weeks entitlement, the statutory

146 Sattler, above n 49.

basis for the entitlement may continue as it will be over and above the national minimum standard.

The harmonised model would work to the exact method used in the OHS harmonisation, whereby the Council of Australia Governments would formally commit to the harmonisation of long service leave laws by signing an Intergovernmental Agreement for Regulatory and Operational Reform in long service leave, containing the commitment of all states and territories and the Commonwealth to work together to develop and implement model long service leave laws in Australia. The effect of a 'harmonisation' model would be that a national minimum standard for long service leave will exist in state and territory statutes, creating certainty for employers and employees. However, all of the options examined above must be balanced with a strong consideration of the practical issues involved.

In conclusion, a nationally consistent long service leave minimum standard would be a significant outcome in Australia as it will ensure that all employees are rewarded for long term service with an employer and will provide employees with a paid break from work while maintaining job tenure. Long service leave entitlements help employees to create a better work and life balance by rewarding employees with a break from work after long term service.

GLOBAL LAW FIRMS AS PROFESSIONAL GATEKEEPERS IN CORPORATE GOVERNANCE AND FINANCIAL SYSTEM STABILITY

MAGDALENE D'SILVA[*]

ABSTRACT

This paper reviews and critically analyses inter-disciplinary academic literature on global law firm governance and anti-money laundering regulation. The hypothesis which emerges from this review is that global law firms are professional gatekeepers in both corporate governance and financial system stability. These dual functions may in turn expose global law firms to a higher risk of financial crime due to their multi-jurisdictional one firm structure and seamless service offerings.

I. INTRODUCTION

> The dominance of U.S. and U.K. … firms and the rise of the global firm … signal a new era where Anglo-American transnational lawyering is central to the global economy.[1]

This paper critically analyses the impact of globalisation on the legal profession in the context of the global law firm service phenomenon by exploring the way in which global law firms fulfil gatekeeper roles in national and global financial systems through unwitting exposure to cross-border financial crime risks. These risks include for example: bribery, corruption and money-laundering. The analysis involves a review of current literature by some of the leading scholars in the areas of legal profession regulation, legal ethics, lawyer professional responsibility and law firm governance. The review and critical analysis attempts to establish potential research questions and to provide brief preliminary theoretical answers to those questions to create a foundation for future empirical research and debate by other academics, practising lawyers, legal profession organisations and commercial law firms in Australia and internationally. Leading scholars include Christine Parker,[2] Joan Loughrey[3] and John Flood,[4] each of whom have adroitly illuminated the existence of a regulatory and ethical tension between the various professional responsibility duties owed by the individual Anglo-American common law lawyer to their client, and the duties they in turn owe to their employer firm which can contrast with the over-riding professional responsibility duties they simultaneously owe as officers of the courts in the jurisdictions where they are admitted and permitted to practice law. These

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A portion of this paper was done by the author whilst working as a research assistant for the University of Sydney's Business School in 2011. An early draft paper was originally presented by the author at the Business School's conference 'Financial Crime Risks, Globalisation and the Professions' on 2 November 2011. The author acknowledges Dr David Chaikin who asked the author to write and present that draft to the conference and gave comments. The author also thanks two anonymous referees who provided further articles, insights and editorial comments on parts of the author's pre-conference draft. Finally, the author wishes to acknowledge the helpful assistance of Ms Emma Oettinger (Lawyer and Anti-Money Laundering Policy Officer for the Law Society of England and Wales) who gave insights on a later post-conference draft. All opinions and errors remain the author's own.

1 James R Faulconbridge et al, 'Global Law Firms: Globalization and Organizational Spaces of Cross-Border Legal Work' (2007-2008) 28 *North-Western Journal of International Law & Business* 455, 458.

2 Christine Parker et al, 'The Ethical Infrastructure of Legal Practice in Large Law Firms: Values, Policy and Behaviour' (2008) 31 *University of New South Wales Law Journal* 158.

3 Joan Loughrey *Corporate Lawyers and Corporate Governance* (Cambridge University Press, 2011).

4 See John Flood, 'The Re-Landscaping of the Legal Profession: Large Law Firms and Professional Re – Regulation'(July 2011) 59(4) *Current Sociology* 507.

tensions are juxtaposed against the backdrop of national and potential international cross-border regulation of law firms as organisations that employ individual lawyers to provide professional legal services to clients. The regulatory tensions between the individual lawyer's over-riding duty to the court, to clients and then to themselves, contrasts with the responsibility of the law firm as a whole in which the individual lawyer is placed. This tension is receiving well deserved increased attention from legal scholars.[5] However the literature also shows that the globalisation process allows law firms to operate both across and within other jurisdictions and their legal systems (whether common or civil law), which contain different laws, customs and legal traditions. As far as corporate governance and financial crime risk are concerned, this paper theorises that global law firms which are the subject of one form of legal services regulation in their home jurisdiction, may be inevitably exposed to a greater risk of regulatory breaches by virtue of offering seamless services in cross-border corporate and financial deals and transactions in other jurisdictions that take a different approach to legal services regulation. For example the regulation of lawyers and legal services within and across Australia, the United States and the United Kingdom is different. Global law firms operating in all of these jurisdictions must grapple with the regulatory differences. The question that arises from this is whether global law firms play a role in corporate governance and financial system stability at the global level and if so, what role?

Global governance and regulatory issues for the world's legal professions are directly connected to the economic uncertainty which continues to flow from the peak of the 2008 global credit financial crisis. This uncertainty persists despite various sovereign debt re-financing and fiscal stimulus measures (such as 'quantitative easing' in both the United States and the United Kingdom and more recently the numerous debt-restructurings for European Union nations such as Greece). Recent academic research shows that a widespread national culture of the financial crime of tax evasion was and continues to be a significant contributing factor to the financial problems afflicting Greece.[6] However such a link may yet be drawn noting that organisations such as the G20[7] and International Monetary Fund[8] have endorsed what is now (as of 16 February 2012) referred to as the revised Financial Action Task Force (FATF) *International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation* ('AML'). These endorsements might support an argument that a long-term international regulatory solution to global economic uncertainty and financial system instability needs to address financial crime risk in global transactions and money flows.[9]

A. *Key Terms*

For the purposes of this paper some key terms and concepts need clarification. The term 'lawyer' has different meanings in different jurisdictions, noting for example that in the United States lawyers are technically referred to as 'attorneys' whilst in the United Kingdom the traditional divide between 'barrister' and 'solicitor' remains, this tradition having been inherited by former colonial common law jurisdictions such as Australia. In this paper references to *lawyer* are thus broadly intended to encompass any registered legal

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5 Consider Parker et al, above n 2.

6 See, Nikolaos Artvanis, Adair Morse, Margarita Tsoutsoura, 'Tax Evasion Across Industries: Soft Credit Evidence From Greece' (25 June 2012) <http://faculty.chicagobooth.edu/Margarita.Tsoutsoura/research/TaxEvasionWebAugust.pdf>.

7 'Progress Report on the Economic and Financial Actions of the London, Washington and Pittsburgh G20 Summits', prepared by the UK Chair of the G20 (St Andrews 7 November 2009); 'G20 Declaration on Strengthening the Financial System' (London, 2 April 2009).

8 International Monetary Fund, 'Financial System Abuse, Financial Crime and Money Laundering' (Background Paper, 12 February 2001).

9 See Kevin L Shepherd, 'Guardians at the Gate: The Gatekeeper Initiative and the Risk-Based Approach For Transactional Lawyers', (2009) 43 *Real Property, Trust and Estate Law Journal* 607, 611.

practitioner who holds a current practicing certificate regardless of their national jurisdiction.

The term *financial crime* is variously used and understood in different contexts, depending on the criminal law of the national jurisdiction in which an activity is statutorily deemed to be unlawful. Defining the scope of what constitutes financial crime is necessary because this materially affects the level of financial crime risk to which legal services may be exposed. The global context of this discussion would require a deeper exploration of the legal and other meanings of financial crime in a broader sense. For present purposes, the author adopts the classification of financial crime espoused by the International Monetary Fund: 'any non-violent crime resulting in financial loss.'[10] This definition is useful because it enables the inclusion of various unlawful activities such as tax evasion and financial fraud which may arguably fall within the remit of what actually constitutes *money laundering*; a phenomenon that encompasses not only the traditional transactional layering and thereby concealment of illicit monetary proceeds, but potentially the concealment of *any* unlawfully obtained or detained property (such as tax evasion, restructuring a company's operations to avoid responsibilities to creditors, or the purchase and sale of real estate).[11]

Having preferred a wider remit with respect to what constitutes financial crime (of which money laundering is a key example), the research question that emerged from a critical analysis of the literature is whether and if so how, law firm legal services, particularly those provided on global transactions in property and finance matters, are exposed to the risk of unwitting involvement in non-violent unlawful criminal activity that causes financial loss to a third party. The motive for law firm globalisation has been said to be driven by client demands for firms to have a presence abroad.[12] However some commentary points to the possibility that a more likely agenda is that law firms themselves are chasing global money flows.[13] Evidence to support this premise is however somewhat anecdotal and not concrete. Media reports in Australia for example have suggested that the strategy of some global law firms is to service foreign and local finance investment deals.[14] Comments on some large international law firm websites might reflect an intention to ostensibly strive to operate as *one-firm*[15] and provide global clients with a *seamless service.*[16] Putting aside for the moment questions about the authenticity of the 'one-firm seamless service'[17] (and by what criteria any law firm can claim the 'global moniker'[18])

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10 IMF, above 7, 5.

11 Dr Gál István Lásló, 'The Techniques of Money Laundering' (2005) 138 *Studia Iuridica Auctoritate Universitatis Pecs* 129, 129.

12 John Flood, 'Megalawyering the Global Order: the cultural, social and economic transformation of global legal practice' (1996) 3(1-2) *International Journal of the Legal Profession* 169,176.

13 See for example: Alex Boxsell, 'Baker studies money flows', *The Australian Financial Review: Legal Affairs* (Australia), 26 May 2011 <http://www.highbeam.com/doc/1G1-257370731.html>. See also, Don Boyd, 'Globalisation Changes the Legal Services Business' *The Australian* (Sydney), 3 June 2011 <http://www.theaustralian.com.au/business/legal-affairs/globalisation-changes-the-legal-service-business/story-e6frg97x-1226068246632>.

14 Chris Merrit, 'A&O amazed by success of its Aussie venture', *The Australian* (Sydney), 21 October 2011 <http://www.theaustralian.com.au/business/legal-affairs/ao-amazed-by-success-of-its-aussie-venture/story-e6frg97x-1226172286894>.

15 Jens Drolshammer, 'The Future Legal Structure of International Law Firms – Is The Experience of the Big Five in Structuring, Auditing and Consulting Organizations Relevant?' (2000) 2(4) *European Journal of Law Reform* 713,715.

16 Gunter Műller Stewens and Jens Drolshammer, 'Managing the International Law Firm: Nuisance or Necessity?' (2000) 2 *European Journal of Law Reform* 627, 631.

17 Further empirical research is needed to ascertain whether the partnership compensation structures of global law firms genuinely support a seamless one-firm service, see Faulconbridge et al, above n 1, 473-7. See generally, Megan E Vetula, 'From the Big Four to the Big Law: The Swiss Verein and the Global Law Firm' (2009) 22 *Georgetown Journal of Legal Ethics* 1177, 1183-6.

18 David M Brock, Tal Yaffe and Mark Dembrovsky, 'The Global Law Firm: An Initial Study of the Strategy and Performance' (2006) 5(2) *International Journal of Business and Economics* 161, 162.

the research hypothesis theorises that by establishing multi-jurisdictional offices to provide confidential legal services protected by legal professional privilege across national borders in foreign jurisdictions, this results in some lawyers within the same firm being exempt from direct AML regulation (such as in Australia). If the hypothesis is correct the result may be that global law firms which strive to provide seamless cross-border services but are not seamlessly regulated may be *unwittingly* exposed to a higher risk of cross-border financial crime. This risk arises because financial crime uses these legal protections, services and privileges to conceal its existence and commission.

This paper therefore pre-supposes a *global law firm* to be any commercial law firm with offices outside its home jurisdiction that seeks to provide a seamless cross-border one-firm legal service to corporate clients. The nature, operation and model of a global law firm are also factors deserving of further critical analysis. They can directly influence a firm's level of risk exposure to financial crime as well as to AML regulatory risk, depending upon whether the firm's structure is for example, the traditional limited liability partnership (LLP) model or the newer alternative business structure ('ABS'). The reason why a global law firm's operational structure is relevant is that the structure itself may affect the flow of information between lawyers and partners across the firm given the doctrine of imputed knowledge in the traditional law firm partnership model with regard to confidential client information.[19] This may in turn affect the AML regulatory culpability of the firm's head office in its home jurisdiction by virtue of the actual knowledge or suspicion of money laundering held by the firm's partners in an overseas office where AML regulation does not apply to lawyers, depending on whether that knowledge or suspicion is in fact transmitted to the firm's head office partners. In other words: Is the knowledge or suspicion formed by the partners and lawyers in a firm's overseas office, where lawyers are exempt from AML regulation, more likely to be transmitted to the managing partners of the firm's home jurisdiction office (such as in the United Kingdom) where AML regulation does apply to lawyers?

These preliminary research questions may also be relevant to other legal profession regulatory issues such as whether promoting compatible regulation of Anglo-American legal services[20] to facilitate legal services as a trade export[21] should adopt a global approach to all other aspects of legal profession regulation. Two aspects of the lawyer-client relationship which are relevant for AML purposes are client confidentiality and legal professional privilege.[22] This is important because legal professional privilege is defined and applied differently across various common law and civil law legal justice systems,[23] and has been relied upon by legal professions around the world to mount strong resistance to the imposition of AML regulation for lawyers.[24] A consistent approach to AML

19 Sandro Goubran, 'Conflicts of Duty: The Perennial Lawyers' Tale – A Comparative Study Of The Law In England and Australia' (2006) 30 *Melbourne University Law Review* 88, 92

20 Ted Schneyer, 'Thoughts on the Compatibility of Recent U.K. and Australian Reforms with U.S. Traditions in Regulating Law Practice' (2009) *Journal of the Professional Lawyer* 13.

21 Alison Hook, 'Sectoral Study on the Impact of Domestic Regulation on Trade in Legal Services' (Paper presented at Sixth Services Experts Meeting Domestic Regulation and Trade in Professional Services Conference, Paris, 15-16 February 2007). Also see World Trade Organization, Council for Trade in Services, 'Legal Services' WTO Doc S/C/W318 (Background Note by the Secretariat, 14 June 2010).

22 Colin Tyre QC, 'Anti-Money Laundering Legislation: Implementation of the FATF Forty Recommendations in the European Union' (2010) *Journal of the Professional Lawyer* 69; Louise L. Hill, 'The Financial Action Task Force Guidance for Legal Professionals: Missed Opportunities to Level the Playing Field' (2009) *Journal of the Professional Lawyer* 151, 156; Wendy Shuck, 'The Impact of Anti-Money Laundering Laws on Attorney-Client Privilege' (1995-1996) 19 *Suffolk Transnational Law Review* 507, 519-21.

23 James McComish, 'Foreign Legal Professional Privilege: A New Problem for Australian Private International Law' (2006) 28 *Sydney Law Review* 297.

24 See *Federation of Law Societies of Canada v Canada (Attorney General*) [2011] BCSC 1270. The Supreme Court of British Columbia confirmed that state AML regulations for Canadian lawyers, breached the Canadian *Charter of Human Rights and Freedoms* with regard to protecting client confidentiality and legal professional privilege. The regulations were therefore struck down.

regulation may perhaps help to prevent global financial crime risks posed to the lawyer-client relationship.

Presently, legal professional regulation reform in countries such as Australia is focused on nationalisation which has amongst others, the aim of increasing gross domestic product for the purpose of national economic growth.[25] However the benefit of a consistent international approach to AML regulation for lawyers is that it may in turn support the economic imperatives for nationalisation by enhancing the reputation of a particular nation's profession.[26]

B. *Research Premise*

The paper's proposed research hypothesis is to link the professional gatekeeper function of lawyers in corporate governance[27] and financial system stability[28] by considering the special role played by global law firms in preventing cross-border financial crime under AML. The suggested basis for making this link is the fact that the wider aims of corporate governance and AML are arguably the same; that is to strengthen corporate and financial system legitimacy and stability.[29] The rest of the paper attempts to explain the link by considering the financial crime risks posed to the lawyer-client relationship in the context of global legal services.

II. Lawyers as Professional Gatekeepers in Corporate Governance and Financial System Stability

Although there is no accepted universal meaning of the terms corporate governance and financial system stability the paper will broadly refer to *corporate governance* as the way in which a corporation's decisions, behaviour and power are influenced, regulated and made accountable to shareholders and other stakeholders.[30] The term *financial system stability* may be concurrently regarded as the process by which 'financial intermediaries, financial markets and market infrastructure, facilitate the smooth flow of funds between savers and investors'[31] to maintain soundness, confidence, legitimacy and integrity of the national and international (global) financial system.[32]

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25 Chris Arup, 'Legal Services and Professional Regulation Internationally? Australia Abroad' (2009) 37 *Federal Law Review* 417.

26 Consider Loughrey, above n 3, 246.

27 See generally ibid.

28 Patricia Shaughnessy, 'The New EU Money-Laundering Directive: Lawyers as Gatekeepers and Whistleblowers', (2002) 34 *Journal of Law and Policy International Business* 25, 26; Razeen Sappideen, 'Corporate Governance and the Surrogates of Managerial Performance' (2011) 34(1) *University of New South Wales Law Journal* 136.

29 This refers to corporate governance as conducive to economic and social stability rather than shareholder primacy based or stakeholder theories. See for example Charlotte Villiers, 'Controlling Executive Pay: Institutional Investors or Distributive Justice?' (October 2010) 10(2) *Journal of Corporate Law Studies* 309; Kevin T Jackson, 'Global Corporate Governance: Soft Law and Reputational Accountability' (2010) 34 *Brook Journal of International Law* 41, 44-99; Joseph J Norton and Christopher D Olive, 'Globalization of Financial Risks and International Supervision of Banks and Securities Firms: Lessons from the Barings Debacle' (1996) 30 *The International Lawyer* 301, 302.

30 See Stephen Bottomley, *The Constitutional Corporation: Rethinking Corporate Governance* (Ashgate, 2007) 1-16.

31 Reserve Bank of Australia, 'Financial System Stability Review September 2012'<http://www.rba.gov.au/publications/fsr/2012/sep/pdf/0912.pdf>.

32 See IMF, above n 8, 9, 31.

A. *The Professional Gatekeeper in Corporate Governance: The Reputational Intermediary*

The concept of the professional gatekeeper in corporate governance has been variously defined. As Loughrey[33] notes these definitions refer to private parties who can disrupt misconduct by not co-operating with wrongdoers or, sell products and services to clients which are needed to enter a particular market or engage in certain activity. A commonly cited definition of the corporate governance professional gatekeeper is John Coffee's agency concept of the *reputational intermediary*, which is:

> [A]n agent who acts as a reputational intermediary to assure investors as to the quality of the 'signal' sent by the corporate issuer. The reputational intermediary does so by lending or 'pledging' its reputational capital to the corporation, thus enabling investors or the market to rely on the corporation's own disclosures or assurances where they otherwise might not. The gatekeeper has such reputational capital because it is a repeat player who has served many clients over many years.[34]

Coffee's reputational intermediary definition of a professional gatekeeper is preferred in this paper because it is directly linked to the way corporate and financial markets operate in the global financial system.[35] Furthermore, the idea that internal and external lawyers are professional gatekeepers to corporate governance[36] rose to prominence in the wake of the financial frauds and collapses of major corporate entities such as Enron when 'questions were raised about the lawyers for the banks who blessed a series of transactions which Enron designated as trading activity but which were … disguised loans to Enron'.[37]

The economic fall-out from these corporate scandals led to significant law reform around the world that directly affected lawyers and legal services. In the United States ('US') reforms were implemented under the *Sarbanes-Oxley Act of 2002*[38] ('Sarbanes-Oxley') which amongst other aims, recognises the corporate governance gatekeeper role of US securities lawyers as manifested in the 'noisy withdrawal/up-the-ladder'[39] reporting rule enacted by the US Securities Exchange Commission ('SEC'). Under this rule lawyers must:

> [R]eport evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company.[40]

Where the in-house legal counsel or chief executive officer of a corporate client fails to adequately respond, the lawyer must then:

> [R]eport the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.[41]

These reforms arguably manifest state recognition of the role played by corporate lawyers in corporate governance and financial system stability because they directly regulate the

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33 Loughrey, above n 3, 76-7.

34 John Coffee Jnr, *Gatekeepers the Professions and Corporate Governance* (Oxford University Press, 2006) 2.

35 See generally Hal S Scott, *International Finance Transactions, Policy and Regulation* (New York Foundation Press, 2010) chs 1, 2, 4.

36 For example, Robert W Gordon, 'A New Role for Lawyers?: The Corporate Counselor After Enron' (2003) 35 *Connecticut Law Review* 1185.

37 Loughrey, above n 3, 24.

38 *Sarbanes-Oxley Act of 2002,* Pub L 107-204, 116 Stat 745 (2002).

39 Todd Cain, 'Protecting the Perception of the Public Markets: At What Cost? The Effects of "Noisy Withdrawal" on the Long Standing Attorney-Corporate Client Relationship' (2004-2005) 17 *St. Thomas Law Review* 371, 388.

40 *Sarbanes-Oxley Act of 2002,* Pub L 107-204, s 307 (1)(a) 116 Stat 745 (2002).

41 Ibid s 307 (1)(b).

services and duties owed by the lawyers in the corporate/commercial lawyer-client relationship. Questions have been raised as to whether there should be similar regulation of the professional gatekeeper role played by Australian lawyers noting corporate scandals involving prominent Australian law firms.[42] Although Australian corporate lawyer behaviour is already regulated to some extent under the *Corporations Act 2001* (Cth)[43] there is no mandatory requirement for lawyers in Australia to externally report their suspicions or knowledge of regulatory breaches by clients or third parties. Perhaps the regulation of lawyers in Australia as professional gatekeepers first requires unification of the divergent perceptions of the lawyer's role in the common law adversarial system. These perceptions range from the zealous client advocate who is independent of the state, to the responsible officer with over-riding duties to the court.[44] As earlier stated these divergent perspectives apply to the role and conduct of the individual lawyer as well as the law firm as a whole.[45] However it is the latter with which this paper's analysis is concerned.

B. *The Professional Gatekeeper in the Financial System: The Financial Intermediary*

Whilst the professional gatekeeper in corporate governance focuses on the end result of the service provided by a lawyer to their client, the international regulatory landscape defines the professional gatekeeper in the financial system by focusing on the actual service itself. In other words, whilst the corporate governance professional gatekeeper is regarded as a *non-participating* reputational intermediary, the financial system notion of professional gatekeeper is regarded as an *actively participating financial intermediary.* The idea that professionals such as lawyers should be regulated as actively participating financial intermediaries, first emerged in 1999 when the leaders of the Group of Eight Nations ('G8') issued the *Moscow Communiqué* a decade after the formation of the Financial Action Task Force (FATF) by the Group of Seven ('G7') leaders. The FATF is a mandated inter-governmental anti-money laundering policy body consisting of 34 member states (including Australia) which released 40 'recommendations' from 1990 to 2003 with the aim of fostering internationally agreed policies and standards to combat money laundering. An additional nine recommendations were also released following the 11 September 2001 World Trade Centre attacks in New York, to combat terrorist financing (known as the 'FATF 40+9 Recommendations'). The *Moscow Communiqué* recognised the role of financial intermediaries in money laundering schemes and said that the Group of Eight Nations ('G8') would consider requiring and enhancing suspicious transaction reporting by 'gatekeepers' (such as lawyers) to the financial system.[46]

The following two sections of this paper present the preliminary argument that both professional gatekeeper roles are concurrently fulfilled by global law firms.

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42 See Christoph Pippel, 'The Lawyer As Gatekeeper: Is There A Need For A Whistleblowing Securities Lawyer? Recent Developments in the US and Australia'(2004) 16(2) *Bond Law Review* 96; Loughrey, above n 3, 33-4.

43 See *Corporations Act 2001* (Cth) s 79. 'The *Corporations Act* aims to deter actions by persons who directly or indirectly facilitate corporate crime by reliance upon the concept of involvement in a contravention of the Act, including aiding, abetting, counselling or procuring', Pippel, above n 42, 121.

44 Christine Evans and Adrian Parker, *Inside Lawyers' Ethics* (Cambridge University Press, 2007) 23.

45 Robert A Kagan and Robert Eli Rosen, 'On the Social Significance of Large Law Firm Practice' (1984-1985) 37 *Stanford Law Review* 399, 404-22.

46 Shepherd, above n 9, 611.

III. FINANCIAL CRIME AND FINANCIAL SYSTEM STABILITY

A. *The Gatekeeper Initiative: The 40+9 Financial Action Task Force Anti-Money Laundering Recommendations*

It is helpful to briefly explore the financial crime setting and its relevance to financial system stability. FATF released a consultation paper in 2002 known as the *Gatekeeper Initiative*[47] which proposed a new AML regulatory framework that would apply to the non-financial services professions such as lawyers. The academic literature refers to this framework as a typology of financial crime regulation and regulatory risk for legal services. The rationale for the FATF Gatekeeper Initiative was that money laundering, being regarded as a 'process of obscuring the illegal origins of money derived from crime',[48] relies on professionals such as lawyers 'who assist with transactions involving the movement of money in domestic and international financial systems'.[49] Money laundering is therefore a secondary financial crime the aim of which is to conceal the proceeds gained from the commission of a predicate offence[50] and therefore often follows the financial crimes of bribery, corruption, tax evasion and fraud.[51] The impact of globalisation on money laundering is such that it now occurs 'on a mass scale because the financial system can move money rapidly through bank accounts in several countries in a short period'.[52]

The reason why financial crimes such as money laundering threaten financial system stability is that *trust* is considered to be a significant linchpin for the effective operation of the financial market economy as it depends on high levels of professional, legal and ethical standards of behaviour by market participants.[53] The financial markets are nevertheless suspected to be an area in which products such as hedge funds and derivatives are used to commit the financial crimes of tax evasion and money laundering.[54] As a report by the International Monetary Fund explains:

> A reputation for integrity … is one of the most valued assets by investors, financial institutions and jurisdictions. Various forms of financial system abuse may compromise financial institutions' and jurisdictions' reputation, undermine investors' trust in them, and therefore weaken the financial system.[55]

The FATF recommendations to combat money laundering risks were not treaty based so as to avoid imposing elaborate prescriptive regulatory procedures, in recognition that nations have their own diverse legal and financial systems.[56] Instead, the FATF recommendations set minimum standards by which each nation can implement its own domestic regulation of those professional services (including banks, accountants and lawyers) that are unwittingly exposed to the risk of facilitating money laundering. The two main aims of the

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47 Danielle Jasmin Kirby, 'The European Union's Gatekeeper Initiative: The European Union Enlists Lawyers in the Fight Against Money Laundering and Terrorist Financing' (2008-2009) 37 *Hofstra Law Review* 261, 273.

48 David Chaikin and J C Sharman, *Corruption and Money Laundering A Symbiotic Relationship* (Palgrave MacMillan, 2009) 2.

49 Shepherd, above n 9, 611-20.

50 David C Hicks and Adam Graycar, 'Money Laundering' in Manjai Natarajan (ed), *International Crime and Justice* (Cambridge University Press, 2011) 174.

51 Michael Levi, 'International Fraud' in Natarjan , above n 50, 162-9; Adam Graycar, 'Corruption' in Natarajan, above n 50, 215-21.

52 Louise Shelly, 'The Globalization of Crime' in Natarajan, above n 50, 5.

53 IMF, above n 8, 8.

54 See Wolfgang Hertzer, 'Money Laundering and Financial Markets' (2003) 11(3) *European Journal of Crime, Criminal Law and Criminal Justice* 264-77.

55 IMF, above 8, 8-9.

56 Cheong-Ann Peng, 'International Legal Sources III – FATF Recommendations' in William Blair and Richard Brent (eds), *Banks and Financial Crime The International Law of Tainted Money* (Oxford University Press, 2008) 89.

recommendations are to prohibit and detect financial crime. The first aim is to be achieved through mandatory client and beneficial ownership identification and verification of the source of a transaction's funds. Detection is then achieved through mandatory external reporting of suspicious transactions and activity by clients and related third-parties.[57]

B. *Australia*

Not all FATF member states have fully implemented its recommendations. For example Australia's Federal Government enacted the first tranche of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (Tranche 1) for institutions such as banks, which provide 'designated financial services.'[58] Legal services provided by lawyers (such as receiving and transferring client funds through a firm's trust account) that would be otherwise caught under Tranche 1 as 'designated financial services', are specifically exempt unless the service is given in direct competition with licensed financial services providers.[59]

The second tranche of Australia's AML legislation (which is current in the form of draft amendments to Tranche 1 to extend the legislation's application to professional groups including lawyers), has not yet been enacted by Australia's federal parliament, although it was originally intended to apply to professionals such as lawyers. Although Tranche 1 does not affect the law of legal professional privilege ('LPP'),[60] legal profession bodies raised concerns about the impact of Tranche 1 on LPP and client confidentiality in Australia, particularly regarding the imposition of a mandatory obligation on lawyers to make suspicious matter reports about their clients to an external body.[61] However, a question still persists over whether lawyers still have other obligations to externally report knowledge or suspicion of criminal offences (including fraud and money laundering) under Australian criminal law.[62] Otherwise, lawyers in Australia are not required to actively monitor clients or client matters from which suspicions or knowledge of money laundering activity could be acquired and international scholars have consequently observed that Tranche 2 of Australia's AML regime 'has not been adopted.'[63] Nevertheless, signals from an Australian corporate regulator are that *it* will scrutinise lawyers acting in corporate

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57 Financial Action Task Force, 'RBA Guidance for Legal Professionals' (23 October 2008) 4-11.

58 *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) s 6.

59 *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) s 5 defines 'exempt legal practitioner service'. Chapter 40 of the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No.1)* (Cth) outlines what services will be taken to be 'exempt legal practitioner services' for the purpose of the Act.

60 *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) s 242.

61 Law Council of Australia, 'Anti-Money Laundering Guide For Legal Practitioners' (Guidance Release) December 2009 <http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uuid=8FCE74BF-1E4F-17FA-D2A2-C549BD6656B4&siteName=lca>.

62 Under s 316 of the *Crimes Act 1900* (NSW) where a professional such as a legal practitioner acquires a suspicion or knowledge of an indictable offence (such as fraud and money laundering) in the course of practicing their profession and fails 'without reasonable excuse' to report that knowledge to the police, a prosecution against the practitioner must not be commenced without approval of the Attorney General. Legal commentary is that solicitors in New South Wales may have a duty to report suspicions or knowledge of offences such as money laundering as consistent with the duty of client confidentiality under r 2.1.2 of the *Revised Professional Practice and Conduct Rules 1995* (NSW) which allows a solicitor to breach client confidentiality where they are 'permitted or compelled by the law to disclose' client information. However if the information upon which the suspicion or knowledge is based, is itself subject to legal professional privilege as well as being confidential, the solicitor may have a 'reasonable excuse' not to disclose it. For a good analysis and discussion of these issues in New South Wales see Luke Geary, 'Mandatory Reporting of Criminal Behaviour: The Do's and the Don'ts' (Paper presented at Legal Wise Seminar, Sydney, 9 March 2011).

63 Laurel S Terry, 'An Introduction to the Financial Action Task Force and Its 2008 Lawyer Guidance'(2010) *Journal of the Professional Lawyer* 3, 33.

transactions in direct recognition of their gatekeeper role in the Australian financial system.[64]

Interestingly, the FATF conducts periodic mutual evaluations of participating nations to highlight those jurisdictions which have not fully implemented the recommendations, arguably because if one country is weak 'dirty money from around the globe is drawn to that jurisdiction'[65] and '[n]ot compelled to report, lawyers become the obvious channel for money laundering.'[66] A universal regulatory framework may thus be needed to monitor international/cross-border capital movements[67] which may in turn capture global legal services.

C. *The Global Law Firm Link between the Corporate Governance and Financial System Professional Gatekeeper Roles of Lawyers*

This section considers the global law firm agenda for establishing a ubiquitous presence in cross-border transactions and whether this renders them as professional gatekeepers by being a reputational and financial intermediary. The theory proposed is that global law firms manifest a direct link between functions of the corporate governance gatekeeper and the financial system gatekeeper. This arises from a combined assessment of the findings of other academics which arguably points to the same functions played by commercial corporate lawyers and global law firms as reputational (corporate governance) and financial (financial system stability) intermediaries. It is contended that both functions involve seeking to 'create value' for clients through transactional legal skills[68] that requires careful document creation and implementation by which a law firm effectively sells its intellectual capital.[69] That law firm then publicly attaches its global brand reputation to 'sanctify the relationships that global actors form when they engage in business.'[70] This dual gatekeeper role invites a critical analysis of the 'threats to economic stability that are being generated by the globalisation of financial markets, and how lawyers are implicated in maintaining stability and yet paradoxically destabilising it'.[71]

III. GLOBAL LAW FIRM EXPOSURE TO FINANCIAL CRIME RISK

Having established a framework in which to argue for the professional gatekeeper role of global law firms as both reputational and financial intermediaries, further empirical research might be conducted to explore the routes by which global law firms *may* be exposed to the high risk of financial crime. As earlier stated, although a definitive link is yet to be drawn between financial crime and financial system stability, there is scope to argue that the link exists. Presuming for the present that the link exists then the exposure of global law firms to financial crime risk affects their ability to fulfil their financial intermediary gatekeeper function. The following sections therefore consider these risks by

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64 Peter Ryan, 'ASIC Boss Declares War on Corporate Crooks' *ABC News,*1 June 2011 <http://www.abc.net.au/news/2011-05-31/asic-boss-declares-war-on-corporate-crooks/2738382>.

65 Michelle Gallant, 'Sentries or Facilitators? Law and Ethics in Trusting Lawyers with Money Laundering Prevention' (2004-2005) 49 *Criminal Law Quarterly* 34, 44.

66 Ibid pinpoint.

67 Peter Alldridge, 'Money Laundering and Globalization' (2008) 35(4) *Journal of Law and Society* 437-63,458.

68 Ronald J Gilson, 'Value Creation by Business Lawyers: Legal Skills and Asset Pricing' (December 1984) 94(2) *The Yale Law Journal* 239, 249-53.

69 John Flood, 'Megalawyering the Global Order: the cultural, social and economic transformation of global legal practice' (1996) 3(1-2) *International Journal of the Legal Profession* 169,185; John Flood, 'Rating Dating and the Informal Regulation and the Formal Ordering of Financial Transactions' in Michael B Likosky (ed), *Privatising Development* (Martinus Nijhoff Publishers, 2005) 147-71.

70 John Flood, 'Lawyers as Sanctifiers: The Role of Elite Law Firms in International Business Transactions' (Spring 2007) 14 *Indiana Journal of Legal Studies* 35, 38.

71 John Flood, 'The Vultures Fly East: the Creation of and Globalization of the Distressed Debt Market', in David Nelken and Johannes Feest (eds) *Adapting Legal Cultures* (Hart Publishing, 2001) 257.

way of a brief analysis of three areas of cross-border multi-national commercial legal services predominantly provided by global law firms.

A. *Transactional Legal Services and Financial Crime Risk*

It is important to clarify that the paper does not address law firms advising corporate clients on the legal but not financial aspects of an investment transaction or contract, where there is no issue of financial crime. In these cases the transaction's financial risk does not pass to the lawyer and their firm because it arguably does and should remain with the client. What this section highlights is the nature of the relationship between global law firms and their financial institution clients and how the relationship's purpose may expose the firm to a higher level of financial crime risk thereby impacting on its gatekeeper role in financial system stability. This entails briefly returning to the historical rise of the global law firm alongside the expansion of corporate and financial services clients such as investment banks. This expansion caused certain financial markets and therefore certain major international (now 'global') law firms to be predominantly based in the world's two leading financial centres of New York and London, which are both now said to 'matter more than others'.[72]

Cross-border legal practice grew in direct response to that expansion and purportedly in response to the global business demands of clients in London and New York which resulted in an observation by leading scholars that US and UK law firms are leading the law firm race for global expansion.[73]

> The driving force behind the globalization of legal markets … has been the shift in the large transactions market (i.e., M&A, Capital Markets, complex Financing and Projects). The cross-border nature of these transactions, the concentration of these within the multinational group of companies and the growing dominance of UK and US law in these transactions has led to the need for an international capability if a firm is to be a serious competitor in this part of the market.[74]

This globalisation agenda provokes the question of what it is that global law firms actually do which makes them special to the world's leading financial centres? Some academic commentators have described the large international law firms and their lawyers as *creating value*[75] by helping clients structure large transnational/cross-border transactions in this way:

> [A]s stabilisers in transnational business transactions replacing the function of national regulation in simpler, domestic transactions. These transnational transactions are puzzles for the lawyers to solve, using pieces of national law in their solution. The art of creativity, according to Flood and Sosa, comes in the way that lawyers combine bits of different national law with their prior experience in similar transactions to produce credible structures.[76]

The notion that a lawyer's role is to 'create value' has perhaps become trite[77] and may deserve further in-depth analysis itself. If we presently accept that a hall mark of modern legal professionalism is indeed to create value for clients then the role of the global law firm lawyer as a professional gatekeeper in financial system stability arises in cross-border transactions because the lawyer and law firm's function is to manage uncertainty by

72 Arup, above n 25, 423.

73 Carole Silver, David Van Zandt and Nicole De Buin 'Globalization and the Business of Law: Lessons for Legal Education' (2008) 28 *Northwestern Journal of International Law and Business* 399.

74 Alan Hodgart 'Globalization and the Future of International Law Firms – The Perspective of a Management Consultant' (2000) 2(4) *European Journal of Law Reform* (2000) 461, 471.

75 Gilson, above n 68, 249.

76 Silver, Van Zandt and De Buin, above n 73, 413.

77 A concept that today is widely recognised even at the introductory level in the study of law. See for example M Sanson, T Anthony, D Worsnick, *Connecting With Law* (Oxford University Press, 2011) 360.

legitimising financial deals.[78] The hypothesis that global law firms are professional gatekeepers in financial system stability is crystallised by returning to the idea that a stable financial system relies upon trust. The global law firm thus acts as a trust stabiliser in the financial system by fulfilling its corporate governance professional gatekeeper reputational intermediary function. As Flood has said:

> But it is not just the brand; it is also the collective spirit of the law firm … that enables it to confirm that transactions will be accepted as real, true, and valuable by the commercial community at large … large law firm lawyers are endowed with priestly attributes, that by conferring their imprimatur on the transaction, the profane becomes sacred and believers have faith.[79]

This power to influence market risk perception perhaps puts global law firms in an advantageous position because 'only in the global, single firm form can the type of transnational lawyering … occur, and it is, therefore, this model that has become most prominent'.[80] Further research might be needed to review the financial crime risks posed to front-end transactional legal services which might unwittingly occur through the legal advice itself. This is arguably because:

> The modern commercial lawyer is as much a manager as an adviser. At all events, he is a frequent participant in commercial conduct…It is no longer true … that the commercial lawyer … is simply a professional who gives advice but is not concerned with whether the client's objective is achieved so far as it possibly can…Businessman want lawyers who are "business-minded", capable of "getting the job done" or "pushing the deal ahead"…The promotional material in the glossy brochures of the major law firms accepts the need for the commercial lawyer to have business skills.[81]

The global law firm commercial lawyer may therefore be exposed to financial crime risk due to the participating financial intermediary role he plays through planning and implementing commercial transactions which might 'expose him to charges of conspiracy with the client or its executives.'[82] Even where legal advice and services are legitimately given in the absence of any obligation on a lawyer to conduct AML client due diligence or suspicious transaction monitoring and external reporting, the question is whether and to what degree their legal services are exposed to the risk of being unwittingly used to facilitate organised financial crime.[83] One example is mortgage fraud where a lawyer's participation as a reputational intermediary can assist the commission of fraudulent transactions by 'adding credibility'.[84]

The point is that if a global law firm is exposed to financial crime risk, whether the risk is actual or regulatory, the firm's reputation is sullied. This would adversely affect the firm's ability to function as a reputational intermediary in corporate governance, and reduce its actual effectiveness as financial intermediary gatekeeper in the financial system. Ultimately, further and future research of these issues would in turn require consideration of the rule of law and the duty upon lawyers to uphold the rule of law.

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78 John Flood, 'Ambiguous Allegiances in the Lawyer-Client Relationship: The Case of Bankers and Lawyers' (4 June 2009) <http://ssrn.com/abstract=962725> .

79 John Flood, 'Lawyers as Sanctifiers: The Role of Elite Law Firms in International Business Transactions' (2007) 14(1) *Indiana Journal of Global Legal Studies* 35, 66.

80 Faulconbridge et al, above n 1, 467.

81 Michael McHugh, 'Jeopardy of Lawyers and Accountants'(1989) 5(1) *Australian Bar Review* 1, 6.

82 Ibid.

83 David J Middleton and Michael Levi, 'The role of solicitors in facilitating "Organized Crime": Situational crime opportunities and their regulation' (2004) 42 *Crime, Law and Social Change* 123, 129.

84 Ibid 131.

B. *Contentious Legal Services: International Arbitration and Mediation*

> Corruption is the most pressing problem in international trade and commerce. It is pervasive, insidious and endemic in large areas of the world, particularly in what we term the 'emerging markets'.[85]

The same theory arguably applies to contentious legal services provided by global law firms. Although litigation through a nation's public court system is what used to first come to mind when colloquial references are made to 'back-end legal services' the contentious global legal services that may be exposed to a higher risk of financial crime involve the private and confidential alternative dispute resolution methods of international (commercial) arbitration and mediation.

Mediation (by and large) is a fully consensual dispute resolution process in which the parties are encouraged to mutually resolve their dispute by an independent non-judicial person.[86] International commercial arbitration on the other hand is a dispute resolution method (that is *not* considered to be an alternative to litigation)[87] by which the parties formally agree in advance (or on an ad-hoc basis) for an independent non-judicial person to arbitrate a dispute and make a binding enforceable decision. Theoretically, the international arbitration process gives the contracting parties access to cross-border justice through what some now refer to as the *new lex mercatoria*[88] as well as by giving commercial parties the liberty to select the arbitrator and arbitral seat.[89] However, unlike litigation proceedings, which are largely conducted through a nation's public court system, international arbitration has the commercial advantages of being supposedly more expedient and less costly, with perhaps its most attractive feature being its private and confidential non-public nature:

> People engaged in commerce choose arbitration in order to be outside the procedures of any national court. They frequently prefer the privacy, informality and absence of any prolongation of the dispute by appeal which arbitration offers.[90]

As shall be considered further below, the features of international commercial arbitration that increase its attractiveness over litigation may also make it irresistibly attractive for use and abuse by financial crime perpetrators. This premise requires empirical testing, but theoretically accepting it for the present, the increasing popularity of international commercial arbitration in jurisdictions that exempt lawyers from AML regulation may pose a risk for financial system stability. It is interesting to note for example that at the peak of the global credit/financial crisis, arbitration case filings increased at some of the world's leading arbitration centres. There was reportedly a 26.5 per cent increase at the London Court of International Arbitration and a 48 per cent increase at the German Institution of Arbitration.[91] The sentiment of those who practice in this area is thus buoyant:

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85 Arthur Marriot, 'Corruption in Arbitration and Mediation Compared' (2006) 72 *Arbitration* 3, 231.

86 Ibid 234.

87 See for example, Jan Paulsson, Nigel Rawding, Lucy Reed, *The Freshfields Guide to Arbitration Clauses in International Contracts* (Kluwer Law International, 2011) 1.

88 Ole Lando, 'The Lex Mercatoria in International Commercial Arbitration' (1985) 34 *International and Comparative Law Quarterly* 747; Abul FM Maniruzzaman, 'The Lex Mercatoria and International Contracts: A Challenge for International Commercial Arbitration?' (1999) 14 (3) *American University International Law Review* 657.

89 See generally, Nigel Blackaby et al, *Hunter and Redfern on International Arbitration* (Oxford University Press, 2009) ch 1.

90 This quote is taken from the case of *West Tankers v RAS Runione Adriatica di Scurta SpA* [2007] UKHL 4 per Lord Hoffman at 17, as cited by Rashda Rana and Michelle Sanson, *International Commercial Arbitration* (Thomson Reuters, 2011) 10.

91 Stephan Wilske, 'The Impact of the Financial Crisis on International Arbitration' (February2010) 65(1) *International Dispute Resolution Journal* 82, 84-5.

> An outgrowth of a global economy is competition for international arbitration business. International arbitral institutions, including those that are in the arm of the state, are attempting to attract parties to file cases with them. This competition should heat up as a result of the boost in demand for time and cost-efficient arbitration services.[92]

These figures do not correlate with nor support a presumption that an increase in international commercial arbitration automatically signals an increase in financial crime risk. What these figures do suggest is that a further review of international commercial arbitration services may be warranted in those jurisdictions such as Australia, where lawyers are exempt from direct AML regulation.

Australia has implemented law reform to enhance its attractiveness as an international arbitral seat. In 2010 the Australian Federal Parliament passed a range of amendments to the *International Arbitration Act 1974* (Cth). The object of this legislation is to foster trade and commerce in Australia by encouraging commercial parties to: enter arbitration agreements, use arbitration as a dispute resolution method for commercial disputes and enable the recognition and enforcement of arbitral awards regarding trade and commerce matters in Australian courts.[93]

> The main focus of the amendments … is to both increase the attractiveness of international arbitration generally as a dispute resolution method … and to encourage such parties to choose Australia as the venue for their arbitrations.[94]

This recent push for more international arbitration to occur in Australia does not seem consistent with the disdain that has been previously expressed in other jurisdictions about the increasing juridification of commercial disputes through arbitration, such as in the area of construction, where lawyers are perceived to have 'hijacked arbitration'[95] and made arbitration 'a more expensive process than straightforward litigation.'[96] Added to this are anecdotal reports by international lawyers themselves, of incidents of corruption and money laundering through both mediation and international arbitration.[97] As de Lotbiniére McDougall[98] has explained, organised criminal organisations can use international arbitration to launder illicit money by simulating a commercial dispute between related corporate entities that prima facie appear to be unrelated. A false claim for damages based on forged evidence can result in an arbitral damages award that once enforced and paid through the courts, allows the transfer of illicit money without detection because '[u]nlike judicial proceedings, international arbitration offers … a degree of confidentiality, the freedom to organize the proceedings, and the ability to appoint accomplices as arbitrators'.[99]

Other international arbitration financial crime risk scenarios include: the use of legitimate contracts to perpetrate money laundering schemes in ordinary transactions through the import and export of commodities in a foreign country using dirty money, which allows the money launderer to make illicit proceeds appear legitimate.[100]

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92 Ibid 86.
93 *International Arbitration Act 1974* (Cth) s 2D.
94 Richard Garnett and Luke Nottage, 'The 2010 Amendments to the International Arbitration Act: A New Dawn For Australia?'(2011) 7(1) *Asian International Arbitration Journal* 29, 31.
95 John Flood and Andrew Caiger, 'Lawyers and Arbitration: The Juridification of Construction Disputes' (1993) 56 *Modern Law Review* 412, 432.
96 Ibid. The average length of international arbitrations has been reported to be apparently between 17 to 20 months. Chartered Institute of Arbitrators, *CIArb Costs of International Arbitration Survey 2011* <http://www.ciarb.org/conferences/costs/2011/09/28/CIArb costs of International Arbitration Survey 2011.pdf>.
97 Marriot, above n 85, 231; Tatiana Minaeva, 'The Place of Arbitrators in Combating Money Laundering' (2006) *Stockholm International Arbitration Review* 33.
98 Andrew de Lotbiniére McDougall, 'International Arbitration and Money Laundering' (2005) 20(5) *American University International Law Review* 1021.
99 Ibid 1023.
100 Ibid 1024.

International arbitration is also said to be exposed to the financial crime risks of bribery, corruption and fraud.[101] These risks are also present in mediation which being a more informal process not bound by the rules of evidence, arguably affords mediators more opportunity to detect criminal activity in the mediation process and therefore form an actual strong suspicion.[102] Although senior opinion is that when confronted with corruption a mediator should immediately halt the mediation process, the question remaining is whether such mediator also has a duty to externally report their suspicion or knowledge and if so, to whom?[103]

Similar issues have arisen in the context of litigation noting the English decision of *Bowman v Fels*[104] which effectively confirmed that client legal professional privilege and the ordinary conduct of litigation by legal professionals are *not* caught by the offences under Part 7 of the *Proceeds of Crime Act 2002*(UK)[105] ('POCA'). That provision effectively prohibits any involvement in arrangements that facilitate or are suspected of facilitating the acquisition, retention, use or control of criminal property. The effect of *Bowman v Fels* has been interpreted as exempting lawyers in the UK from a duty to report knowledge or suspicion of money laundering where it is acquired or has arisen in the course of litigation. However questions still remain over the legal, ethical and public policy position of lawyers acting in arbitrations or as arbitrators[106] who become aware that a contract which is the subject of an international arbitration involves bribery, money-laundering or corruption .[107] Even where allegations of such crimes are dismissed by an arbitral tribunal, questions may persist over the enforceability of the tribunal's award by the courts.[108]

> It is exactly this type of problem that is more pressing than ever in light of sustained international action against bribery and money laundering in recent years. These activities can no longer be discretely overlooked by multinational corporations or arbitral tribunals as an inevitable by-product of doing business in less-developed regions of the world.[109]

Whilst it is beyond the scope of this paper to canvass these issues to the level they deserve, their existence is another area that may benefit from further empirical investigation of the potential financial crime risks that increased international arbitration activity may attract to legal services provided in jurisdictions where lawyers remain exempt from a regulatory obligation to conduct AML client due diligence and suspicious matter monitoring.

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101 Antonio Crivellaro, 'Arbitration case law on bribery' in Kristene Karsten and Andrew Berkeley (eds), *Arbitration, Corruption, Money Laundering and Fraud* (International Chamber of Commerce, 2003) 109; Alan Philip, 'Arbitration – money laundering, corruption and fraud' in Karsten and Berkeley, ibid 147.

102 Marriot, above n 85, 235.

103 Ibid.

104 *Jennifer Mary Bowman v William John Fels* [2005] EWCA Civ 226 (8 March 2005, [42] (Lord Justice Brooke).

105 *Proceeds of Crime Act 2002* (UK) c 29, Part 7, s 328.

106 Anonymous author, 'Confidentiality and the Duty of Disclosure Sub-group 4: Impact of the initiatives on other areas of the law'(2003) 6(3) *Journal of Money Laundering Control* 248, 250.

107 Bernardo M Cremades and David J A Cairns, 'Corruption, International Public Policy and the Duty of Arbitrators' in the American Arbitration Association's, Chapter 4 in the *Handbook on International Arbitration and ADR* (American Arbitration Association, 2nd ed, October 2010); Marriot, above n 85, 233.

108 Cremades and Cairns, above n 107, 37. de Lotbiniere McDougall, above n 98, and others have commented, an arbitral award that is found to be tainted by evidence of illegality (such as money laundering), might not be enforced under Article 36 of the United Nationals Commission on International Trade Law, *Model Law on International Commercial Arbitration,* on the grounds of it being contrary to national public policy. This is reflected in Australian legislation. See the *Commercial Arbitration Act 2010* (NSW) s 36(1)(b)(ii); *International Arbitration Act 1974* (Cth) s 8(7)(b).

109 Cremades and Cairns, above n 107, 37.

C. *Multi-jurisdictional Office AML Regulatory Risk*

A law firm partnership structure that genuinely operates as one-firm with multi-jurisdictional offices around the world, may be inherently exposed to the financial crime regulatory risks presented by disparate national laws in an environment where 'money launderers are known to use lawyers' accounts to conceal funds'.[110] The regulatory inconsistencies faced by the multi-jurisdictional lawyer acting for clients across different borders are a quandary.[111] When we extend this quandary from the individual lawyer to the global law firm, further empirical analysis is needed to assess whether and if so how the law firm as a whole may be exposed to criminal liability for AML offences under applicable legislation. This question arises due to the idea that global law firms are 'seamless service' structures. The supposedly seamless nature of global law firms may arguably increase the likelihood that information and knowledge of unlawful activity, as held by the partners of a firm's overseas office, is physically passed to the managing or other partners of the head office in the home jurisdiction where AML regulation does apply to lawyers. The seamless nature of global law firms may be such that this information is in fact transmitted to the files, record retention management systems and email in-boxes in the head office where those lawyers and partners have direct access. Although AML regulation such as the UK's *POCA*, does not apply to lawyers acting outside its jurisdiction, questions have been raised by legal profession organisations about the potential extraterritorial applicability of *POCA*, not only to individual lawyers but also limited liability partnerships ('LLPs').[112] This arises because pt 7 of *POCA* creates offences for a failure to disclose knowledge or suspicion of money laundering by 'persons' in the UK, whether they be individual natural persons (including foreign lawyers who conduct fly-in fly-out legal services) or corporate legal entities. In this regard guidance might be obtained from the evolution of criminal law in jurisdictions such as the UK and Australia which has attempted to trace corporate criminal culpability back to the persons within a company who are 'directing its mind and will' (such as the Chief Executive Officer and/or board of directors).[113] Can the same criminal culpability for AML regulatory offences be applied to the global law firm structure that seamlessly operates in foreign jurisdictions where AML laws do not apply to lawyers? Can the knowledge or suspicion of money laundering activity by partners in an overseas law firm office (recalling this includes knowledge of financial or property proceeds derived from another predicate offence) be factually traced back to the directing mind and will of the firm's partners in the home office? This question and others have been presciently raised by legal profession bodies (such as the Law Society of England and Wales)[114] and the following diagram attempts to more clearly illustrate the quandary.

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110 John W Brooks and Roberta Vassallo, 'Attorney Cathy's Quandary, Or, Can The Gatekeeper Initiative Be Reconciled with the Multi-Jurisdictional Practice of Law?' (2007) 41 *The International Lawyer* 59, 64.

111 Ibid 61-2.

112 Consider the response of The Law Society to the *SRA Consultation on the Regulation of International Practice Law Society of England and Wales* (February 2012) which states at 2-4, that the SRA has the power to regulate both firms and individuals under the *Legal Services Act 2007* (UK) c 19, see pt 3, ss 13(2), 15, 18.

113 This principle, as first enunciated in the English case of *Tesco Supermarkets v Nattrass* [1972] AC 153, has been previously criticised as failing to enable criminal culpability to be found against corporations where the alleged conduct can only be attributed to middle and lower management: see Brent Fisse, 'The Attribution of Criminal Liability to Corporations: A Statutory Model' (1991) 13 *Sydney Law Review* 277, 278.

114 Consider, the United Kingdom's Law Society's *Anti-Money Laundering Practice Note* (October 2012) <http://www.lawsociety.org.uk/advice/practice-notes/aml/ >.

Figure 1 – Global Law Firm Acts on a Cross-Border Merger and Acquisition

In Figure 1 above, a global law firm acts on a cross-border transaction in its London and Sydney offices. The client is a Chinese investor who gives instructions to the firm's partners in the Sydney office to issue a take-over bid for an Australian company. Some aspects of the matter require legal advice from the London partners due to the fact funds for the bid are to be raised on the European capital markets. The Sydney partners *suspect* that the client has paid bribes to Australian officials to approve aspects of the bid and they *know* that the third party Australian company (which is being represented by another global law firm and is the subject of the client's take-over bid) has breached Australian environmental protection laws.

D. *Questions*

Question that arise include: what and whether any client due diligence identification or mandatory reporting is made by the partners in the London or Sydney office regarding the knowledge and suspicions held by the Sydney partners.

Where knowledge is factually and automatically conveyed from the Sydney office to the London office under a *one-firm seamless* structure, does a duty then fall upon the firm's London partners to externally report this transmitted knowledge of the transaction's third party's breach of Australian environmental laws, to the relevant UK authority? Presuming that the nature of the work carried out by the partners of both offices falls within the definition of 'regulated work' under the UK's *POCA*, do the Sydney partners rely on the London partners to comply with client due diligence requirements under UK law? Or, on the other hand, if most of the legal work and therefore monitoring of the client and the transaction itself can realistically only be conducted by the Sydney office partners within Australia, how much if any suspicious activity monitoring and reporting would occur when lawyers in Australia are prima facie exempt from such obligations under Tranche 1 of Australia's AML regulatory regime?

Finally, what is the entire firm's criminal liability risk for committing failure to disclose knowledge and suspicion offences under *POCA* back in the UK, where under a seamless service structure, suspicions or actual knowledge by the partners in the Sydney office can be traced back to the directing mind and will of the partners in London?

The answers to these questions will depend upon further quantitative and qualitative research of the structural operation of global commercial law firms, alongside analysis of legal profession regulation in those jurisdictions where global law firms are predominantly based. Global commercial law firms appear to fulfil a distinct and vital role in both corporate governance and financial system stability and further research may help to bolster and protect the broader functions that they serve.

CONCLUSION

> Lawyers are likely to become more attractive to money launderers if they remain the only profession which can avoid disclosing suspicion to the authorities by taking advantage of the LPP exception.[115]

Further critical investigation of global law firm exposure to cross-border financial crime risk is important at a time of ongoing international financial system instability and disparate AML laws across different jurisdictions. Although empirical research is also required to obtain adequate evidence by which to test the veracity of the actual financial crime risks posed to global law firm services, present studies and academic literature indicate a need for more critical analysis of the role played by these firms in the national and global financial system. By linking the dual roles of professional gatekeepers in both corporate governance and the financial system with regard to AML as a potential prototype for financial crime regulation generally, the research questions outlined in this paper are designed to prompt a broader search for a long-term solution to the financial crime risks posed to the global lawyer-client relationship.

Further research would also depend on the collaborative co-operation between academics and global law firms. In the meantime, as more global law firms arrive in Australia their potential unwitting risk of exposure to cross-border financial crime risk deserves more attention before the enactment of Tranche 2 of Australia's AML regime.

115 Middleton and Levi, above 83, 137.

THE FINANCIAL ADVISER AS FIDUCIARY

A BRAVE NEW WORLD?

KRISTY RICHARDSON AND JENNY BUTLER[*]

ABSTRACT

The November 2009 Report delivered by the Parliamentary Joint Committee on Corporations and Financial Services examined the role of financial advisers in the Australian context. The Parliamentary Committee questioned whether the apparent tension between client-focussed financial advice and product-focussed financial advice would be remedied by parliament imposing a statutory fiduciary duty of care upon financial advisers. The Corporations Amendment (Future of Financial Advice) Bill 2011(Cth) and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011(Cth) have now been passed by the House of Representatives and the Senate. This paper suggests that the imposition of a statute based duty should not represent entry into a brave new world but is a reflection of the role that financial advisers play in contemporary society.

I. INTRODUCTION

In 2006, Professor Malcolm Cope observed that, '[t]he courts have declined to adopt any comprehensive definition of who is a fiduciary and have left open the possibility that such a relationship might arise in an infinite variety of circumstances.'[1] He noted however, that the courts have extended the duty of care into the area of financial services where there is, due to the nature of the specific relationship on the facts, 'a reasonable expectation on the part of one party, to the relationship that the other will act in the interests of that party and not in the interests of himself or herself or the interests of some third party'.[2] This means that a fiduciary relationship is not presumed to apply in every financial adviser/client relationship. For such a relationship to exist, the specific facts and circumstances of each case will need to be considered. Professor Cope's statements were made before scandals such as the Opes Prime and Storm Financial collapses in 2008.[3] Undoubtedly these scandals had an adverse effect on the public's perception of financial advisers as the failures called into question the role, function and standard of financial advisers. These

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1 Malcolm Cope, 'A Comparative Evaluation of Developments in Equitable Relief For Breach of Fiduciary Duty and Breach of Trust' (2006) 6(1) *Queensland University of Technology Law and Justice Journal* 118, 121.

2 Ibid. Professor Cope goes on to note that, '[a]side from lawyers and their clients, the other professional relationship in which breach of fiduciary duty claims are being raised, is in the context of the relationship of a financial adviser and client. All of the usual fiduciary duties may be brought into play, although as yet the body of case law is sparse, but is steadily increasing as a result of the growth of financial advisory work undertaken by banks, financial institutions, firms of accountants and others operating as independent financial advisers. There have been instances of successful claims based on conflict of duty and interest established against financial advisers, and of additional obligations having to be discharged because of the advisory role undertaken which will result in the court examining the quality of the advice and the fairness of the transaction. There have also been instances in which the courts have intervened where there has been a conflict of duty and duty on the part of the manager (citations omitted): at 127.

3 The Australian Securities and Investments Commission has dedicated websites for information relating to the collapses. See *Overview of ASIC's Storm Website* <https://storm.asic.gov.au/storm/storm.nsf> and *Opes Prime* <http://www.asic.gov.au/asic/asic.nsf/byheadline/Opes+Prime?openDocument>.

calls were not only made in the public arena[4] but resonated into the political domain ultimately resulting in the Parliamentary Joint Committee on Corporations and Financial Services ('the Parliamentary Committee') being convened to 'inquire into and report … on issues associated with recent financial product and services provider collapses'.[5] The absence of financial advisers falling into an established category of fiduciary relationship was highlighted in the Report delivered by the Parliamentary Committee. This absence provided the impetus to the Parliamentary Committee to support, 'the proposal for the introduction of an explicit legislative fiduciary duty on financial advisers requiring them to place the clients' interests ahead of their own.'[6] The Parliamentary Committee suggested that an explicit recognition of a fiduciary duty being owed to clients by financial advisers would assist in resolving any conflicts of interest issues that seem inherent in the role of the financial adviser. The federal government responded by proposing that a 'best interests obligation' be incorporated into the *Corporations Act 2001* (Cth).[7] The best interests obligation is accepted as not being akin to establishing a fiduciary relationship as between financial adviser and client but something lesser.[8] Whilst the statutory best interests obligation may be regarded as something lesser it is suggested, notwithstanding, that the relationship between financial adviser and client is such that the fiduciary duty ought to apply to financial advisers. It should apply not only based upon the *professional* relationship that financial advisers have with respect to their clients but society's expectations of the role financial advisers now fulfil.

The paper is organised by initially examining the notion of the fiduciary relationship. This is followed by an examination of the duty imposed upon fiduciaries. This includes reference to the historical conception of the role of the financial adviser and seeks to

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4 See for example, Michael West, 'Storm Turns into Typhoon', *The Sydney Morning Herald* (Sydney), 12 December 2008 <http://www.smh.com.au/business/storm-turns-into-typhoon-20081212-6x2y.html>; Michael West, 'No Shelter from Storm', *The Sydney Morning Herald* (Sydney), 11 December 2008 <http://www.smh.com.au/business/no-shelter-from-storm-20081211-6wgr.html>; Richard Webb, 'Countdown to the big clean-up', *The Sydney Morning Herald* (Sydney), 2 May 2010 <http://www.smh.com.au/business/countdown-to-the-big-cleanup-20100501-u09g.html>; Alan Kohler, 'Opes Prime Collapse: Billion Dollar Bust', *The Business Spectator*, 29 March 2008 <http://www.thebusinessspectator.com.au> at 26 October 2010.

5 Parliamentary Joint Committee on Corporations and Financial Services, Commonwealth Parliament, *Inquiry into Financial Products and Services in Australia* (November 2009) 1 ('2009 Inquiry'). The Committee's Terms of Reference required the Committee to pay particular reference to:
1. The role of financial advisers;
2. The general regulatory environment for these products and services;
3. The role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers
4. The role played by marking and advertising campaigns;
5. The adequacy of licensing arrangements for those who sold the products and services;
6. The appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served;
7. Consumer education and understanding of these financial products and services;
8. The adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers; and
9. The need for any legislative or regulatory change.

Added later was the requirement that:

> The committee will investigate the involvement of the banking and finance industry in providing finance for investors in and through Storm Financial, Opes Prime and other similar businesses, and the practices of banks and other financial institutions in relation to margin lending associated with those businesses.

6 Ibid 110.

7 See Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) s 961C(1); and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Cth) s 961B.

8 See Parliamentary Joint Committee on Corporations and Financial Services, Commonwealth Parliament, *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011* (29 February 2012) ('2012 Inquiry') <http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/future_fin_advice/report/index.htm>.

reconcile that with the fiduciary principle. This is followed by a comment upon the potential impacts of the imposition of a statutory duty of care.

II. THE FIDUCIARY RELATIONSHIP

Professor PD Finn has noted that the, 'fiduciary law's concern is to impose standards of acceptable conduct on one party to a relationship for the benefit of the other where the one has a responsibility for the preservation of the other's interests.'[9] Professor Finn suggests then that '[t]he "fiduciary" standard for its part enjoins one party to act in the interests of the other – to act selflessly and with undivided loyalty.'[10] Because of the fiduciary standard Perkins and Monahan suggest that:

> The standard of care prescribed for fiduciary duties is higher than the normal contractual or tortious duties of care and include a rebuttable presumption that the adviser has an undue influence over the client. It is the adviser therefore who bears the onus of proof that the terms of their engagement and remuneration do not conflict with the fiduciary duty to his or her client.[11]

Whilst this statement of the duty is clear there is no comprehensive definition of who is a fiduciary or a codification of the relationships that are regarded as fiduciary.[12] Rather the court will consider the nature of each relationship deciding whether a fiduciary relationship exists. If the relationship falls outside the *accepted* categories of fiduciary relationships the existence or not of a fiduciary relationship will occur on an ad hoc[13] basis and depend upon an application of the principles underlying the process of identification. As Professor Cope identifies:

> Key factors singled out in the leading Australian High Court authorities have been a position of disadvantage or vulnerability on the part of one of the parties, which causes him or her to place reliance on the other, and in undertaking to act for or on behalf of, or in the interests of the another in the exercise of a power that will affect the interests of that other in a legal and practical sense.[14]

One of the leading High Court authorities referred to by Professor Cope is *Hospital Products Ltd v United States Surgical Corporation.*[15] The comments of Mason J are oft quoted as indicating the justification for a fiduciary relationship to exist. As Mason J noted in *Hospital Products Ltd v United States Surgical Corporation*:

> The accepted fiduciary relationships are sometimes referred to as relationships of trust and confidence or confidential relations … viz, trustee and beneficiary, agent and principal, solicitor and client, employee and employer, director and company, and partners. … The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power of discretion to the detriment of that other person who is accordingly vulnerable to abuse for the fiduciary of his position. The expressions 'for', 'on behalf of' and 'in the interests of' signify that the fiduciary acts in a 'representative' character in the exercise of his responsibility …[16]

Given that the categories of fiduciary are not closed the test becomes one of looking to the nature of the relationship as between the parties. As Professor Finn suggests:

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9 PD Finn, 'The Fiduciary Principle' in TG Yourdan (ed), *Equity, Fiduciaries and Trusts* (Carswell, 1989) 2.

10 Ibid 4.

11 Michael Perkins and Robert Monahan, *Estate Planning* (Lexis Nexis Butterworths, 2nd ed, 2008) 364.

12 Cope, above n 1,120.

13 Professor Finn has noted that, '[t]hey can arise *ad hoc* because in the actual circumstances of a relationship the requisite ascendancy or trust has in fact been obtained, or given, or confidential information has in fact been acquired.': Finn, above n 9, 43.

14 Cope, above n 1, 121.

15 (1984) 156 CLR 41.

16 Ibid 96-7.

> The initial difficulty is with the term 'adviser' itself. When used simply to designate a person who provides or is expected to provide information, opinion, or prediction to another either entirely voluntary or after solicitation so as to possibly inform that other in making a decision, it covers such a diverse range of social and business possibilities as to be uninstructive as a term of legal import. It is therefore not surprising to find judicial observations to the effect that 'the mere giving of advice does not convert a business relationship … into a fiduciary relationship'. It is likewise, not surprising to find the regular assertion that advisers, at least of particular types, are fiduciary.[17]

There is therefore some difficulty with the terms 'advice', 'information' or 'opinion' being relied upon to determine whether or not what exists between financial adviser and client is a fiduciary relationship. A more precise test needs to be applied to determine whether the relationship between financial adviser and client is a fiduciary one. To that end, Professor Finn suggests that the following questions should be asked of any situation to determine the existence or not of a fiduciary relationship:

1. What are the nature, purpose and progress of the actual relationship between the parties particularly as manifest in their dealings *inter se*
2. What, given the circumstances of the relationship, is the one party entitled to expect (generally or in particular circumstances) of the other in or in virtue of the relationship: that he will act on his own interests; that he will have regard to the former's interests; or that he will act in the former's interests?
3. Are there any independent reasons in public policy which, of themselves, call for the regulation of the conduct of one party, or which would justify according a significant primacy to the expectation of the other?[18]

Relevantly Professor Finn suggests with respect to these questions that:

> The one matter that warrants present emphasis is that reasonable expectations – an amalgam of actual expectations and judicial prescription – are a potential factor in the identification of the standard appropriate to a given situation.[19]

Arguably, it is this notion of 'reasonable expectations' that is a more precise determinative factor as it does not rely on the need to determine whether what was being provided by the adviser was 'mere advice', 'information' or 'opinion'. As Professor Cope identifies the reasonable expectation approach is one:

> … which requires the establishment of a reasonable expectation on the part of one party, to the relationship that the other will act in the interests of that party and not in the interests of himself or herself or in the interests of some third party. The expectation must be such that the fiduciary must act not merely having regard to the other party's interests, but must act solely and selflessly in the interests of the beneficiary.[20]

Arguably where there is a 'reasonable expectation' on the part of a client, the ability for the relationship of financial adviser and client to fall within the scope of a fiduciary relationship is far more evident. Indeed, given this adjustment in focus to determine whether a fiduciary relationship exists or not based upon the reasonable expectations approach, Vince Battaglia suggests that, 'it would seem that the financial services industry provides many circumstances where there is a potential for a fiduciary relationship to arise.'[21] On that point, Professor Finn explains:

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17 Finn, above n 9, 49.
18 Finn, above n 9, 7.
19 Ibid.
20 Cope, above n 1, 121.
21 Vince Battaglia, 'Dealing with conflicts: The equitable and statutory obligations of financial services licensees' (2008) 26 *Company and Securities Law Journal* 483, 485. As Professor Cope noted, '[p]otentially many kinds of financial service relationships are open in scrutiny, including banks when they come to occupy the position of an investment adviser. Under the approach based on the reasonable expectation of the client, such findings are open irrespective of the level of sophistication of the customer

> … fiduciary responsibilities will be exacted where the function of the adviser represents himself as performing, and for which he is consulted, is that of counselling an advised party as to how his interests will or might best be served in a manner considered to be of importance to his personal or financial well-being, and in which the adviser would be expected both to be disinterested, save for his remuneration, and to be free of adverse responsibilities unless the contrary is disclosed at the outset.[22]

In the context of the role and function of the financial adviser/client relationship the demarcation between the provision of advice and information is not an easy one to specifically pinpoint. It becomes more a matter of considering the relationship and reasonable expectations the party had given a particular relationship situation. Given this, Battaglia argues that:

> The best view is that a relationship in a financial services context is to be marked as fiduciary only after an *examination of the facts*. An examination of the facts requires an assessment, in particular, of whether the contract of engagement permits the pursuit of multiple interests, and it cannot be said a priori that all professional relationships, where a financial service is provided … are fiduciary in character.[23]

Such an examination of the facts and circumstances is not required if the relationship is accepted as falling into one of the established fiduciary relationships. In other words, if financial advisers have a statutorily imposed duty of care, the examination of the clients' 'reasonable expectations' becomes irrelevant. The existence of a fiduciary relationship between financial adviser and client will no longer be found on an *ad hoc* basis but will exist as an *established* relationship. Where a fiduciary relationship does exist the requirement to then act in accordance with the fiduciary duty will have a dramatic effect upon the relationship as the duty must be seen to have been discharged for liability to be avoided. Given the nature of the fiduciary relationship, compliance with the duty becomes significant in the context of the financial adviser/client relationship.

III. THE FIDUCIARY DUTY IN THE CONTEXT OF FINANCIAL ADVISER/CLIENT

It is accepted that the fundamental duties of a fiduciary are that a fiduciary must not place himself or herself in a situation where their interest will conflict with that of the client without the client's express, informed consent. Also, a fiduciary must not make a profit out of the relationship without the client's express and informed consent.[24] As Professor Finn notes:

> Two themes, it may be noted, are embodied in this: the one concerns itself with misuse of the fiduciary position: the other with conflicts of duty and interest or conflicts of duty arising in or in virtue of that position.[25]

Once the role of the financial adviser is examined in more detail, particularly as (explained below) the role of the financial adviser has emerged, there is an inherent conflict of interest in the relationship. In that respect in its report the Parliamentary Committee noted that:

> A significant conflict of interest for financial advisors occurs when they are remunerated by product manufacturers for a client acting on a recommendation to invest in their financial product.[26] … These payments place financial advisers in the role of both broker and expert adviser, with the potentially competing objectives of maximising remuneration

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or the ability of the customer to accept or reject the advice. It does not require a total assumption of power by the adviser or total reliance of the client on the adviser.': Cope, above n 1, 122-123.

22 Finn, above n 9, 27.

23 Battaglia, above n 21, 486 (emphasis in original).

24 Perkins and Monahan, above n 11, 364.

25 Finn, above n 9, 27.

26 Parliamentary Joint Committee on Corporations and Financial Services, '2009 Inquiry', above n 5, 75.

> via product sales and providing professional, strategic financial advice that serves clients' interests.[27]

These issues need to be considered in an historical context, particularly in the context of the emergence of financial advisers within the industry. As Perkins and Monahan note in their text:

> The policy direction of government is certainly to redefine the role of financial product advisers who are now being seen to be representatives of the interests of the financial product consumer, not primarily the financial product provider. This tension is not present in relation to other professions in servicing the financial services industry as those other professions have not had the experience of being developed first as a distribution channel for financial service products and only more recently as a recognised profession and source of client rather than product-focussed advice.[28]

The Parliamentary Committee also referred to this historical legacy. The Parliamentary Committee described that legacy as being, 'potentially inconsistent with contemporary expectations that financial advisers provide a professional service that meets their clients' best interests'.[29] Despite the apparent societal change in the expectation of the role and function of a financial adviser the Parliamentary Committee noted that:

> The most common method for providing financial advisory services in Australia is through one of the approximately 160 dealer groups currently operating in Australia. There are just over 18,000 financial advisers in Australia working for 749 advisory groups operating over 8,000 practices. The largest 20 dealer groups hold approximately 50 per cent of the market share. Around 85 per cent of financial advisers are associated with a product manufacturer, either as financial advisers working within the group and using the dealer's support services or as directly employed authorised representatives under that corporate entity's AFSL (Australian Financial Services Licence).[30]

This tension between the role and function of the financial adviser and the management of conflicts of interest was expressed by the Parliamentary Committee in the following way:

> The financial advice industry has significant structural tensions that are central to the debate about conflicts of interest and their effect on the advice consumers receive. On one hand, clients seek out financial advisers to obtain professional guidance on the investment decisions that will serve their interests, particularly with a view to maximising retirement income. On the other hand, financial advisers act as a critical distribution channel for financial product manufacturers, often through vertically integrated business models or the payment of commissions and other remuneration-based incentives.[31]

When examining whether the financial adviser/client relationship is fiduciary in nature, the apparent shift in the reasonable expectation of clients flowing from the financial adviser/client relationship is difficult to reconcile with the structure of the industry and the *contemporary* role of a financial adviser. If a fiduciary duty exists the central issue will become one of how to manage the conflict of interest that inheres in the provision of financial advice. The resolution of any conflicts of interest becomes even more important if the fiduciary relationship falls within one of the established categories of relationship as there is no opportunity to argue that the relationship does not exist on the facts of a particular case.

The report of the Parliamentary Committee canvassed how financial advisers might manage[32] disclosure of potential conflicts of interest and commented that:

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27 Ibid 75-6.
28 Perkins and Monahan, above n 11, 358.
29 Parliamentary Joint Committee on Corporations and Financial Services, '2009 Inquiry', above n 5, 69
30 Ibid 16.
31 Ibid 69-70.
32 As required by ss 947B and 947C of the *Corporations Act 2001* (Cth).

> The Committee is of the opinion that disclosure documents are too long and confusing for conflicts of interest caused by commission-based remuneration and vertical ownership structures to be properly understood by consumers. There are also limits to the usefulness of disclosure, however clear and concise, in an environment where clients have already committed in their mind to their trusted adviser's chosen strategy. Present conduct standards are useful in that they prohibit clearly inappropriate advice being given to consumers, but the threshold is low enough to allow advice that favours the adviser's interests above those of the client. Therefore, consumers are not necessarily getting advice that is in their best interests but, because of the limitations of disclosure often do not realise this.[33]

The Parliamentary Committee recommended then that the *Corporations Act 2001* (Cth) be amended so as to require advisers to disclose prominently in marketing material the restrictions on the advice they are able to provide consumers and any potential conflicts of interest.[34] The Parliamentary Committee was of the view that, '[t]his is particularly important, where conflicts of interest attributable to the ownership structure, will exist even if commission payments to advisers are eliminated as a form of remuneration.[35] Whether a court will accept this as satisfying the fiduciary duty will remain to be seen.

In addition to the above recommendation with respect to disclosure the Parliamentary Committee was of the opinion that:

> The regulatory framework has not compelled the industry to shift from acting as a distribution network to providing a professional unbiased service. Instead, the transition from product sales to professional advice seems to be occurring gradually as a consequence of some sections of the industry's desire to improve consumer confidence in their services.[36]

In an attempt to force this shift the Parliamentary Committee was of the opinion that, '[t]hat the Corporations Act [needs to] be amended to explicitly include a fiduciary duty for financial advisers operating under an AFSL, requiring them to place their clients' interests ahead of their own.'[37] Whilst the Parliamentary Committee drew, 'no conclusion about whether such a duty would automatically preclude the payment of commissions to financial advisers' it made a recommendation that 'the remuneration structures that are incompatible with a financial adviser's proposed fiduciary duty be removed.[38]

In terms of the obligation to avoid conflicts of interest the issue of remuneration and organisational structures will need to be considered and will become an even more pressing consideration if a fiduciary relationship is *accepted* to exist between the financial adviser and client.

The best interests obligation as imposed by s 961B of the *Corporations Act 2001*(Cth) requires that:

1. The provider must act in the best interests of the client in relation to the advice.
2. The provider satisfies the duty in subsection (1), if the provider proves that the provider has done each of the following:
    a. identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;
    b. identified:
        i. the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and

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33 Parliamentary Joint Committee on Corporations and Financial Services, '2009 Inquiry', above n 5, 87.
34 Ibid 115.
35 Ibid.
36 Ibid 70.
37 Ibid 110.
38 Ibid 127.

ii. the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the client's relevant circumstances);

c. where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information;
d. assessed whether the provider has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice;
e. if, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product:
    i. conducted a reasonable investigation into the financial products that might achieve those of the objectives and meet those of the needs of the client that would reasonably be considered as relevant to advice on that subject matter; and
    ii. assessed the information gathered in the investigation;
f. based all judgements in advising the client on the client's relevant circumstances;
g. taken any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.

In terms of the requirement to manage conflicts of interest, s 961J of the *Corporations Act 2001* (Cth) requires that:

1. If the provider knows, or reasonably ought to know, that there is a conflict between the interests of the client and the interests of:
    a. the provider; or
    b. an associate of the provider; or
    c. a financial services licensee of whom the provider is a representative; or
    d. an associate of a financial services licensee of whom the provider is a representative; or
    e. an authorised representative who has authorised the provider, under subsection 916B(3), to provide a specified financial service or financial services on behalf of a financial services licensee; or
    f. an associate of an authorised representative who has authorised the provider, under subsection 916B(3), to provide a specified financial service or financial services on behalf of a financial services licensee;
    g. the provider must give priority to the client's interests when giving the advice.

Interestingly, notwithstanding that the best interests obligation is something lesser than the statutory fiduciary duty called for by the Parliamentary Joint Committee on Corporations and Financial Services the second referral of the Bills to the Committee did not result in any amendment to the sections.[39] The question of whether the statutory best interests obligation displaces any obligation that the financial adviser may be found to have if they are found to be in a fiduciary relationship with the client will remain an issue to be decided by the court. In that respect there is no statutory provision which details how the statutory

39 See Recommendations 4.66 and 467 of the Parliamentary Joint Committee on Corporations and Financial Services Corporations, '2012 Inquiry', above n 68 Recommendation 4.66: 'The committee considers that the introduction of a statutory best interests duty for financial advisers to act in the best interests of their clients is a vital reform for the financial advice industry. This duty will help increase the professionalism of the industry and provide additional protection for consumers'. Recommendation 4.67: 'The committee believes that the formulation of the best interests obligation in the Bill strikes an adequate balance between providing certainty for the industry while ensuring professional standards are raised'.

obligation interacts with other laws.[40] So do these changes really mean a brave new world for financial advisers?

IV. THE FINANCIAL ADVISER AS FIDUCIARY: A BRAVE NEW WORLD?

Professor Finn has noted that the fiduciary principle:

> … has been used, and is demonstrably used, to maintain the integrity, credibility and utility of relationships perceived to be of importance in a society. And it is used to protect interests, both personal and economic, which a society is perceived to deem valuable. … as perceptions of social interests and values change so also can the ambience of the fiduciary principle itself.[41]

He suggests then that:

> It originates, self-evidently, in public policy: in a view of desired social behaviour for the end this achieves. To maintain the integrity and utility of those relationships in which the (or a) role of one party is perceived to be the service of the interests of the other, it insists upon a fine loyalty in that service.[42]

There is much that is positive to be drawn from such statements in the context recognising the worth of financial advisers in our contemporary society. The fall of such financial advisers as Storm Financial and Opes Prime has demonstrated that there is a social and economic need to maintain the integrity and utility of financial advisers and the advice that they can provide. Underlying this then is the perception that there is a 'way' that financial advisers should act and interact with society and clients and that 'way' needs to be reflected in the law as an expression of that public policy aim. As Professor Finn argued above, the finding that a fiduciary relationship exists is one way by which this perception and social expectation can be incorporated into the legal (common law or statutory) regulation of the relationship to facilitate a change in behaviour. Whilst this recognition of the financial adviser is positive, there are perils associated with being regarded as a fiduciary. In the end, the imposition of a statutory fiduciary duty upon financial advisors may not be the issue. Undoubtedly, there is already scope (legal[43] and professional[44]) to accept that the financial adviser/client relationship is fiduciary in nature. So the imposition of the statutory duty should not be the starting point of the 'brave new world'. What will be the *brave new world* is whether the industry has the capacity to both structurally and organisationally ensure that the demands of the fiduciary duty have been met.

V CONCLUSION

Following the financial adviser collapses of Storm Financial and Opes Prime the role and function of financial advisers was brought into the public and political domain for examination. Once in the political domain the impetus for change gained momentum and the report produced by the Parliamentary Joint Committee on Corporations and Financial Services recommended that a statutory fiduciary duty of care be confirmed as existing between financial adviser/client. Arguably this was a reflection of societal influences and the importance and worth of financial advisers to society. The law is a reflection of societal

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40 As for example, s 185 of the *Corporations Act 2001*(Cth) does with respect to Director's Duties. Section 961M(8) of the *Corporations Act 2001*(Cth) provides that the civil remedies available where there has been a breach 'do not affect any liability that a person has under any other law'.

41 Finn, above n 9, 26.

42 Ibid 27.

43 See for example, *Mathas v Slater; Donnybrook Properties Pty Ltd v Simpson* [2009] NSWSC 1397; *Evans & Ors v Brannelly & Ors* [2008] QDC 269.

44 Battaglia, above n 21, 485. See also the rewritten/updated Code of Ethics and other professional practice standards of the Financial Planning Association of Australia; Financial Planning Association of Australia, *The Pillars of Our Profession: Code of Professional Practise* (July 2011) <http://www.fpa.asn.au/media/FPA/FPA Standards/CodeofPractice_July 2011.pdf>.

influences and expectations and has been willing, given certain circumstances, to accept already that there is capacity for the financial adviser/client relationship to be fiduciary in nature. The statutory amendment to the *Corporations Act 2001* (Cth) should then not represent a brave new world but just a step in the direction of recognising societal expectations of the financial adviser. What will be a brave new world is how the industry, given its historical development, will restructure to demonstrate that the client's interests have been put first and any conflicts of interest have been appropriately managed.

ADOPTION IN VANUATU

Sofia Shah[*]

Vanuatu is known for its pluralistic society where there are more than one form of law governing the land and people, statutes and customary law.[1] This area of research is very extensive and as this is ongoing research I will narrow down this paper to focus on the statutory approach to inter-country adoption in Vanuatu and then discuss the customary approaches to adoption.

I. International Law in regard to Adoption

Internationally there has been a lot of recognition given to the rights of the child regarding adoption. This is evident through the *Convention on Protection of Children and Co-operation in Respect of Intercountry Adoption* (‘*The Hague Convention I*’),[2] the *United Nations Declaration on Social and Legal Principles Relating to the Protection and Welfare of Children with Special Reference to Foster Placement and Adoption Nationally and Internationally*[3] (‘*UN Declaration 1986*’) and the *United Nations Convention on the Rights of the Child*[4] (‘*CRC*’).

Most of the provisions from these international conventions, which are for the welfare and good of the children, have been suggested to the regional countries. The regional countries need to incorporate these laws into their domestic legislation, if they are signatories to the conventions.

According to the *Hague Convention I,* the child who is to be adopted has to be less than 18 years of age and unmarried. However, *Hague Convention I* can only be invoked if the state where the adoption is taking place is a signatory to this Convention.[5]

Under Article 6 of the *Hague Convention I*, an adoption will be granted if it is deemed to be in the interest of the child. The court under this Convention has to make an inquiry in regard to the adopters, the child and his or her family. Whether adoption is an international or domestic matter, Article 21 of the *CRC* specifically states that states have an obligation to ensure the best interests of the child as the paramount consideration in matters of adoption. So in adoption cases, states need to comply with the law and proper procedures. According to *Hague Convention I*, the application for intercountry adoption should be made to the central authority in the state of their habitual residence which is then referred to the central authority of the child’s country. The receiving state then decides if the adopter is eligible or not for the adoption after the background check is finalised according to Article 17 whereby consent of the parents is an important aspect.[6] Therefore, states must ensure that their domestic legislation protects the child, that proper procedures are in place,

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1 David Weibrot, ‘Custom, Pluralism, and Realism in Vanuatu: Legal Development and the Role of Customary Law’ (1989) 13(1) *Pacific Studies* 65 <https://ojs.lib.byu.edu/spc/index.php/PacificStudies/article/viewFile/9578/9227>.

2 *Convention on Protection of Children and Co-operation in Respect of Inter-country Adoption*, opened for signature 29 May 1993, 85 UNTS 89 (entered into force 1 May 1995) *(‘The Hague Convention I’).*

3 *United Nations Declaration on Social and Legal Principles Relating to the Protection and Welfare of Children with Special Reference to Foster Placement and Adoption Nationally and Internationally,* opened for signature 11 December 1985, A/RES/41/85 (entered into force 3 December 1986)(1993) 32 ILM 1134, UNGA Resolution 41/85, UNGAOR, UN Doc A/41/85 (‘*UN Declaration 1986*’).

4 *United Nations Convention on the Rights of the Child*, opened for signature 20 November 1989, 140 UNTS 195 (entered into force 2 September 1990) (*‘CRC’*).

5 Dejo Olowu, ‘The Legal Regime of Child Adoptions in the South Pacific and the implications of International Regulatory Standards’ (2007) 19 (No.1) *Sri Lanka JIL* 109. Vanuatu is not a signatory to *Hague Convention I,* but is a signatory to *CRC*..

6 *The Hague Convention I* arts 14, 15, 16, 17.

that parents must give their consent, and that adoption procedures do not facilitate the sale of children.

The *CRC* endorses intercountry adoption where a child cannot be placed in foster care or an adoptive family cannot be found in the child's country of origin as per Article 21. Article 3 of the *CRC* is very explicit in that in regard to all actions concerning children, whether undertaken by public or private social welfare institutions, administrative authorities, courts of law or legislative bodies, the best interest of the child shall be the primary consideration.[7] The *Hague Convention I* seeks to ensure that where intercountry adoption takes place it does so in the best interest of the child and that children are protected from abduction, sale or trafficking.

Adoptive parents come from New Zealand and Australia in some circumstances. These countries are signatories to these conventions. However, the Pacific Island countries have limited international obligations in respect of intercountry adoption procedures as per Articles, 4, 14 and 22 and the role of central authorities and the regulation and control of agencies involved in the adoption process as per Articles 6 to 13.[8] In Vanuatu the adoption provisions are found in the *Adoption Act 1958* (UK). The *Adoption Act 1958* (UK) is applicable in Vanuatu by virtue of Article 95 of the *Constitution of the Republic of Vanuatu*.[9]

Intercountry adoptions' aim has been to assist childless couples and at the same time provide for the many orphans and children who need a home around the world.[10] Usually when couples adopt a child they prefer that the child grows up to know them as being the child's biological parents.[11] Intercountry adoptions have been on the rise as shown by the following statistics. Australia reported a total of seven adopted children from Fiji and Tonga between 2001 and 2004[12] while New Zealand reported 557 children being adopted between 2001 and 2003 from six South Pacific countries namely Fiji, Papua New Guinea, Samoa, Tonga, Tuvalu and Vanuatu.[13] In 2011 the number of children being adopted has been 384 for Australia out of which 62 per cent were intercountry adoptions[14] and 199 children[15] were adopted by families in New Zealand. The United States of America reports to have over 5 000 adoptions for 2011.[16]

II. POTENTIAL PROBLEMS WITH INTERCOUNTRY ADOPTION

It is good to see that international efforts are being made to find homes for these homeless children but at the same time one has to bear in mind the growing number of offences

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7 *CRC* art 3

8 *UN Declaration 1986.*

9 Article 95 of the *Constitution of the Republic of Vanuatu*: Existing Law
(1) Until otherwise provided by parliament, all joint regulations and subsidiary legislation made thereunder in force immediately before the Day of Independence shall continue in operation on and after that day as if they had been made in pursuance of the Constitution and shall be construed with such adaptations as may be necessary to bring them into conformity with the Constitution. …(3) customary law shall continue to have effect as part of the law of the republic of Vanuatu.

10 Olowu, above n 5, 111 at [1].

11 bid 111 at [1].

12 Hague Conference on Private International Law, *Australia- Annual Adoption Statistics 2001-2003* <http://www.hcch.net/upload/adostats_au.pdf>.

13 Sue Farran, 'Child Adoption: The Challenges Presented by the Plural Legal Systems of South Pacific Island States' (2009) 21(4) *Child and Family Law Quarterly* 462.

14 Australian Institute of Health and Welfare, *Adoptions Australia 2010-2011* <http://www.aihw.gov.au/WorkArea/DownloadAsset.aspx?id=10737420773>.

15 Hague Conference on Private International Law, 'Annual Adoption Statistics Forms: Preliminary Document No 5 of April 2010 for the attention of the Special Commission of June 2010 on the practical operation of the *Hague Convention of 29 May 1993 on Protection of Children and Co-operation in Respect of Intercountry Adoption*' (April 2010) 8 <http://www.hcch.net/upload/wop/adop2010pd05_nz.pdf>.

16 Bureau of Consular Affairs, US Department of State, 'FY 2011 Annual Report on Intercountry Adoption' (November 2011) 3 [Table 2] <http://adoption.state.gov/content/pdf/fy2011_annual_report.pdf>.

against children such as child trafficking, sexual abuse, adoptee's loss of identity, denial of access to historical records, and violence against children.[17] Also according to Troy, intercountry adoption has its advantages but also has its share of problems such as child trafficking.[18]

According to academic Sue Farran, adoption of Pacific Island children by non-Pacific Islanders gives rise to a few issues.[19] These children lose the connections with their language, culture and their Pacific identity. Loss of identity of a child has also been addressed by Article 8 *CRC* whereby the obligation is upon the state party to respect the right of the child to preserve his or her identity, including nationality, name and family relations as recognised by the law without any unlawful interferences. In cases where the child is deprived of some or all elements of their identity, the state shall provide appropriate assistance and protection to re-establish the child's identity.[20] State parties need to take note of this and apply it in protecting the child from identity loss in adoption proceedings. There is also the danger that the increasing demand for infants available for adoption could lead to abuse of process. There have been outcries from time to time that the children are virtually been sold into the adoption market. Sometimes non-indigenous residents of Pacific Island states choose to adopt Pacific Island children while living in the Pacific region.[21] The mother or both parents of the child may be known to the adoptive parents. While the adopted child will have the advantage of being brought up within his or her island country, some problems may be experienced as a result of being raised by parents of a different ethnic or racial group.[22] It is also possible that ultimately these 'expatriate' adoptive parents will return to their own country or move to other countries, taking the child with them and thereby severing links with the child's country of origin.[23]

In some cases it may be just a single parent who applies for adoption.[24] Miller views single parent adoptions positively since they come with more flexibility.[25] This theory has been supported by Strauss.[26] This trend is also growing in the Pacific, where couples after divorce or while still single tend to adopt children and look after them.

However, issues with the citizenship of child and adoptive parents can arise in some cases.

In the case of *In re Chelsea Lee,*[27] the adoptive parents were Australian. Although they had been residents of Vanuatu for some time, they appeared to have no intention of renouncing their Australian citizenship.[28] Thus the statutory requirement for domicile according to the Section 1 of *Adoption Act 1958* (UK) had not been satisfied. However, while citizenship was not a pre-requisite for granting the adoption order, there was a pre-requisite for proof of continued domicile in Vanuatu.[29] The court went on to satisfy itself that the adoption was in the best interest of the child.

The court according to the law must always be concerned about the welfare of the child, particularly where the effect of an adoption order will see the child removed from her

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17 Olowu, above n 5, 111 at [2]

18 CJ Troy, 'The Need for Reform in U.S. Inter-country Adoption Policy' (2011-2012) 35(4) *Seattle University Law Review* 1525 at[1].

19 Sue Faran, *Law and the Family in the South Pacific* (University of South Pacific, 2011) 64[1] .

20 *CRC* art 8.

21 Faran, above n 19, 64 at [2].

22 Ibid.

23 Ibid.

24 Naomi Miller, *Single Parents by Choice* (Insight Books, 1992) 58 at [2]

25 Ibid.

26 Kenneth Strauss, 'Recent Developments in Single Parent Adoptions' (2000) 2(1) Journal of Contemporary Legal Issues 597 at [1].

27 [2000] VUSC 22, < http://www.paclii.org>.

28 Ibid 2 at [10].

29 Olowu, above n 5, 135 at [3].

country of origin, natural parents and wider natural family.[30] In the case of *The Child M Adoption case*,[31] Justice Spears has dealt with this issue in detail.

III. CUSTOMARY ADOPTION IN THE COURTS

Customary adoption is widespread in the region both historically and at present day. The customs vary and the extent of its recognition by statute also varies. One of the problems with customary adoption is not only that the customs that apply may vary within the jurisdiction,[32] but also that often customary adoption takes place in different ways and it might be different from island to island like in Vanuatu.[33] Therefore, there are no codified customary laws available to consider what the practice or procedure for a customary adoption should be. The proof of these customs is another challenge to prove if adoption was really made.

The role of the near family in approving the adoption and accepting it becomes important especially when the adopted person claims rights to succession.[34] The reason for seeking an annulment of the adoption will often be material, for example because issues of succession to property are raised or because the adopted child has become a burden. In Vanuatu in the case of *M v P Re the Child G*,[35] the mother of the child claimed that she had given the child to a relative to care for only because she had ten other children to care for. She maintained some limited contact with the child through visits but made little material provision for him.[36] The question arose whether the child had been adopted in custom. The petitioner's claim was that 'in Erakor custom if you give a name to a child then the child belongs to you'.[37] She had kept some contact with the child usually by visiting the child but had not made much material provision for the child.[38] The issue was whether the child had been adopted under customary laws. The petitioner maintained her claim that under custom if the child has been given a name by the biological parents then the child belongs to them. The permission of the chief might be sought and a feast may be given but this was not necessarily the case.[39] The judge was persuaded that the child had been adopted in accordance with local custom despite the fact that the child was not a Ni-Vanuatu. The court noted that the arrangement of the mother to place the child with the adoptive family was more than a temporary arrangement.[40]

However in custom there is no such restriction as in statutory law as to who may adopt the child. If procedures are followed in custom then anyone whether resident or foreigner may adopt a child and vice versa. Both these cases are from Vanuatu but the adoption procedures according to custom in both are different. Similarly, the child has no say in the custom proceedings as the legal proceedings. The child is never asked anything in relation to being given up for adoption. The decision of the elders and family members overrides the opinion of the child.[41]

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30 *The Child M Adoption case* [2011] VUSC 16, <http://www.paclii.org>.
31 Ibid 3 at [14].
32 *M v P Re the Child G* [1980-1984] Van LR 333, 4 at [4].
33 *Tebahai v Habnai* [1986] VUSC 9, 5 at [7]. Both these cases are from Vanuatu but the adoption procedures according to custom in both are different.
34 [1986] VUSC 9, 2 at [1].
35 [1988] VUSC 2, 2 at[2].
36 Ibid 2 at [4].
37 Ibid 4 at [3].
38 Ibid 2 at [5].
39 Ibid 3 at [4].
40 Ibid 2 at [5].
41 Olowu, above n 5, 120 at [2].

IV. STATUTORY ADOPTION IN VANUATU

In Vanuatu according to the decision of Justice Spears, the judges can make an adoption order under the Act by exercising their discretion as per s 1 of the *Adoption Act 1958* (UK).[42]

According to Justice Spears:

> The law and practice relating to intercountry adoption has undergone great change internationally in the recent years. In particular, the 1993 Hague Convention (Convention for the protection of Children and Cooperation in respect to Intercountry Adoptions) came about to meet a growing post-World war II demand for intercountry adoption. Furthermore, it was recognised that there was a corresponding need for clear guidelines to apply to intercountry adoptions particular to safeguard the child.[43]

Vanuatu is not a signatory to the *Hague Convention I*. However, this Convention gives effect to article 21 of the *CRC* and Vanuatu is a signatory to *CRC*.

The principles embedded in Article 21 of the *CRC* are those that deal with adoptions and intercountry adoptions. According to the judgement of Justice Spears, this requires paramount consideration to be given to the rights of the child in question. For this the court has outlined the needs to consider the following factors:

a. first considering national solutions- that is, the placement for adoption in the country of origin;
b. ensuring that the child is 'adoptable'
c. Ensuring that the information about the child and his/her parents is preserved;
d. Ensuring that the prospective adoptive parents are evaluated thoroughly by and independent, responsible and competent government agency in their country;
e. Ensuring that the match of adoptive parents and child is suitable;
f. Imposing additional safeguards where required;
g. Ensuring that the placement in the foreign country will be monitored and generally supervised by a responsible and appropriate arm of that foreign country.[44]

Therefore the developed international approach to intercountry adoptions requires that the two countries -that of the adoptive parents and the adoptee child- work together by sharing responsibilities so that the best interest of the child can be ensured.

In this case there was no guarantee that any responsible and suitable government body would take up any responsibility to assess the prospective adoptive parents and further ongoing supervision and monitoring of the adoption. Therefore an invitation was extended to the Attorney General to intervene so that proper consideration could be given to the implications and international responsibilities arising out of the proposed adoption.[45]

The government should confer with the relevant UN agencies, the civil society and experts in the field of child rights so that they can provide appropriate specialised and technical training for professionals such as judges, magistrates, state counsels, police officers, immigration officials, customs officials, social welfare workers and all other individuals and community, who are involved in the daily administration of child adoption laws or child adoption processes.[46] The training should be across disciplines and the communities should be involved in creating such awareness about child adoption and child rights. The Vanuatu government has to come up with clear policies and guidelines which actually consider the 'best interests of the child in relation to intercountry adoptions'.

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42 *The Child M Adoption case* [2011] VUSC 16 <http://www.paclii.org>.
43 Ibid 3 at [8].
44 Ibid 7 at [14].
45 Ibid, 8 at [20].
46 Olowu, above n 5,144 at [4].

A. *Conflict of Laws*

Conflict of laws is often seen as a hindrance when determining which country's laws should apply on deciding issues of child adoption. The American states have taken a step forward and adopted the *Inter-American Convention on Conflict of Laws Concerning the Adoption of Minors* (1985). Article 4 clearly states:

> The law of the domicile of the adopter (or adoptee) shall govern:
>
> a) the capacity to be an adopter;
>
> b) the age and marital status requirement to be met by an adopter;
>
> c) the consent of an adopter's spouse, if required, and
>
> d) the other requirements for being an adopter[47]

It has to be noted that if the requirements of the law of the adopter (or adopters) are less strict than those of the law of the adoptee's country, then the law of the adoptee's country shall govern the adoption.[48] This is a very interesting aspect as the adoptions in Vanuatu are governed by the laws of Vanuatu when in most of the cases the adopter or adopters are from another country. This is an indication to Vanuatu on the steps it can take to ensure that the adopter or adopters meet the requirements of adoption in their own country before adopting a child from Vanuatu. Of course, if Vanuatu's laws regarding adoption are stricter than those of the law of the adopter's country then they would apply.

B. *Requirements regarding Consent*

Another important factor is the consent of the biological parents to give the their child up for adoption. This is also provided for under sections 4, 5 and 6 of *Adoption Act 1958* (UK) and given prominence in court. However, there is no provision that actually seeks the consent of the child who is brought up for adoption. In many cases it is an infant but in other cases where the child is old enough to reason there are no provisions to take the child's views into consideration before making the court orders.[49] There are no participatory rights of adoptee children in the adoption proceedings which need to be addressed by the countries involved.

V. DIFFERENT APPROACHES TO CUSTOMARY ADOPTION ON VANUATU

Now we move on to consider the customary approaches regarding adoption in the islands of Vanuatu. Information on customary approaches to adoption in Vanuatu was gathered in an interview with Mr Stevie Namali, the National Customary Lands Officer of the Malvatumauri, National Council of Chiefs, Vanuatu.[50]

In 1993 there was an attempt made by the Vanuatu National Council of Chiefs (VNCC) to codify customary laws of the country however, no reference was made to the adoption of children.[51] The flexible, variable and adaptable nature of the customary laws also makes it difficult to integrate the doctrine of 'best interests of the child' into the customary practices of child adoption.[52] Also it becomes difficult to identify the rights of the adopted child in relation to inheritance, property and marriage due to the uncertainty and unwritten nature of customary laws.[53] Moreover customary law does not cater for intercountry

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47 Article 4 of *Inter –American Convention on Conflict of Laws Concerning the Adoption of Minors* (1985) 24(2) *International Legal Materials* 460.

48 Ibid.

49 Olowu, above n 5, 121 at [3].

50 Interview with Stevie Namali, National Customary Lands Officer of the Malvatumauri, National Council of Chiefs, Vanuatu (National Council of Chiefs Office, Port Vila, 10 May 2012).

51 Vanuatu National Council of Chiefs, 'Kastom Polisi Blong Malvatumauri of 1993*'* art 14.

52 Olowu, above n 5, 141 at [1].

53 Ibid.

adoptions. According to the National Council of Chiefs, intercountry adoption is for the courts to deal with while domestic adoptions can take place under customary laws of the land.[54]

A. *Reasons for Customary Adoptions*

One of the reasons why customary adoption may be resorted to in families is where the couple has no sons. In this case the couple may adopt a son from the husband's sister and the child would come and take over the rank of the adoptive father.[55] Another reason is when there is a lot of tribal warfare and the tribe is nearly wiped out. In this case the village would adopt a son who could come and start breeding and put a stop to the fight.[56]

In many cases two tribes may exchange a child to put a stop to the warfare and bloodshed.[57] These children are regarded as replacement and both tribes would bring them up as their own child.[58] This increases friendship and good-will amongst the tribes. These sacred adoption ceremonies are supervised by the chiefs and later on the chief and the family also supervise how the child is being kept and treated by the adopted parents.[59]

However it is important to note that in all cases the parents need to give consent for the child to be adopted. According to Mr Stevie Namali, in situations where there is an unwanted pregnancy, the mother has no choice but to give up her baby for adoption. So family members who want a child would talk to her and under custom adopt the child as theirs. Once the child is adopted the biological parents have no right over the child. Similarly, where a couple has a lot of children it may become difficult for them to provide for all of them and may give up a child for adoption but this may be problematic in some cases as was in the case of *M v P Re the child G*.[60] As considered by the Honorable Patrick E Mc Gann, some of the reasons why a child is given up for adoption are: parents who cannot afford another child giving them up for adoption, a woman in a relationship gets pregnant and her partner walks away gives the child up for adoption, or in some cases the victims of rape choose to give the child up for adoption.[61] However, in all these cases the parent of the child gives their consent before the adoption process is finalised.[62]

B. *Different Customary Rules for Adoption in Vanuatu*

There are various islands in Vanuatu and they have different customary rules for the adoption of a child. I will briefly look at these different islands customary approaches to adoption.

On Malekula or Malampa Island the prospective parents have to make payments in custom to the biological parents of the child and perform the customary ceremony.[63] A child in Malekula can be adopted from the age of one month old till six months old.[64] This adoption has to be registered with the Council of Chiefs as a form of record which will later become useful when sorting out succession rights of the adopted child. This customary process of adoption in Malekula is supervised by the chief.[65] For the adoption to take place, both biological parents need to give their consent.[66] Once the child has been

54 Interview with Stevie Namali, above n 50.
55 Ibid.
56 Ibid.
57 Ibid.
58 Ibid.
59 Ibid.
60 [1988] VUSC 2.
61 Patrick E Mc Gann, 'Inside the Adoption Hearing Room' (2007) 27(3) *Children's Legal Rights Journal*110 at [6,7].
62 Ibid 111 at [3].
63 Interview conducted with Mr Stevie Namali, above n 50.
64 Ibid.
65 Ibid.
66 Ibid.

adopted, the biological parents do not have any further rights to that child under custom and vice versa, the adopted child has no rights to the biological parents neither in custom and nor in property.[67] Also, once the child has been adopted, the biological parents cannot take their child back from the adoptive parents.[68]

Even though the customary adoption is being practised and recognised, the adopted child has to be legally registered to get the legal recognition. This is to ensure the rights of the child are safeguarded and the chiefs are made aware of this process.[69]

VI. ADVANTAGES OF CUSTOMARY ADOPTION

The advantages of customary adoption are that it gives adoptive parents a child if they cannot bear children. It strengthens the links and relationships between the biological and adoptive families. There are fewer burdens on the biological parents if they have many children to care for. The advantage of this customary practice of adoption is that it is less expensive for the parties. It is done within the family tribe and everyone gets involved so they know who has been adopted by whom. Also, as it is performed in custom, there are not many documents or paperwork required and it can be done anytime, unlike in the courts where a date has to be given specifically.

The advantages of customary adoption in Santo are that a lot of love is expressed in such arrangements and the children do not feel neglected. Also very little or no costs are involved. It decreases separation or divorce rates especially where couples have a role to provide care for the children. Also, on the other islands, due to custom there is a lot of respect amongst the families and they would not mistreat the child as everyone will see the adoptive parents as the natural parents.

If in any case the child is mistreated there is a hefty fine imposed on the family by the chiefs. The adoptive parents may seek to reconcile by bringing mats, food, kava or even cash, however the child is never sent back to the adoptive parents who abused the child. Customary adoption maintains and builds the relationship amongst the people and decreases differences between families as all the children are taken care of in the same way. It is a symbol of a living covenant within families and villages.

VII. DISADVANTAGES OF CUSTOMARY ADOPTION

The disadvantages of the customary practice are that the child may still live too close to the biological parents. Also the adoption has to be registered at the court rather than the customary ceremony, so people have to travel all the way to have their customary adoption registered, which of course involves expenses for the families.

The formal and legal adoption procedures to give it legal recognition involves costs and time and heartache for the people as they might feel that their well recognised customs need a further step under the legal system. It is interesting to note that the *Constitution* of Vanuatu recognises customs but yet there are these legal procedures and requirements to give them formal recognition.

Another disadvantage is that custom is unwritten in many places and the procedures may vary. The younger generations do not know the customary practices, so teaching these practices to the children of today is very important for the people of Vanuatu.

The customary way of adoption is a more peaceful, cost effective process which involves trust and harmony. The disadvantage is that there may be chances of the child being mistreated by the adoptive parents.

Finally, if the adoptive parents have other children of their own it may cause ill feelings and hatred and jealousy amongst the children when they are fully grown up and may not be

67 Ibid.
68 Ibid.
69 Ibid.

equally treated. It may also create family conflicts, especially if both parents depend on the child when the child grows up.

VIII. CONCLUSION

In conclusion it can be seen that both forms of adoption, statutory and customary, give some form of recognition to the rights and welfare of the child. They have, however, different ways to attain this. For foreign adoptive parents the child has to be adopted through the formal statutory procedures as biological parents may not be able to supervise how their child is being treated in another country. It is one area where the government needs to expand and invest resources especially during these times when child trade has become a money making business. Adoption under customary law seems a lot safer as the child stays and is cared for within the bigger family and within the jurisdiction which is witnessed by all. In intercountry adoption, on the other hand, the adoptive parents take the child away to another country. Supervision of the treatment and care given to the child is currently impossible as this requires both countries to work together under the UN Conventions to put supervisory structures in place and if a country is not a signatory then enforcement is useless.

There is a need for Vanuatu to put in place effective legal and procedural frameworks regarding child adoption within the region. For Vanuatu to become compliant with all the requirements under the international conventions regarding intercountry child adoption, would demand a massive awareness program, legislation and policy reforms as well as technical assistance from the international community and involvement of the grass root people. It is imperative that courts inquire into matters of consent being obtained from biological parents as well as where appropriate to keep the child involved and properly represented at these adoption proceedings. It is essential for the Pacific Island nations to ratify the *Hague Conventions I* and *II*. However, if these countries do not have the means to put in place the necessary structures to make these operative, it would be of no use.

In the meantime it would be helpful to protect the interests of the child and to comply with the UN conventions by requiring that the country of the adopter play a major role in monitoring that the child is given all its rights and the convention has been complied with. This would mean that the family courts, welfare agencies, and immigration authorities of the adopter's country such as Australia, New Zealand or the United States, work very closely and comprehensively with the Pacific Island communities such as Vanuatu to ensure that the best interests of the child is adhered with in the adopter's jurisdiction.[70] This would also enable the adopter's jurisdiction to monitor the child's welfare and report it to the relevant authorities in the adoptee child's jurisdiction. Courts also have a duty to oversee that intercountry as well as customary adoption of children adhere to the best interest of the child and enforce it in Vanuatu.

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70 Sue Farran, 'South Pacific Children: the law on adoption and issues of concern' (2008) 6(2) *New Zealand Family Law Journal* 30.