Prof. Bob Baxt, Partner, Competition Law Group, Freehills, Melbourne

Conflicts of Interest in Financial Services Firms

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Bob Baxt AO, Partner Freehills and Professorial Associate of the University of Melbourne[♦]

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1 Introduction

It is a great pleasure for me to present a paper at this conference on the occasion of the 25th anniversary of the Association. When I helped form the Banking Law Association (as it then was) whilst a Professor at Monash University Law School, little did I anticipate just how important this area of the law (which of course now embraces financial services more generally) would become.

My major interest in this area has always been associated with issues of governance and the duties of fiduciaries, ie directors and others, in organisations such as companies, and trusts and partnerships. In that context the banking institutions and their relevant operations captured my interest. I have never lost that interest and still follow with eagerness some of the matters that are being discussed at this conference.

New challenges arise for the industry and for those advising the industry every day. However most of them in my view pale into some insignificance when compared to the crucial question of conflicts which pervade not just the operations of financial institutions but of many organisations and those advising them.[♣]

The decision in *ASIC v Citigroup Ltd*[162] (*Citigroup*) whilst it quietened the nerves of many in the financial services sector (and those advising them), because of the positive rulings of Jacobson J on the facts of the case, as well as on some issues of the law, nevertheless poses some interesting further problems in the context of conflict issues. The particular facts of the case meant that some of the more critical questions arising in the context of potential conflicts of interest were distinguished. What is needed, going forward, is for greater focus on some of the underlying questions of conflict which have been raised in a number of different ways in recent times. Professor Jack Coffee, in his

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[♦] I am very grateful to Thea Chesterfield, paralegal assistant and graduate employee elect of Freehills, and Gillian McKenzie, paralegal, for their assistance in the preparation of this paper.

[♣] Since this paper was presented on 26 July 2008, momentous events have occurred in financial markets throughout the world. Insofar as the scenarios that were discussed at the Conference, and they were alluded to in my oral presentation as well, is that Australia has taken a tougher line on short selling with the enactment of the *Corporations Amendment (Short Selling) Act 2008*; a temporary ban continues on short selling (being reviewed from time to time by the Australian Securities and Investments Commission).

In addition, the Corporations and Markets Advisory Committee (**CAMAC**) has been given a reference on the topic of *Market Integrity*. Under this reference, CAMAC will be reviewing some of the issues that are touched upon in this paper.

[162] *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* **(2007) 160 FCR 35.**

pioneering work *Gatekeepers: The Professions and Corporate Governance*[163] poses some of these questions in the context of accounting firms (reviewing the extraordinary events surrounding the collapse of Arthur Andersen and Co) rather than focusing on the industry the subject of the *Citigroup* case.

In this paper what I hope to do is to discuss some of these broader conflict issues before turning to a more detailed examination of the *Citigroup* case. To me, the critical questions that we have to face in Australia is whether our economy, and the small markets which operate in a number of the relevant areas, warrant a more or less robust approach in dealing with questions of conflicts. Pioneers we might be in the area of climate change; I am not sure whether the professional services market would be happy for our courts to be too pioneering in the context of conflict of interest solutions illustrated by some of the matters that I will discuss in this paper.

2 Some other conflict scenarios

With your indulgence, I will deal with some other matters initially (in the broad context of conflicts) before turning to examining the spotlight that has been provided to this area of the law by the decision of the *Citigroup* case.

The question of conflict of interest arose most starkly for me when I was Chairman of the Trade Practices Commission (the Commission **– now the Australian Competition and Consumer Commission) from 1988 to 1991.**

Very early in my term as Chairman I learnt that the former immediate past Chairman of the Commission, the late Bob McComas, wanted to appear before the Commission to argue for a clearance by the Commission of a merger on behalf of his new client (the Arnott's Biscuit Company) a company which just six months earlier he and the Commission were vigorously 'assessing' in the context of a different matter. I raised with the Attorney General of the day Lionel Bowen the question of how a former Commissioner (or Chairman) of a regulator could within weeks of retiring from that position appear as a protagonist before that very same Commission.

In the US and Canada there is a compulsory period of quarantine (12 months to 2 years) for such public officials. Similar rules of course apply to judges of the Federal Court and other courts appearing before those courts once they retire from the judiciary and return to practise. The Attorney General advised me that the Australian market was too small to introduce such a rule. Yet the dangers of a former regulator lobbying an organisation of which he/she was either in charge or a member very soon after stepping down from their position are not insignificant. The issues that I raise here still raise problems, perhaps even more so.

3 Apparent conflict in the regulation of the stock markets

Whilst the Australian Securities Exchange (ASX**) is the sole 'player' in the non-governmental regulation of our securities markets (there are new companies ie AXE-ECN and Liquidnet Australia seeking recognition), it also is the administrator which governs the activities of many persons who operate in the securities markets. It is the overseer of the relevant securities market in which ASX Limited has its shares listed and traded. This particular scenario, which some have described as a potential problem, is not discussed by Eric Mayne as a problem. He is the ASX's Chief Supervision Officer and he suggests that the relevant parts of the ASX's operations are 'separately managed' from the rest of the ASX. In a paper delivered on 23 May 2008 he states that the supervising arm**

[163] Oxford University Press, 2006.

of the ASX "has a purpose to make supervisory decisions in accordance with the legal and rule framework, the policies and principals on which they are based, and the ASX's licence obligations under the Corporations Act".[164] He added in the relevant paper that in the long term its supervisory responsibilities are broadly aligned with its commercial interests, in the sense that its sustainability as a business depends on its ability to operate markets of the highest integrity.[165]

However, this view is not shared by many in the community and there has been a number of issues raised by executives of companies such as QBE Insurance, and by Adele Ferguson in the Australian newspaper of 17 September 2007.[166] A number of general conflicts of interest can arise for the ASX.

This was particularly relevant this time when short selling/market margin and lending difficulties have been prevalent. These difficulties have lead to an emergency regulation in the US being introduced on 16 July 2008.

Some would suggest that the ASX occupies three different roles – it is a company whose shares are listed on its own market; it is the regulator of the relevant market; and it also operates "in partnership" with the Australian Securities and Investments Commission (ASIC**) in dealing with critical issues (eg short selling) thus occupying a very influential regulatory role over our financial services markets.**

The essence of the conflict argument is that the position of the ASX as a company listed on its own exchange - from which it derives a large amount of income from higher trading volumes - renders it less likely to act firmly against hedge-funds and other investors who might be prepared to drive down share prices – an issue that was critical earlier this year and remains a matter of great concern in the US where the new regulations have just been introduced. Critics suggest that the ASX is no longer best placed to protect shareholder interests. This issue continues to place pressure on the Federal Government at a time when new entrants referred to earlier are seeking licences to undertake a similar role in the market to the ASX.

In defence of the ASX Eric Mayne noted in the paper referred to earlier that all of the functions that the ASX performs, in particular its market supervisory functions, are reviewed annually by ASIC.[167]

4 Conflicts of interest in corporate law

This is an area of great interest to me. Some very difficult questions arise in particular in the ability of the relevant person to 'contract out' of fiduciary obligations. The traditional approach in corporate law has been much stricter than that which operates in other areas of the law where the contractual relationship plays a more significant role. I will deal with this topic at the end of my paper.[168]

[164] See Eric Mayne, 'No Conflicts in ASX's Market Role', *The Age* (Melbourne), 23 May 2008, Business 10.

[165] This point is made in the introduction to the ASX's 'Commercial & Supervisory Conflict of Interest Policy for All ASX Group Employees' (1 March 2007) available at: http://www.asx.com.au/supervision/conflicts/. But note the appointment announced on 21 July 2008 of Alan Cameron, former Chair of ASIC, as the new Chairman of ASX Markets Supervisor (see comment in the Australian Financial Review on 22 July 2008 at page 7).

[166] Adele Ferguson, 'Query on ASX's Supervisory Power', *The Australian* (Australia), 17 September 2007, Finance 36.

[167] Mayne, above n 164.

[168] A good example of conflict arising in the corporate law scenario and one which can arise fairly regularly is that described in *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187.

5. Conflict scenarios arising out of decisions concerning law firms

In *Citigroup* (which is the key decision for discussion), Jacobson J makes heavy reference to leading decisions dealing with conflict of interest issues in law firms and in particular *Prince Jefri Bolkiah v KPMG (*Prince Jefri Bolkiah*).*[169] I will deal with issues arising out of conflict scenarios in law firms as a backdrop to the decision in the *Citigroup* case.

In *Prince Jefri Bolkiah*, the House of Lords considered how and when a 'Chinese wall' might be used to lessen the danger of a conflict of interest in the context of a large accounting firm, particularly those that offer a full range of legal services through their legal arms. The case confirmed that an accounting firm, by analogy to a firm of solicitors, may be restrained from acting in a matter which involves a former client. The House of Lords decision reflects a fairly strict approach towards the protection of former clients' confidential information, and importantly, a rejection of the idea that the interests of client confidentiality should be balanced against the commercial interests of the firm when deciding whether an injunction should be granted to safeguard confidentiality.

5.1 *Prince Jefri Bolkiah* – factual scenario

At the risk of boring you, it is appropriate to discuss the facts of the case in a little detail before turning to a discussion of the legal issues. An injunction was sought by the plaintiffs to restrain the accounting firm KPMG from continuing an investigation into the affairs of Prince Jefri, the youngest brother of the Sultan of Brunei. Prince Jefri had been the Chairman of the Brunei Investigation Agency (BIA**) until his removal in 1998. For a period of 18 months between 1996 and 1998, Prince Jefri had instructed KPMG to investigate his financial affairs in anticipation of private litigation (a matter which KPMG codenamed 'Project Lucy'). The litigation settled in March 1998, and up until that point KPMG's forensic accounting department had provided extensive litigation support services, performing a number of tasks usually undertaken by solicitors. During the course of the retainer KPMG had obtained extensive confidential information about Prince Jefri's assets and financial affairs.**

Prince Jefri was subsequently removed as chairman of BIA, after which BIA sought to engage KPMG to investigate the alleged use by Prince Jefri of BIA's assets for his own use (which was codenamed 'Project Gemma'). KPMG took the view that no conflict of interest arose, as the firm had ceased to act for Prince Jefri more than two months prior, and no longer had a client relationship with him. Nevertheless, the firm decided to erect a Chinese wall in an effort to prevent the misuse of confidential information that was obtained when acting under Prince Jefri's instructions. The Chinese wall had two components:

(1). staff were selected for Project Gemma so as to exclude those in possession of confidential information obtained in the course of Project Lucy; and

(2). steps were taken to ensure that those working on Project Gemma did not become exposed to such confidential information in the future. Among other measures, the work on Project Gemma was carried out in a separate project room with restricted access, in a building separate to that which houses the forensic accounting department.

KPMG did not inform Prince Jefri of the new assignment, nor did it seek his consent to it acting for BIA.

5.2 The decision in *Prince Jefri Bolkiah*

I will not discuss the decisions of the lower courts but I should note that there are some very interesting issues raised by the Court of Appeal in this matter

[169] [1999] 2 AC 222.

which are picked up by the House of Lords in its decision. In essence the approach of the majority in the Court of Appeal was to consider three issues:

(1). whether there was confidential information which, if disclosed, was likely to adversely affect Prince Jefri's interests;

(2). Whether there was a 'real or appreciable risk' that the confidential information would be disclosed; and

(3). whether the nature and importance of the former fiduciary relationship meant that the confidential information should be protected by an order of the kind sought.

I note that the House of Lords, in its decision, agreed that these were the relevant issues for consideration. The majority of the Court of Appeal balanced the different interests involved in this particular matter and reflected on the positive obligation of the accounting firm by reference to whether it had taken reasonable efforts to protect the relevant confidential information. Prince Jefri's original successful application for injunction was overturned by the majority and an appeal was lodged with the House of Lords.

Lord Millett, who delivered the leading judgment in the House of Lords, was careful to draw a distinction between the duties owed by solicitors to existing clients (and by analogy, duties owed by accountants providing litigation support services), and those duties that survive the termination of the retainer. Lord Millett commented that:

> **"Where the court's intervention is sought by a former client… the court's jurisdiction cannot be based on any conflict of interest, real or perceived, for there is none. …The only duty to the former client which survives the termination of the client relationship is a continuing duty to preserve the confidentiality of information imparted during its subsistence."[170]**

In essence the plaintiff had to establish whether there was information held by the accountants/lawyers that was confidential to the plaintiff and in a situation where no consent had been given to its disclosure; if the information was new then whether disclosure of it might act adversely to the plaintiff. The question of whether confidential information exists is always a question of fact. Lord Millett rejected the exercise undertaken by the Court of Appeal in balancing the different interests of the parties in these circumstances. He added:

> "Where in addition the information in question is not only confidential but also privileged, the case for a strict approach is unanswerable. Anything less fails to give effect to the policy in which legal professional privilege is based. It is of overriding importance for the proper administration of justice that a client should be able to have complete confidence that what he tells his lawyer will remain secret. This is a matter of perception as well as substance."[171]

The presumption adopted by Lord Millett was that the court would intervene unless it could be satisfied there was no risk of disclosure. The risk however must be a real one not a fanciful one.

He then examined whether the Chinese walls that had been created by the accounting firm were adequate. In Lord Millett's view there was no rule of law that arrangements such as Chinese walls are insufficient to eliminate the risk of disclosure, but the starting point must be that unless special measures are taken, information moves within the firm. In the case at hand, the Chinese wall had been established 'ad hoc' and was erected within a single department, and this reduced its effectiveness. On Lord Millet's view, for the wall to be effective, it "needs to be established as part of the organisational structure of the firm, not created ad hoc and dependent on the acceptance of evidence sworn for the purpose by members of staff engaged on the relevant work."[172]

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[170] Ibid 235.
[171] Ibid 236.
[172] Ibid 239.

He further ruled that KPMG had failed to discharge the heavy burden of showing that there was no risk that confidential information obtained through Project Lucy could inadvertently or unwittingly be leaked to those staff working on Project Gemma. Mere physical segregation would not suffice – especially in the context of preparation for litigation, which typically involves the sharing of information and expertise between partners and managers, as new and unusual issues are generated. As a result the appeal was allowed and the injunction was granted on the terms originally proposed at first instance.

5.3 Australian decisions

I could spend a significant amount of time differentiating between the approaches taken in New South Wales, Victoria and Queensland in dealing with these matters. In my view the New South Wales approach would appear to coincide broadly with that of the House of Lords (see in particular *Blythe v Northwood*).[173] In that case Mason P stated that the relevant principles in the *Prince Jefri Bolkiah* case “reflect a proper understanding of the extent to which Equity acts on the conscience of a fiduciary”.[174] His views are not necessarily the views adopted in all Australian jurisdictions.

In Victoria there are two interesting cases which are worthy of some consideration – *Spincode Pty Ltd v Look Software Pty Ltd*[175] (***Spincode***) and the later decision of *Village Roadshow Limited v Blake Dawson Waldron* (***Village Roadshow***).[176]

(a). The *Spincode* case

In *Spincode* the Victorian Court of Appeal unanimously agreed with the primary judge’s decision to grant an injunction. The test enunciated by Justices Brooking and Ormiston was quite ‘severe’. In particular Justice Brooking was critical of the notion that the duty of loyalty discussed by the House of Lords in *Prince Jefri Bolkiah* had ‘perished’ once the retainer which was applicable to the legal firm had been spent. He was critical of this rather ‘slick’ differentiation and made the following comments:

> “Once the contract of retainer comes to an end the solicitor does, it is true, cease to have active duties to perform for the former client. But why should we not say that “loyalty” imposes an abiding negative obligation not to act against the former client in the same matter? The wider view, and the one which commends itself to me as fair and just, is that the equitable obligation of “loyalty” is not observed by a solicitor who acts against a former client in the same matter.”[177]

This view was not supported by either Ormiston or Chernov JJA although Ormiston J expressed some sympathy for Brooking JA’s view. Goldberg J in the Federal Court did not share that view and preferred the approach taken by the House of Lords in *Prince Jefri Bolkiah* in deciding *Photocure ASA* v *Queen’s University at Kingston*.[178]

(b). The *Village Roadshow* case

This decision is arguably one of the most interesting Australian decisions on this particular topic. The relevant facts were briefly these. Certain interlocutory proceedings were brought by a company called Boswell Fimgesellschaft MBH (**Boswell**) against the law firm Blake Dawson Waldron (**BDW**) on the basis that there was a conflict of interest in the fact that BDW owed a duty to a former client namely the Permanent Trustee Company Ltd (**Permanent Trustee**). The proceedings followed a plan by Village Roadshow Limited (**Village**) to buy back all of its A Class Preference shares by an arrangement under Part 5.1 of the *Corporations Act 2001* (**the Act**). For the purpose of the buy-back, Village entered into a trust deed with Permanent Trustee in compliance with Part 2L of the Act. BDW acted for Permanent Trustee, and in that capacity, the firm was involved in a review of the initial buy-back scheme booklet.

[173] (2005) 63 NSWLR 531.
[174] Ibid 542.
[175] (2001) 4 VR 501.
[176] (2004) Aust Torts Reports 81-726.
[177] (2001) 4 VR 501, 522.
[178] (2002) 56 IPR 86.

At some point after the scheme booklet had been made publicly available, BDW commenced acting for Boswell, a shareholder of Village and a 'determined opponent' of the buy-back scheme.[179] Boswell had engaged BDW apparently with a view to opposing the preference share buy-back, and contended that the scheme booklet contained misleading and deceptive information. When Village sought to have the scheme approved in the Victorian Supreme Court, Boswell obtained an order dismissing that application, with BDW acting for them in the matter. That order was the subject of an appeal which was pending at the time the present judgment was handed down.

Meanwhile, Village announced that it would pursue a second arrangement in order to achieve the original objective of the share buy-back. The scheme booklet was modified and a supplemented trust deed was prepared and executed with Permanent Trustee (this time with minimal involvement of BDW). Shortly thereafter the scheme booklet was made publicly available.

Minter Ellison (who acted for Village in the scheme) expressed its concern to BDW that BDW was acting for both Permanent Trustee and Boswell in the matter, and that this gave rise to a conflict of interest. An application was then made to the Supreme Court of Victoria to restrain BDW from continuing to act in relation to the second buy-back scheme.

Byrne J restated what he believed to be the relevant principle in these words:

> "Solicitors acting in the nature of a fiduciary, when faced with an allegation of conflict, should show the client's consent to the course that they would follow. And as officers of the court, they should do so with a candour which I regret was not here present."[180]

In his view there were two major issues that he had to consider:

(1). the risk of leakage of confidential information; and

(2). the question of whether a duty of loyalty was pre-eminent in these circumstances.

(c). Risk of leakage

On the facts, Byrne J felt that there was no real danger that confidential information obtained by BDW when acting for Permanent Trustee might be used to the disadvantage of Village, and to the advantage of Boswell. Leading up to this conclusion, he outlined the following applicable legal principles:

- The court will act where

  > "a reasonable person informed of the facts might reasonably anticipate a danger of misuse of confidential information of a former client and that there is a real and sensible possibility that the interest of the practitioner in advancing the case in the litigation might conflict with the practitioner's duty to keep the information confidential, and to refrain from using that information to the detriment to a former client." (citing *Sent & John Fairfax Publishing Pty Ltd* [2002] VSC 429 at [33] per Nettle J);[181]

- In applying the principle above, the client need not point to a specific item of confidential information (as in doing so they may defeat the purpose of the duty of confidentiality by exposing that information to the court and to the other party).[182]
- The confidential information may comprise "no more than the knowledge of the client's thinking, its attitudes and of the personalities involved."[183] Byrne J said that, given the relationship between solicitor and client, the ambit of

[179] *Village Roadshow Ltd v Blake Dawson* Waldron (2004) Aust Torts Reports 81-726, [20].
[180] Ibid [31].
[181] Ibid [33].
[182] Ibid [36].
[183] Ibid.

professional confidence and the professional privilege in which it is manifested, "the court should… not be slow to accept the existence of such confidential information."[184]

(d). The duty of loyalty and public policy

Village's second submission was based on the practitioner's duty of loyalty to its clients, both former and present, and the need to protect the wider public confidence in the special relationship between solicitor and client. Byrne J restated the principle outlined by Brooking JA in *Spincode*:

> "The principle does not depend upon any risk of leakage of confidential communication, it depends upon an equitable duty reposed in a practitioner, even after the client's retainer has concluded, not to act for another person in the same matter or in a closely related matter against the interests of the former client."[185]

This obligation was likened to that of a fiduciary, such that a solicitor may be permitted to act where they establish that the former client has given their informed consent.[186]

For some reason, both parties accepted Brooking JA's reasoning in *Spincode* as a correct statement of the law, and confusingly, Byrne J applied elements of both *Prince Jefri Bolkiah* and *Spincode* without attempting to reconcile the conflict between the theoretical approaches employed in each.

Village argued successfully that in acting for Boswell with the aim of countering the first and second buy-back arrangements, BDW breached its duty of loyalty to Permanent Trustee, which had retained BDW to act for it in preparation of the first arrangement. Byrne J noted the applicant's comment that "for a firm of solicitors to take money from a client for erecting a legal edifice, it should not then take a fee from some other to dismantle it."[187]

Byrne J also noted the public policy consideration: the question of how this breach might influence public confidence in the administration of justice. On this issue he considered first the factual question of whether the matter for which Permanent Trustee had initially retained BDW was the same matter, or a matter related to, the Boswell retainer. This required an examination of the substance of the relationship. Here, Byrne J found that the work of BDW in preparing the trust deed was 'sufficiently related' to its work in opposing the buy-back arrangement to attract the aforementioned principle.

The focus then turned to the reaction that this would draw from the hypothetical 'well-informed reasonable bystander'. On this limb Byrne J concluded that an apprehension that the solicitor might act on a related transaction for a person with an adverse interest would be likely to erode public confidence in the administration of justice.

It was not enough for BDW to promise not to act for any other party than Permanent Trustee on matters arising out of a trust deed. It would be unclear to the hypothetical reasonable bystander who would enforce such a promise, especially if an issue concerning the trust deed was exposed in litigation over the second arrangement, which was likely to ensue in the coming months.

(e). Particular problems for the Australian legal market

It was the view of Byrne J that the Australian legal market raised some rather unusual difficulties for large law firms acting in matters of this kind. He made these rather interesting comments about the prevalence of conflict scenarios where there were potentially major cases of dispute resolution.

> "It is a notorious fact that a good deal of commercial litigation in this state is conducted by a handful of very large firms. How is a client to obtain the services of one of them if the conflict rule is applied too strictly? To my mind, this is the price which the clients of such firms and the firms themselves must

[184] Ibid.
[185] Ibid [40].
[186] Ibid.
[187] Ibid [41].

pay. The firms have found it commercially convenient to become large. This is but one disadvantage of this trend. It is certainly no reason for the courts to weaken the traditionally high standard of a practitioner's loyalty to the client which have characterised the practice of law in this State."[188]

Byrne J concluded that in accepting the retainer from Boswell, BDW was in breach of its duty of loyalty to Permanent Trustee. Byrne J noted that the relief sought was discretionary, and that in the present case he had reason to doubt the bona fides of Village's application (which, he suggested, was probably brought as a tactical ploy to disadvantage Boswell). Nonetheless, the restraining order was made, as the focus was on the concern of upholding public confidence in the client/solicitor relationship.

In Queensland there are two interesting single judge decisions in *Flanagan v Pioneer Permanent Building Society Ltd*[189] and *Pott v Jones Mitchell*.[190] Both Justices Dutney and McMurdo adopted the minor reasoning in *Prince Jefri Bolkiah* rather than the harder line taken in Victoria.

(f). Summarising the Australian approaches to conflicts of interest in legal firms

A useful summary of the position in Australia was set out by Justice Brereton in *Kallinicos v Hunt*.[191] I reflect on an extract from his judgment, which I have set out below without citations, in which he refers to a significant number of other cases in which these issues are discussed. These are in addition to the cases that I have discussed earlier in this paper.

- "During the subsistence of a retainer, where the court's intervention to restrain a solicitor from acting for another is sought by an existing client of the solicitor, the foundation of the court's jurisdiction is the fiduciary obligation of a solicitor, and the inescapable conflict of duty which is inherent in the situation of acting for clients with competing interests (*Prince Jefri Bolkiah*).
- Once the retainer is at an end, however, the court's jurisdiction is not based on any conflict of duty or interest, but on the protection of the confidences of the former client (unless there is no real risk of disclosure) (*Prince Jefri Bolkiah*).
- After termination of the retainer, there is no continuing (equitable or contractual) duty of loyalty to provide a basis for the court's intervention, such duty having come to an end with the retainer (*Prince Jefri Bolkiah*; *Belan v Casey*; *PhotoCure ASA*; *British American Tobacco Australia Services Ltd*; *Asia Pacific Telecommunications Ltd*; contra *Spincode Pty Ltd*; *McVeigh*; *Sent*).
- However, the court always has inherent jurisdiction to restrain solicitors from acting in a particular case, as an incident of its inherent jurisdiction over its officers and to control its process in aid of the administration of justice (*Everingham v Ontario*; *Black v Taylor*; *Grimwade v Meagher*; *Newman v Phillips Fox*; *Mitchell v Pattern Holdings*; *Spincode Pty Ltd*; *Holborow*; *Williamson v Nilant*; *Bowen v Stott*; *Law Society v Holt*). *Prince Jefri Bolkiah* does not address this jurisdiction at all. *Belan v Casey* and *British American Tobacco Australia Services Ltd* are not to be read as supposing that *Prince Jefri Bolkiah* excludes it. *Asia Pacific Telecommunications Ltd* appears to acknowledge its continued existence.
- The test to be applied in this inherent jurisdiction is whether a fair-minded, reasonably informed member of the public would conclude that the proper administration of justice requires that a legal practitioner should be prevented from acting, in the interests of the protection of the integrity of the judicial process and the due administration of justice, including the appearance of

[188] Ibid [49].
[189] [2002] QSC 346.
[190] [2004] QSC 048.
[191] (2005) 64 NSWLR 561, 582-3

justice (*Everingham v Ontario*; *Black v Taylor*; *Grimwade v Meagher*; *Holborow*; *Bowen v Stott*; *Asia Pacific Telecommunications Ltd*).

- The jurisdiction is to be regarded as exceptional and is to be exercised with caution (*Black v Taylor*; *Grimwade v Meagher*; *Bowen v Stott*).
- Due weight should be given to the public interest in a litigant not being deprived of the lawyer of his or her choice without due cause (*Black v Taylor*; *Grimwade v Meagher*; *Williamson v Nilant*; *Bowen v Stott*).
- The timing of the application may be relevant, in that the cost, inconvenience or impracticality of requiring lawyers to cease to act may provide a reason for refusing to grant relief (*Black v Taylor*; *Bowen v Stott*)."

5.4 Some observations about overseas jurisdictions – the USA, Canada and New Zealand

(a). The United States

The approach taken in the United States differs from that of the House of Lords in *Prince Jefri Bolkiah* in that the courts usually rely on presumptions.

Where a transferring lawyer actually possesses, or is *presumed to possess* confidential information relating to a client of his or her former firm, the lawyer will be disqualified from acting against the interests of the former client. The traditional approach has been that, so long as the prior retainer involved a substantial relationship between the lawyer and client, there is an irrebuttable presumption that the lawyer possesses confidential information. Moreover, their disqualification from acting for a new client against the former client does not depend on actual disclosure of confidential information.

To determine whether the entire firm to which the lawyer has transferred should be disqualified, the court presumes that transferring lawyers share confidences with other lawyers in the firm. This presumption is now rebuttable where the law firm can conclusively show that other lawyers did not receive confidential information from the transferring lawyer. It is unclear what is required for the firm to establish this, though Chinese walls are one method of preventing disqualification of firms.

(b). Canada

In Canada, there is an important judgment of the Canadian Supreme Court (*MacDonald Estate v Martin* (MacDonald**)).[192] That case concerned a junior lawyer who possessed confidential information about a plaintiff involved in litigation. The lawyer subsequently transferred to the firm representing the defendant in that litigation, and the plaintiff sought an order disqualifying that firm from acting for the defendant.**

Sopinka J delivered the judgment for the majority in the court, which recognised a number of competing policy considerations that had to be balanced in determining the outcome of the case. He commented:

> **"There is first of all the concern to maintain the high standards of the legal profession and the integrity of our system of justice. Furthermore, there is the countervailing value that a litigant should not be deprived of his or her choice of counsel without good cause. Finally, there is the desirability of permitting reasonable mobility in the legal profession."[193]**

The test adopted by His Honour in determining whether a firm could continue to act was whether a reasonably informed member of the public would be satisfied that confidential information would not be used. This involves a two stage inquiry:

(1). the court must determine whether the lawyer received confidential information from the former client that is relevant to the current matter, and then

(2). whether the lawyer will misuse the confidential information he or she possesses.

[192] (1991) 77 DLR (4th) 249.
[193] Ibid 254.

> **A rebuttable presumption arises with respect to the first step that confidential information will have been communicated by the former client in the course of the retainer. The onus of rebutting this presumption is a heavy one. It is virtually automatic that the transferring lawyer will be disqualified, because the potential for misuse of confidential information is great.**
>
> **The law is less clear on whether and in what circumstances the firm as a whole will be disqualified. Acknowledging the commercial realities of the modern Canadian legal services market (which would be quite similar to the position in Australia), Sopinka J considered that a rule assuming that the knowledge of one lawyer is the knowledge of every lawyer in the firm was "unrealistic in the era of the mega-firm".[194] However, there is a second rebuttable presumption that lawyers working together within a firm share confidences. A firm will therefore be disqualified unless it can show that 'all reasonable measures' were taken to ensure against the possibility of disclosure. Sopinka J considered that Chinese walls might be an example of such 'reasonable measures'.**
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> **The minority judges in *MacDonald* argued for a stricter duty on the basis of the need to ensure the appearance of justice.[195] The essence of this approach was expressed by Cory J (Wilson and L'Heureux-Dube JJ agreeing) in this comment:**
>
>> **"Our judicial system… cannot function properly if doubt or suspicion exists in the mind of the public that the confidential information disclosed by a client to a layer might be revealed."[196]**
>
> **Cory J rejected the argument that a Chinese wall could reassure public confidence in client confidentiality:**
>
>> **"No matter how carefully the Chinese Wall might be constructed, it could be breached without anyone but the lawyers involved knowing of that breach …The public would, quite properly, remain skeptical of the efficacy of the most sophisticated protective scheme."[197]**
>
> **Cory J gave a strong and uncompromising response to policy arguments about the need to maintain a reasonable degree of mobility within the legal profession:**
>
>> **"… no matter how strong may be the current rage for mergers or how desirous the mega-firms may be to acquire additional lawyers, neither the large firms nor the lawyers who wish to join them or amalgamate with them should dictate the course of legal ethics."[198]**
>
> **The minority judgment in *MacDonald* parallels the reasoning of Byrne J in *Village Roadshow.* The argument that the commercial needs of large firms should not dictate the course of legal ethics echoes Byrne J's strict attitude toward firms that have 'found it commercially convenient to become large'. Similarly, while Cory J viewed Chinese walls as being of limited relevance to the issue, Byrne J emphasised that "what is here in issue is the concern of the court to uphold the public confidence in a solicitor/client relationship where the client does not affirmatively approved the conduct of its solicitor".[199]**

(c). New Zealand

It is appropriate discuss the case of *Equiticorp Holdings Ltd v Hawkins*[200] (*Equiticorp*). This case was concerned with similar issues to those raised in earlier decisions – the same firm of solicitors acting for a range of litigants in opposition to each other was alleged to be acting in breach of its duties to its clients. This arose because three partners within the particular law firm wished to change firms and the client of that firm wished to prevent the transferring partners from acting. Henry J, who decided the case in

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[194] Ibid 268.
[195] A useful discussion of both the majority and minority approaches, as contrasted with approaches adopted in the United States and New Zealand, can be found in David Coull, 'Typhoid Marys: The ethical dilemma of lawyers who switch firms' (1998) 28 *Victoria University of Wellington Law Review* 41, 51-56.
[196] *MacDonald Estate v Martin* (1991) 77 DLR (4th) 249, 272.
[197] Ibid 273-4.
[198] Ibid 274.
[199] *Village Roadshow Ltd V Blake Dawson Waldron* (2004) Aust Torts Reports 81-726, [53].
[200] [1993] 2 NZLR 737.

favour of the client, was influenced by the decision of the Canadian Supreme court in *MacDonald*. He noted:

> **"I have reservations as to the desirability of introducing Court-prescribed presumptions whether they be rebuttable or irrebuttable, to stated situations. I prefer an approach which is directed to applying facts to general principle so as to ensure the aim of the protection is fairly met in the particular circumstances."[201]**

Henry J held that the transferring lawyer could not act against his former client's interests in the continuing litigation.

The more difficult issue was whether the firm to which he transferred should be disqualified from acting for their existing client. Here, the new firm had not put in place sufficient safeguards to prevent the inadvertent disclosure of confidential information. Although the risk of disclosure was small, it nonetheless outweighed the competing considerations of the client's interest in retaining the firm of their choice, and the lawyer's interest in having mobility between firms. Whilst acknowledging that the latter factor was of particular concern, Henry J stated that it must "yield to the greater public interest in maintaining the integrity of the principle of protection".[202]

The approach taken in *Equiticorp* seems more flexible than the House of Lords' approach. It requires the court to weigh the competing policy considerations in light of the circumstances of the case. A further difference is that, while Henry J considered whether there was a 'reasonable possibility' that confidential information had been disclosed, Lord Millett said that the court should intervene unless it is satisfied that there is *no* risk of disclosure. The risk must be real, and not merely fanciful or theoretical, but it need not be substantial.

6 Conflicts of interests in the Financial Services industry

6.1 ASIC's investigation of AMP

There are many opportunity for conflicts of interest to arise in the provision of financial services. The *Citigroup* case provides one example. A further example which I will now briefly discuss is provided by ASIC's investigation in 2006 of financial advice provided by AMP Financial Planning Pty Ltd (AMP**).**

The investigation centred around advice provided to clients by AMP's financial planners recommending that they switch to a new superannuation fund. In the vast majority of cases customers were advised to switch to an AMP product. Of particular importance in this case was that in certain cases (for example where a client's existing superannuation fund was and industry fund or was not one on AMP's Approved Products and Services List) the advice was provided without also providing an assessment of the client's existing product.

At the conclusion of its investigation ASIC formed the view that AMP's financial planners may have contravened s 945A as well as several other sections of the Act. Section 945A requires that financial planners give personal advice only where they have a reasonable basis for that advice. In ASIC's view this obligation requires that a financial planner make adequate inquiries into, and give due consideration to, the client's existing product.

ASIC concluded that the advice given to clients recommending that they switch products may have been deficient in that:

- **they did not set out the consequences to the client of changing products (ie by setting out the difference in the value of ongoing costs between the existing product and the new product), and**

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[201] Ibid 740.
[202] Ibid 741.

- **they did not adequately set out the fees and commissions payable to the trustee, the investment fund manager, and the financial planner resulting from the switch to an AMP product.**

In the present context it should be noted that ASIC also concluded that AMP may have contravened section 912A(1)(aa) by failing to have in place adequate arrangements for managing conflicts of interest. In ASIC's view "because of the presence of a number of potential conflicts of interest and the tendency for switches towards the AMP Flexible Lifetime – Super product…. AMPFP's must have robust arrangements for managing conflicts of interest and its supervision of its representatives to ensure that advice given by AMPFP Planners is appropriate".[203]

In resolution of ASIC's concerns ASIC accepted an enforceable undertaking from AMP to revise its procedures (and provide training on the new procedures) to ensure that clients are not given advice to switch products unless and until the financial planner can advise on both relevant products and the advice is vetted for compliance with the Act. AMP also committed to offering a review of advice previously given to affected clients, providing redress where that advice is found to be inadequate, and undertaking a compliance review on both its disclosure obligations and its arrangements for managing conflicts.

This case and the *Citigroup* case discussed below highlight many of the issues that I have discussed in the previous part of the paper. In the *Citigroup* case, what has most concerned members of the financial services industry, and those advising the industry, was that this was a test case being run by the regulator at a time when it was felt that the market itself, and those advising the 'players', were trying to work out strategies to deal with the particular issues thrown up by the operation of section 912A of the Act and attempts both by ASIC and by the ASX to deal with the managing of conflicts. ASIC had dealt with this matter in its Regulatory Guide 181. In the course of his judgment Jacobson J had to assess how Citigroup and its advisors managed to deal with the operation of these guidelines.

An additional question, the question of insider trading and the operation of Chinese walls (in the context of both section 912A and the insider trading provisions of the legislation) make the case a particularly interesting one. I will not be discussing the insider trading issues in any detail other than to deal briefly with the discussion of Chinese walls by Jacobson J.

6.2 The *Citigroup* case - the facts♠

The facts of the case were briefly these. Citigroup Global Markets Australia Pty Ltd (**Citigroup**) was the Australian branch of the global financial services organisation Citigroup Inc. The Australian company was divided into a 'private side' (areas of the company where employees were exposed to confidential, market sensitive information - such as the investment banking division) and a 'public side' (areas not exposed to such sensitive information, such as the Equity Division, where employees were expected to perform their role solely on the basis of publicly available information). Citigroup constructed a Chinese wall to deal with the conflict of interest and insider

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[203] Enforceable Undertaking under section 93AA of the *Australian Securities & Investments Commission Act 2001* provided by AMP Financial Planning Pty Limited to the Australian Securities and Investment Commission on 27 July 2006, [2.6]

♠ Since this paper was delivered, the *Citigroup* case has been the subject of a number of interesting comments and published articles. Two of the more interesting and perhaps significant articles are:

Jennifer Butler, 'Are we there yet? The journey of the insider trading provisions' (October 2008) 26(7) *Company and Securities Law Journal* 260 – 469; and

Vince Battaglia, 'Dealing with conflicts: The equitable and statutory obligations of financial services licensees' (November 2008) 26(8) *Company and Securities Law Journal* 483 – 500.

The decision has been referred to in the interesting case *Motor Trades Association of Australia Superannuation Fund v Rickus (No 3)* [2008] FCA 1986. Flick J, in discussing the *Citigroup* case and the question of fiduciary duties in the context of the fact scenario outlined in that case, made a number of references to it (see paras 70 – 72).

trading issues and restrict flow of information from private to public. ASIC's case concerned, among other things, the adequacy of Citigroup's Chinese wall arrangements in fulfilling these objectives.

At the relevant time, Citigroup was providing corporate advisory and investment banking services to Toll Holdings Limited (Toll**) in relation to its planned takeover of Patrick Corporation Ltd (**Patrick Corp**). On the last day of trading before the takeover was to be announced, one of Citigroup's proprietary traders (who was employed in the public side of the business) purchased over $1 million worth of shares in Patrick Corp on-market. ASIC did not allege that the particular trader had inside information regulated by the Act at that particular point in time. Rather ASIC took issue with the fact that, after Citigroup's employees became aware of this transaction, there was some informal communication about the share purchase between specific employees and the particular trader, after which the trader sold, (on the market) over $200,000 worth of the shares he had bought earlier that day. Although ASIC agreed with the fact that Citigroup had established what was generally known as Chinese walls to 'regulate' communications between those who worked in the private and public sides of its business, it was ASIC's view that, even though the particular trader had been instructed to stop buying further shares in Patrick Corp once private side employees learnt of the original purchase, that nevertheless, some of the relevant shares were sold after the instruction to stop trading had been issued. In ASIC's view the steps taken by Citigroup in relation to the flow of information demonstrated the inadequacy of the Chinese walls it had in place and the sales breached the insider trading provisions of the Act.**

The more critical and fundamental point was, in ASIC's view, that as Citigroup was providing strategic advice to Toll in relation to its proposed takeover of Patrick Corp, it occupied a relationship which was, in all critical respects a fiduciary relationship. In that position, it was further argued by ASIC, that Citigroup was placed in a position where it had to ensure that it could not allow a conflict to arise, either in actual fact or potentially, which might compromise its duty of loyalty to Toll, and its other major concern, which was to generate as much profit as it could from the proprietary trading in the shares of Patrick Corp.

Justice Jacobson summarised ASIC's position as follows:

> **"… if trading by an institution such as Citigroup in the shares of its client's target company is to be undertaken, the institution needs to obtain the informed consent of the client. It is not sufficient, according to ASIC, for consent to be given indirectly. What is said to be required is the client's express permission for trading".[204]**

6.3 Does the contractual relationship override the fiduciary relationship in such a situation

In certain areas of the law it is not possible for contractual or other relationships to override a fiduciary relationship between the parties. I say this with some confidence by referring to the area of corporate law, because the Act overrides the fundamental principle in company law that directors (the fiduciary in this context) owe a duty only to the company (and in very special cases the shareholders). I infer this from the statutory set of duties contained in sections 180-184 of the Act that persons other than the shareholders (or the company) may seek enforcement of these duties through the operation of section 1324 of the Act. I will return to this issue briefly later.

In contrast to the position in corporate law, however, it is not clear that any fiduciary relationship that exists between a company such as Citigroup and its client Toll is based on any statutory regime. There has been a great deal written on the subject matter of when a fiduciary relationship exists and what elements the courts take into account to determine whether a fiduciary relationship can be created from a set of facts. The traditional areas are well understood –

[204] *ASIC v Citigroup* (2007) 160 FCR 35, 44.

company director and company, partners, joint venturers etc. That courts have considered that relationships of a fiduciary nature can arise between stockbrokers and clients[205] is perhaps the classic illustration. Andrew Tuch in his leading article *Investment Banks as Fiduciaries; Implications for Conflicts of Interest*[206], referred to at some length by Jacobson J in the *Citigroup* case, discusses the implications of the fiduciary relationship in investment banks and similar bodies. A different basis for assessing the nature of a fiduciary or similar relationship and the obligations imposed on persons who are in the position of, say, a financial advisor, is considered in a very entertaining and effective way by Professor Jack Coffee in his pioneering work *Gatekeepers: The Professions in Corporate Governance*.[207]

In the *Citigroup* case, Jacobson J felt that the contractual relationship was such that the fiduciary relationship was nullified or qualified. He relied heavily on two important statements in the High Court of Australia. In particular, he gave support to the judgments of Mason J in *Hospital Products Ltd v United States Surgical Corporation*[208] (Hospital Products**) and Gummow J in *Breen v Williams*[209] (**Breen**). In his view these two important judgments enabled him to hold that in the type of situation that he was asked to consider in this case, it was possible for the parties to exclude or modify the fiduciary relationship that otherwise existed between them.**

The first comment relied on by Jacobson J was that of Mason J in *Hospital Products* where that judge noted:

> **"That contractual and fiduciary relationships may co-exist between the same parties has never been doubted. Indeed, the existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship. In these situations it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them. The fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction."[210]**

The views of Mason J were supported in principle by Gummow J in *Breen* where he noted:

> **"The mere presence of a contract does not exclude the co-existence of concurrent fiduciary duties and the contract may, in particular circumstances, provide the occasion for their existence. That is not to deny that a contractual term may be so precise in its regulation of what a party may do that there is no scope for the creation of a fiduciary duty."[211]**

In the view of Jacobson J "[i]t follows from these statements of principle that it is open to the parties to contract to exclude or modify the operation of fiduciary duties."[212]

Whilst Jacobson J agreed that this particular exclusion would not cover the whole field, the limitations of its operation were fairly specific:

> **"It may well be that a fiduciary cannot exclude liability for fraud or deliberate dereliction of duty but beyond that there appears to be no restriction in the law to prevent a fiduciary from contracting out of, or**

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[205] *Daly v the Sydney Stock Exchange Limited* (1986) 160 CLR 371.
[206] (2005) 29 Melbourne University Law Review 478.
[207] Oxford University Press 2006.
[208] (1984) 156 CLR 41.
[209] (1996) 186 CLR 71.
[210] *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 97.
[211] *Breen v Williams* (1996) 186 CLR 71, 132-3.
[212] *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* **(2007) 160 FCR 35,** [278].

> **modifying, his or her fiduciary duties, particularly where no prior fiduciary duty relationship existed and the contract defines the rights and duties of the parties…"[213]**

The comments made by Jacobson J in relation to the nature of the fiduciary relationship are important. ASIC had not argued that the specific relationship that had been struck between Citigroup and Toll fell within any of the established categories of fiduciary duties known to the law. Of course the courts have made it clear that new fiduciary relationships can arise in particular circumstances.

In *Citigroup* ASIC argued that the fiduciary relationship arose from the letter appointing Citigroup. Drawing on a range of English and Australian authorities,[214] Jacobson J stated that:

> **"…where a fiduciary relationship is said to be founded upon contract, the ordinary rules of construction of contracts apply. Thus, whether a party is subject to fiduciary obligations, and the scope of any fiduciary duties, is to be determined by construing the contract as a whole in light of the surrounding circumstances known to the parties and the purpose and object of the transaction."[215]**

ASIC had vigorously argued that for a proper exclusion clause to operate Citigroup should have drawn to the attention of Toll the specifics of the exclusion, and that the relationship was being qualified. ASIC had emphasised this 'obligation' by referring to some of the cases dealing with the duty owed by solicitors in the line of cases flowing from the *Prince Jefri Bolkiah* case which I have discussed above.

Justice Jacobson referred to the obligation on the part of solicitors who wished to enter into time charging cost agreements with their client to make full disclosure to the client of all the implications of such an agreement. This duty can still apply where a cost agreement is made *before* the solicitor is instructed. It follows, then, that the fiduciary relationship in that circumstance can exist before the solicitor is actually retained, and can apply in the course of the making of the agreement between solicitor and client.

However, Jacobson J rejected the arguments put forward by ASIC and noted:

> **" …the authorities dealing with solicitors cost agreements have, as their foundation, the Court's inherent jurisdiction over solicitors and the fiduciary nature of the solicitor and client relationship as an established fiduciary category. … ASIC's case was that the fiduciary relationship between Citigroup and Toll arose from the mandate letter. …It follows that there is no place in these proceedings for the application of the principle that a person who is already subject to fiduciary obligations must obtain the client's fully informed consent to the exclusion or modification of these obligations."[216]**

Justice Jacobson then spent further time dealing with the relevant question not only by examining the facts, but also assessing some interesting decisions from Australia and also some comments from a US case (ie *Securities and Exchange Commission v Chenery Corp*).[217] In essence he felt it was essential for a fiduciary relationship to be spelt out in detail for the facts to support the

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[213] Ibid [280].

[214] I have not referred to many other cases, writings and reports in relation to this area. Other important decisions include the Full Federal Court decision of *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390; and the decision of Austin J in *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corp Ltd)* (2001) 19 ACLC 1006.
Tuch has also written a follow up article "Obligations of Financial Advisors in Change of Control Transactions: Fiduciary and Other Questions" (2006) 24 Company and Securities Law Journals 488 which is referred to by Jacobson J in the decision.

[215] *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* **(2007) 160 FCR 35,** [281].

[216] Ibid [303] - [307].

[217] (1942) 318 US 80.

nature of the fiduciary relationship. The proposition that a fiduciary relationship of some particularity had to be established by those facts is emphasised by the decision of Mahoney JA in *Law Society of New South Wales v Foreman (No 2)*.[218]

ASIC apparently felt that the rather unusual case, *Australian Breeders Cooperative Society Limited v Jones*[219] (Australian Breeders**) assisted it in distinguishing the more traditional views. In summarising his conclusions on the arguments put forward by ASIC that a special type of a fiduciary relationship existed in this matter, Jacobson J noted that this would be to in effect say that "a person who is not a fiduciary may nevertheless owe an obligation which flows from a fiduciary relationship. That could hardly be correct".[220] In reaching that view Jacobsen J argued that the decision in the *Australian Breeders* case was rather an unusual one – it involved a person who was acting in a professional capacity in the establishment of a thoroughbred horse breeding venture and who sought to limit the extent of that duty in providing advice. In the view of Jacobson J this was not a case which involved a contractual acknowledgement that there was in fact no fiduciary relationship. In that case the court found that the consent provided by the advisee was not effective.**

In Jacobson J's view of the facts, Toll was fully aware of the possibility that there would be proprietary trading by Citigroup and that this in fact amounted to informed consent.

6.4 The Act – section 912A(1)(aa)

The decision then goes on to discuss the five alleged breaches of the Act. It is interesting to note that in Jacobson J's view, ASIC had not established any of these alleged breaches.

This discussion required the court to consider the operation of the relevant provisions of section 912A(1)(aa) (s 912A**) of the Act.**

In effect this section provides that a financial services licensee (as defined by the relevant legislation) must:

> **"have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative."**

This statutory provision will only apply where a financial service is being provided. In Jacobson J's view, Citigroup was not providing a financial service under the terms of this statutory provision. Despite this finding Jacobson J went on to consider the obligations imposed by s 912A – the need to have in place adequate arrangements for the management of conflicts of interest. In this context he again considered the *Prince Jefri Bolkiah* case and the organisational structures considered by the House of Lords in that case. Citigroup described measures it had taken in this regard, including the physical separation between departments, education programmes for staff, procedures for dealing with 'crossing the wall', monitoring by compliance officers and disciplinary sanctions.

Upon consideration of the evidence Jacobson J believed that the measures taken by Citigroup would have been effective for the purposes of the statute. Nevertheless, and this is important, Jacobson J warned that:

> **"…it is not always realistic to place reliance on arrangements comprising Chinese walls… Adequate arrangements require more than a raft of written policies and procedures. They require a thorough**

[218] (1994) 34 NSWLR 408.
[219] (1997) 150 ALR 488.
[220] *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* **(2007) 160 FCR 35, [**346].

> **understanding of the procedures by all employees and a willingness and ability to apply them to a host of possible conflicts."[221]**

6.5 Insider trading and Chinese walls

A number of technical issues were raised in relation to section 1043A of the Act dealing with insider trading. ASIC raised a number of interesting technical issues which I will not be discussing here – the only question I wish to discuss in this regard are the views of Jacobson J in relation to the Chinese wall defence in the insider trading legislation.

The Act provides a 'Chinese wall defence' which will eliminate the possibility of a breach. For this defence to operate, the relevant Chinese wall has to meet 2 requirements:

- the Chinese wall must have been 'reasonably expected' to prevent the communication of insider information to the person who traded in the shares, and (s 1043F(b))
- the wall must have *in fact* prevented such communication (s 1043F(c)).

In applying this provision, Jacobson J found that Citigroup's Chinese wall arrangements were adequate to invoke the defence under s 1043F. Referring to the informal 'cigarette on the pavement' conversation between Citigroup's 'public side' and 'private side' employees, Jacobson J commented that:

> "…what the unscripted actions of [the relevant staff members of Citigroup] show is the practical impossibility of ensuring that every conceivable risk is covered by written procedures and followed by employees. However, the arrangements required to satisfy s 1043F(b) of the Corporations Act do not require a standard of absolute perfection. The test stated in the section is an objective one."[222]

Underlying ASIC's attack on the adequacy of Citigroup's Chinese wall procedures was the argument that in order for the wall to be effective, Citigroup must have obtained Toll's informed consent to Citigroup's proprietary trading. But Jacobson J rejected this idea as "contrary to the express recognition of the Chinese walls defence in s 1043F of the Act".[223]

We have considered earlier the effectiveness of the 'Chinese wall' aspects of s 912A of the Act.

6.6 The interaction of the Chinese wall requirements for financial services licensees and fiduciary duties

It is significant to note that s 912A of the Act is framed so as to require the relevant company to create arrangements which we have described throughout this paper (as they are generally known) as Chinese walls. This obligation obviously sits side by side with the fiduciary duty which may arise in appropriate circumstances to avoid a conflict of interest.

The kinds of arrangements that a licensee could implement to meet the requirements of s 912A of the Act may also be sufficient to invoke the defence to a claim of insider trading based on s 1043F of the Act discussed above. However, it may be the case that such arrangements do not shield a financial services licensee from a claim based on the fiduciary duty to *avoid* a conflict of interest.

ASIC considered what it means to 'manage' a conflict in its Regulatory Guide #181 - *Licensing: Managing conflicts of interest.* At RG 181.20 it outlines three mechanisms that licensees would generally use to manage conflicts of interest. Licensees could control conflicts, avoid conflicts and disclose conflicts. Whilst many conflicts will be manageable through internal controls and disclosure, some situations will require the

[221] Ibid [453] – [454].
[222] Ibid [591] – [592].
[223] Ibid [598].

licensee to avoid the conflict or refrain from providing the affected financial service.[224] Such will be the case where the financial services licensee owes, in addition, a fiduciary duty to avoid a conflict of interest.

The Regulatory Guide notes:

> "Many licensees are also bound by common law obligations that affect their management of conflicts of interest. For example, many licensees have fiduciary obligations to their clients to whom they provide advice or for whom the act in a trustee capacity. These obligations operate in addition to the statutory requirements and should be taken into account when formulating conflicts management arrangements."[225]

Not all investment banks acting in an advisory capacity will owe fiduciary duties. Reflecting on this in *Citigroup,* Jacobson J concluded that the question of whether a fiduciary relationship exists, and the scope of any duty, will depend upon the factual circumstances and an examination of the contractual terms between the parties. As I have discussed earlier, investment banks have developed contractual techniques to modify or displace fiduciary obligations. Citigroup had, on the other hand, sought to exclude the fiduciary relationship by the terms of the mandate letter. As we have also discussed earlier, Jacobson J held that the contract effectively achieved the exclusion in this manner.

6.7 Conclusions from the Citigroup case

Because ASIC failed to establish a fiduciary duty on the part of Citigroup, the outcome of the case turned on the question of whether or not Citigroup had fulfilled its statutory duty to 'manage' potential conflicts of interest. Jacobson J's judgment reflects a general acceptance of the efficacy of Chinese walls in meeting such statutory requirements, though in evaluating Citigroup's Chinese wall he drew on general law principles established in cases involving fiduciary relationships.

In s 1043F of the Act, the Chinese wall defence to an insider trading claim requires that the body corporate implement arrangements that could be 'reasonably expected' to prevent the proscribed communication. This differs from Lord Millett's comment in *Prince Jefri Bolkiah* that the court should intervene unless it is satisfied that there is *no risk* of disclosure. Nevertheless, when discussing Citigroup's Chinese wall arrangements in the context of the s 912A duty, Jacobson J infers that Lord Millett's comments in *Prince Jefri Bolkiah* were generally useful in determining which kinds of arrangements would constitute an effective Chinese wall. It is clear that, while the statutory provisions appear to incorporate elements of the equitable law of fiduciaries, there remains some conceptual and theoretical unease about the interaction of the statutory requirements with traditional approaches to the no-conflicts rule.

In any event, I believe two points at least can be drawn from *Citigroup*:

- The law does not prevent an investment bank from contracting out of, or modifying, any fiduciary obligations. This is because, where parties to an agreement do not fall within an established category of fiduciary relationship, there can be no need for one of those parties to draw the other's attention to the clause and gain their informed consent to it for it to be effective.
- When considering the adequacy of a Chinese wall in the statutory context of 'conflict management', equity and statutory law operate independently, even though the concept of conflict management derives from equity and may be understood by reference to equitable doctrines.

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[224] Australian Securities and Investments Commission, Regulatory Guide 181, 'Licensing: Managing Conflicts of Interest', 30 August 2004, 181.27.
[225] Ibid 181.19.

6 Company law issues

Earlier on, I commented on the fact that in the area of company law, the ability to exclude a fiduciary relationship, or what is in effect an attempt to forgive a breach of duty, may fail because of the co-existence of statutory duties. I do not know to what extent one can extrapolate from all of this principles that may be transferred to other areas in the law (including that which impacts on the investment advisors). With increasing pressure in our community for conflicts of interests to be adequately managed, I reflect very briefly on some of the corporate law issues.

One of the most heavily litigated areas involving conflict of duties arise from the actions of company directors. They are subject to well known statutory and common law duties. One of the most interesting cases to illustrate the problems that can arise in this context (outside of the obvious scenarios where directors are trying to 'feather their own nest' at the expense of the company) is where a director believes that he or she cannot participate in a transaction because of a conflict, and this creates a problem for the company which no longer has the benefit of that director's expertise and knowledge in relation to that transaction.

In *Permanent Building Society (in liq) v Wheeler*,[226] the relevant facts arose when a company that invested in certain property at a significantly inflated price was faced with a potential challenge to that decision. It was alleged that the transaction involved a breach of fiduciary duties on the part of a number of directors.

The Chief Executive of Permanent Building Society – Hamilton – held an office of directorship in the companies on both sides of the relevant transaction, and abstained from voting due to the potential conflict of interest. Justice Ipp regarded Hamilton as being in breach of his duty of care to the company which entered the transaction to its detriment. The fact that Hamilton knew he had a conflict and abstained from voting was not sufficient to discharge his duty of care. Justice Ipp commented that the nature of the transaction required something further that mere abstention from voting:

> **"It was manifest that the transaction was capable of causing PBS serious harm... It may be that, because of the conflict, he should not have spoken or voted in favour of the resolution. But as chief executive and managing director there was a responsibility on him to ensure that the other directors appreciated the potential harm inherent in the transaction, and to point out steps that could be taken to reduce the possibility of that harm. Hamilton could not avoid that duty by, metaphorically speaking, burying his head in the sand while his co-directors discussed whether PBS should enter into such a potentially detrimental transaction."[227]**

In this case, the dual directorship gave rise to a situation where it would be virtually impossible to adequately discharge the director's duties to both companies at once. Similar problems have arisen in other high profile company law cases involving company directors. Perhaps the most notable problems face nominee directors. The Corporations and Markets Advisory Committee Report on *Corporate Groups* (2000) still has much to offer us in this regard.[228]

There are associated questions of whether a company can forgive a director faced with a conflict of interest situation. The impact of section 1324 of the Act and the rights of creditors remains a question yet to be tested.

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[226] (1994) 11 WAR 187.
[227] Ibid 241.
[228] Much has been written in relation to this area, and there are many other interesting comments from the courts that illustrate the impossible position that directors find themselves in when they are faced with a direct conflict. I will not deal with them here. I have discussed this at some length in an article *The Duty of Care of Directors: Does it Depend on the Swing of the Pendulum* published in Ramsay Ed *Corporate Governance and the Duties of Company Directors* (1997) Melbourne University Press.

Section 1324 of the Act takes away from the shareholders of the company the ability to forgive breaches of duty which arise under the provisions of the Act. The right of individuals whose interests are affected to seek an enforcement of the statutory duties under s 1324 have been discussed by me in various articles. It was recently referred to with some approval in a joint paper delivered at a Law Council of Australia Federal Workshop by John Sheahan SC and Leon Zwier.[229]

The fact that shareholders cannot forgive a statutory breach was emphasised by Santow J in *Miller v Miller & Miller.*[230] Whilst the matter was not referred to directly by the High Court of Australia in *Angas Law Services Pty Ltd (in liq) v Carabelas*,[231] it was inferred from the decision that shareholders could not override statutory rights that were vested in the interested parties by virtue of s 1324 of the Act. This is clearly a different situation to that which exists in relation to the provisions of s 912A of the Act where, in fact, there are parameters laid down for companies to create 'Chinese walls' and other arrangements to modify, or perhaps minimise, the nature of fiduciary relationships.

7 Conclusions

It is a trite observation to suggest that the *Citigroup* decision has drawn a definitive line in the sand. In relation to the problems of conflict, we as advisors and commentators face many future challenges in this area of the law. I look forward to evaluating and commenting on them in the years ahead.

[229] 'Directors' Duties and Creditors' (25 – 27 March 2006, Sydney).
[230] (1995) 16 ACSR 73.
[231] (2005) 226 CLR 507.