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Conflicts of Interest in Financial
Services Firms

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Conflicts of regulators

- Conflict may arise where a former member of a regulator appears before that regulator soon after retiring from their position.
- In the US and Canada there is a compulsory period of quarantine for public officials.
- According to Lionel Bowen (former Attorney General) the Australian market is too small for a compulsory period of quarantine.

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Australian Stock Exchange

ASX has 3 roles:

1. non-government regulator of the securities market;
2. administrator of the securities exchange; and
3. company listed on the securities exchange.

Potential for conflict:

- ASX obtains increased revenue from higher trading volumes
- Its listing on its own exchange may mean it is less likely to act against investors who seek to drive down prices

ASX claims:

- commercial interests and supervisory responsibilities are aligned
- ASX's operations are nonetheless separately managed

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Conflicts of Legal Practitioners

- Prince Jefri Bolkiah v KPMG
 - per Lord Millett:
 - the court will prevent a firm from acting unless there is *no risk of disclosure*
- Spincode Pty Ltd v Look Software Pty Ltd
- Village Roadshow Limited v Blake Dawson Waldron
 - per Justice Byrne:
 - the court will act where a reasonable person informed of the facts might *reasonably anticipate* a danger of misuse of confidential information AND there is a *real and sensible possibility* of a conflict of interest

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Conflicts of Legal Practitioners

“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 client of such firms and the firms themselves must 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 standards of a practitioner’s loyalty to the client which have characterised the practice of law in this State.”

per Byrne J

Village Roadshow Limited v Blake Dawson Waldron
(2004) Aust Torts Reports 81-726, [50]

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Citigroup Global Markets Australia Pty Ltd

'private' side: exposure to confidential, market sensitive information

'public' side: roles performed on basis of publicly available information

1. Employee in 'public side' purchased shares in Patrick Corporation just prior to announcement of Toll Holdings takeover of the company.
2. After an 'informal cigarette on the pavement' conversation between that employee and employees from the 'private side' some of the shares were sold.

ASIC argued that:

- the share sales breached the insider trading provisions of the Corporations Act
- Citigroup had a fiduciary relationship with Toll due to its advisory role in the takeover
- the Chinese walls erected by Citigroup were inadequate to prevent the flow of information between the 'private' and 'public' sides of its business

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Citigroup – fiduciary & contractual duties

“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 modifying, his or her fiduciary duties, particularly where no prior fiduciary relationship existed and the contract defines the rights and duties of the parties..”

per Jacobson J

ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)
(2007) 160 FCR 35, [278]

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Citigroup – Chinese walls

s 1043F: ‘Chinese wall defence’ to insider trading where:

1. the Chinese wall was *reasonably expected* to communication of insider information; and
2. the Chinese wall has *in fact* prevented such communication.

According to Jacobson J, the test is an objective one:

- the section *does not require* absolute perfection; and
- it *does not require* every conceivable risk to be covered.

Satisfaction of requirements under s 912A(1)(aa) to have ‘adequate arrangements for the management of conflicts of interest’ may be sufficient to invoke s 1043F defence.

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Directors' duties

Permanent Building Society v Wheeler

The Chief Executive (**Hamilton**) held office of directorship in companies on both sides of a transaction. He abstained from voting due to his conflict of interest.

Justice Ipp found that:

- simply abstaining from voting on the transaction was not sufficient
- as the Chief Executive and Managing Director, Hamilton had a duty to:
 - ensure the other directors appreciated the potential harm inherent in the transaction, and
 - to point out steps that could be taken to minimise the possibility of harm

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Conclusion

Questions of conflicts continue to be crucial for many organisations and those that advise them.

There are many questions yet to be answered in this area. The cases discussed today provide some guidance as to how fiduciary duties and potential conflicts can be managed in today's business environment.

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