Equitable and statutory regulation of conflicts of interests and duty

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Introduction

In this presentation, I will start with what may be some very familiar propositions as to when fiduciary duties arise, or are imposed; then move from there to a question as to the scope of the conflict of interest rule which is one of those duties at general law; then to specific applications of, and modifications of, that duty by statute, as applied to company directors and participants in the financial services industry.

When a fiduciary duty arises at general law

A fiduciary duty can arise at general law in several relationships which are traditionally recognised as giving rise to such duties. Traditional examples of such relationships include that between trustee and beneficiary, agent and principal, director and company, solicitor and client, and at least in some circumstances, an employee and his or her employer.[1]

A fiduciary duty may also arise within a fact-based (or "ad hoc") fiduciary relationship, in the circumstances of the relationship. In *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41; [1984] HCA 64 ("*Hospital Products*"), Gibbs CJ observed (at 68) that the case law provided "no comprehensive statement of the criteria by reference to which the existence of a fiduciary relationship may be established". Mason J observed (at 96–97) that "the critical feature" of the traditional fiduciary relationship was the undertaking or agreement by the fiduciary to "act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense" and that:

> "The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position … It is partly because the fiduciary's exercise of the power or discretion can adversely affect the interests of the person to whom the duty is owed and because the latter is at the mercy of the former that the fiduciary comes under a duty to exercise his power or discretion in the interests of the person to whom it is owed …"

Deane J similarly observed (at 141–142) that, although no single test would identify a fiduciary relationship:

> "There is, however, the notion underlying all the cases of fiduciary obligation that inherent in the nature of the relationship itself is a position of disadvantage or vulnerability on the part of one of the parties which causes him to place reliance upon the other and requires the protection of equity acting upon the conscience of that other ..."

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[1] *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41; [1984] HCA 64 per Gibbs CJ at 68.

In *Breen v Williams* (1996) 186 CLR 71 ("*Breen v Williams*") at 106–107, Gaudron and McHugh JJ similarly observed that Australian courts have consciously refrained from adopting a general test for the existence of a fiduciary relationship, and pointed to matters that may suggest the existence of a fiduciary relationship, including a relation of confidence, inequality of bargaining power, an undertaking by one party to perform a task or fulfil a duty in the interests of the other party, the unilateral exercise of a discretion or power by one party which may affect the interests of the other, or reliance by one party on the other arising from dependence or vulnerability.

In *Bristol & West Building Society v Mothew* [1998] Ch 1 (dealing with whether a solicitor's conduct amounted to breach of fiduciary duty), Millett LJ similarly observed (at 18) that:

> "A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of the fiduciary."

That observation has since been applied in numerous cases in the United Kingdom including by the United Kingdom Supreme Court in *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45 at [5].[2]

In *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35; 62 ACSR 427 (dealing with whether an investment bank owed fiduciary duties to its takeover bidder client), Jacobson J referred, inter alia, to *Hospital Products* and observed (at [272]) that:

> "Apart from the established categories, perhaps the most that can be said is that a fiduciary relationship exists where a person has undertaken to act in the interests of another and not in his or her own interests but all of the facts and circumstances must be carefully examined to see whether the relationship is, in substance, fiduciary ..."

In *John Alexander's Clubs Pty Limited v White City Tennis Club Limited* (2010) 241 CLR 1; [2010] HCA 19 at [87], a unanimous High Court identified the 'critical feature' of fiduciary relationships as being that:

> "'the fiduciary undertakes or agrees to act *for or on behalf of* or *in the interests of* another person in the exercise of a *power or discretion* which will affect the interest of that other person in a legal or practical sense.' From this power or discretion comes the duty to exercise it in the interests of the person to whom it is owed."

In *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296; [2012] FCAFC 6, the Full Court of the Federal Court (Finn, Stone and Perram JJ) observed (at [177]) that a fiduciary duty may exist:

> "when and insofar as that person has undertaken to perform such a function for, or has assumed such a responsibility to, another as would thereby reasonably entitle that other

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[2] For other cases, see *Global Container Lines v Bonyad Shipping Co* [1998] 1 Ll Rep 528 at 546; *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 at 599; *Brandeis (Brokers) Ltd v Black* [2001] 2 All ER (Comm) 980 at [32]; *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch); [2005] Ch 119 at [55]; *Sinclair Holdings SA v Versailles Trade Finance Ltd* [2007] EWHC 915 (Ch) at [78]; [2007] 2 All ER (Comm) 993; *JD Wetherspoon plc v Van de Berg & Co Ltd* [2009] EWHC 639 (Ch) at [74].

> to expect that he or she will act in that other's interest to the exclusion of his or her own or a third party's interest."

Their Honours also noted (at [174]) that the relevant fiduciary duties were:

> "concerned with the setting of standards of conduct for persons in fiduciary positions. Its burden, put shortly, is with exacting disinterested and undivided loyalty from a fiduciary – hence, for example, its focus on conflicts between duty and undisclosed personal interest, conflicts between duty and duty and misuse of a fiduciary position for personal gain or benefit."

The question of when fiduciary duties are, or should be, recognised at general law has given rise to a voluminous academic literature.[3] By way of illustration, Professor Finn has argued that fiduciary duties arise from a duty of loyalty that reflects "higher community standards or values" and give rises to a "legitimate expectation that the other party will act in the interests of the first party or at least in the joint interests of the parties and not solely self-interestedly". He argues that factors relevant to the existence of such an expectation are the importance of the client interest involved in the relationship, so that the protection of the client's physical or financial well-being justifies the imposition of a fiduciary relationship; the societal significance of the role of the service provider; community expectations as to the standard of probity to be expected of a service provider of that type; and whether the nature of the service is one in which the service provider could be expected to be promoting a separate interest of his or her own.[4] He also suggests that a service relationship will be fiduciary if "the actual circumstances of a relationship are such that one party is entitled to expect that the other will act in his interests in and for the purpose of the relationship" and that:

> "The critical matter in the end is the role that the alleged fiduciary has, or should be taken to have, in the relationship. It must so implicate that party in the other's affairs or so align him with the protection or advancement of that other's interests that foundation exists for the fiduciary expectation".[5]

In a recent article, Professor Finn has described the basis for a fiduciary relationship as that:

> "A person will be in a fiduciary relationship with another when that other is reasonably entitled to expect that he or she will act in the other's interest (or their joint interest) to

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[3] For a modest selection from a vast literature, see AW Scott, "The Fiduciary Principle" (1949) 37 *Cal L Rev* 539; LS Sealy, "Fiduciary Relationships" (1962) 20 *Cambridge LJ* 69; PD Finn, *Fiduciary Obligations,* 1977; T Frankel, "Fiduciary Law" (1983) *71 Calif L Rev* 795; PD Finn, "The Fiduciary Principle" in T Youdan (ed), *Equity, Fiduciaries and Trusts*, 1989; PD Finn, "Contract and the Fiduciary Principle" (1989) 12 *UNSWLJ* 76; R Cooter & D Freedman, "The Fiduciary Relationship: Its Economic Character and Legal Consequences" (1991) 66 *NYU Law Rev* 1045; JR Macey and GP Miller, "An Economic Analysis of Conflict of Interest Regulation" (1997) 82 *Iowa LR* 965; DA Demott, "Beyond Metaphor: An Analysis of Fiduciary Obligation" (1998) 37 *Duke LJ 879*; S Worthington, "Fiduciaries: When is Self-Denial Obligatory?" (1999) 58(3) *Camb LJ* 500; M Conaglen, "The Nature and Function of Fiduciary Loyalty" (2005) 121 *LQR* 452; M Conaglen, "Fiduciary Regulation of Conflicts between Duties" (2009) 125 *LQR* 111; M Leeming "The scope of fiduciary obligations: How contract informs, but does not determine, the scope of fiduciary obligations" (2009) 3 *J Eq* 181; M Conaglen, *Fiduciary loyalty: Protecting the due performance of non-fiduciary duties*, 2010; PD Finn, "Fiduciary Reflections" (2014) 88 *ALJ* 127.
[4] PD Finn, "The Fiduciary Principle" in T Youdan (ed), *Equity, Fiduciaries and Trusts*, 1989.
[5] Ibid pp 46–47.

the exclusion of his or her own several interest, for a purpose, or for some or all purposes, of their relationship."[6]

On the other hand, Professor Conaglen argues that fiduciary principles provide specific and prophylactic protection for non-fiduciary duties and that their purpose is to enhance the proper performance of non-fiduciary duties by seeking to avoid influences or temptations likely to distract the fiduciary from the proper performance of those duties.[7] This explanation may be straightforward in circumstances involving conflicts of duty and interest, since a non-fiduciary duty is likely to be necessary to give rise to a conflict in the first place. He summarises this position as follows:

> "The view that fiduciary doctrine offers a subsidiary and prophylactic form of protection for non-fiduciary duties clarifies what the various principles of fiduciary doctrine are concerned to achieve, which is important in considering whether it is appropriate for fiduciary doctrine to apply. The view that fiduciary duties are protective of other non-fiduciary duties indicates the need for non-fiduciary duties to exist in order that fiduciary duty can serve its protective function vis-a-vis those non-fiduciary duties."[8]

Justice Edelman in turn argues that fiduciary duties arise as obligations based on the manifestation of a voluntary undertaking to another person, and are not duties imposed by law and are not referable to relationship or status, but are based upon contract. He argues that that approach explains why contract can modify fiduciary duties, why they cannot be imposed on a contract to alter its intended operation and why fiduciary duties arising in the context of a contractual undertaking cannot survive termination of the contract.[9]

The scope of the fiduciary obligation

A fiduciary obligation will arise only in relation to that part of the relationship which is fiduciary in character[10] and the duty owed by a fiduciary will be limited to the scope of the service which it undertakes to provide.[11] For example, in *Howard v Commissioner of Taxation* (2014) 309 ALR 1; [2014] HCA 21, a taxpayer argued, inter alia, that he was not liable for a tax on a judgment in his favour because he had received the relevant amount as constructive trustee for a company for which he was a director. The High Court held that, where the taxpayer had not obtained any gain or benefit by use of his position as a director, there was no conflict and no substantial possibility of conflict between his personal interest and his duty to the company and no basis for a constructive trust. French CJ and Keane J noted (at [34]) that the limits of fiduciary duties were to be determined by the character of the relationship, the parties' express agreement and their course of dealings and that:

> "[t]he scope of the fiduciary duty generally in relation to conflicts of interest must accommodate itself to the particulars of the underlying relationship which give rise to the duty so that is consistent with and conforms to the scope and limits of that relationship".

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[6] PD Finn, "Fiduciary Reflections" (2014) 88 *ALJ* 127 at 137.
[7] M Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties*, 2010, p 4.
[8] Id p 245.
[9] J Edelman, "When do fiduciary duties arise" (2010) 126 *LQR* 302; see also J Edelman "The importance of the fiduciary undertaking" (2013) 7 *J Eq* 128.
[10] *Birtchnell v Equity Trustees Executors and Agency Co Ltd* (1929) 42 CLR 384 at 408 per Dixon J; *New Zealand Netherlands Society 'Oranje' Inc v Kuys* [1973] 1 WLR 1126 at 1130 per Lord Wilberforce.
[11] *Aequitas v AEFC* (2001) 19 ACLC 1006 at [307].

A contract governing the relationship between the fiduciary and the beneficiary may also define the nature of the relationship and obligations between the parties in a way which limits the scope of any fiduciary duty. In *Hospital Products Ltd v United States Surgical Corporation* above at 97, Mason J observed that:

> "[T]he contract … regulates the rights and liabilities of the parties, the fiduciary relationship … must accommodate itself to the terms of the contract so that it is consistent with, and conforms, to them."[12]

Alternatively, the contract may authorise an act that would otherwise be a breach of fiduciary duty, so as to narrow the scope of that duty, or amount to informed consent or ratification.[13] The parties to a relationship may also seek expressly to provide that their relationship is not fiduciary in character, although the effectiveness of such a term has been controversial in the cases and the academic literature.[14]

The no conflict rule

Broadly, a fiduciary is required to act with undivided loyalty towards the beneficiary of the fiduciary duty in performing the duty.[15] In *Breen v Williams* above, the High Court emphasised that Australian courts only recognise proscriptive or prohibitive duties, imposing the obligation on the fiduciary not to obtain an unauthorised profit or to be in a position of conflict, and the existence of a fiduciary relationship does not impose a positive legal duty on the fiduciary to act in the beneficiary's interests. The same view was taken in *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 197–8; [2001] HCA 31 ("*Pilmer v Duke Group*"). I note, in passing, that the emphasis on the proscriptive character of fiduciary duties in Australian law has led to the rejection of any affirmative duty of disclosure as a separate fiduciary duty or an incident of the no conflict rule, so that non-disclosure of information relevant to the beneficiary, or indeed of a fiduciary's breach of duty, is not in itself a separate breach of duty.[16] The fact of disclosure may, of course, still be relevant to informed consent to or ratification of conduct that would otherwise be a breach of fiduciary duty. English law has taken a different approach, treating a fiduciary's non-disclosure of a breach of duty as itself a potential breach of fiduciary duty.[17]

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[12] See also *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410 at 539; *Breen v Williams* above per Gummow J at 132–133; *Eric Preston Pty Ltd v Euroz Securities Ltd* (2010) 77 ACSR 135; [2010] FCA 97, aff'd (2011) 274 ALR 705; [2011] FCAFC 11.

[13] For example, in *National Nominees Ltd v Agora Asset Management Pty Ltd (No 2)* [2011] VSC 425.

[14] *South Sydney District Rugby League Football Club Ltd v News Ltd* (2000) 177 ALR 611 at [134]–[135]; *ASIC v Citigroup Global Markets Australia Pty Ltd (no 4)* above at [296], [337]; P Finn, "Fiduciary Reflections" (2014) 88 *ALJ* 127; M Leeming, "The scope of fiduciary obligations: How contract informs, but does not determine, the scope of fiduciary obligations" (2009) 3 *J Eq* 181.

[15] *Bristol & West Building Society v Motthew* at 18–19; *Maguire v Makaronis* (1997) 188 CLR 449 at 465; *Bofinger v Kingsway Group* [2009] HCA 44; (2009) 239 CLR 269 at [49]; J Campbell, "Fiduciary Relationships in a Commercial Context", Sydney Law School, Legal Studies Research Paper, No 14/26.

[16] *Compaq Computer Australia Pty Ltd v Merry* (1998) 157 ALR 1 at 21; *National Mutual Property Services Australia Pty Ltd v Citibank Savings Ltd* [1998] FCA 564; *Fitzwood Pty Ltd v Unique Gold Pty Ltd (in liq)* (2001) 188 ALR 566; [2001] FCA 1628 at [32]–[33]; *Dresna Pty Ltd v Linknarf Management Services Pty Ltd (in liq)* (2006) 156 FCR 474; [2006] FCAFC 193 at [130]–[132]; *P & V Industries Pty Ltd v Ponto* [2007] VSC 64 at [24]–[30]; *Collard v Western Australia (No 4)* [2013] WASC 455 at [1096], [1211]–[1214].

[17] *Item Software (UK) Ltd v Fassihi* [2004] EWCA (Civ) 1244; *Hanco ATM Systems Ltd v Cashbox ATM Systems Ltd* [2007] EWHC 1599 (Ch) at [65]; *GHLM Trading Ltd v Maroo* [2012] 2 BCLC 369 at [192]–[195]; *McTear v Engelhard* [2014] EWHC 1056 (Ch) at [10]–[91].

The "no conflict" rule is potentially the most demanding of several duties that I consider here, since it requires a fiduciary to avoid and not merely "manage" a conflict of interest or prioritise one interest over another. Lord Cranworth LC formulated that rule in *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq 461 at 471 as that:

> "no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect."

The test for when a conflict arises has been expressed in various ways in the cases, but the shorthand "real [and] sensible possibility" is often applied. In *Boardman v Phipps* [1967] 2 AC 46 at 124, Lord Upjohn formulated the test for whether a conflict exists as whether a:

> "reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict."

In *Chan v Zacharia* (1984) 154 CLR 178 at 198, the test was expressed as "a conflict … or significant possibility of such conflict". In that case, Deane J (with whom Brennan and Dawson JJ agreed) also referred to an observation of Sir Frederick Jordan in *Chapters in Equity in New South Wales* (6th ed 1947, p 115) that:

> "It has often been said that a person who occupies a fiduciary position ought to avoid placing himself in a position in which his duty and his interest, or two different fiduciary duties, conflict.
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> This is rather a counsel of prudence than a rule of equity; the rule being that a fiduciary must not take advantage of such a conflict if it arises."

His Honour also noted (at 198) that that formulation, even as an unqualified counsel of prudence, may be inappropriate in some circumstances and that:

> "The equitable principle governing the liability to account is concerned not so much with the mere existence of a conflict between personal interest and fiduciary duty as with the pursuit of personal interest by, for example, actually entering into a transaction or engagement 'in which he has, or can have, a personal interest conflicting … with the interests of those whom he is bound to protect' (per Lord Cranworth L.C., *Aberdeen Railway Co v Blaikie Brothers* [1854] 1 Macq 461 at p 471 or the actual receipt of personal benefit or gain in circumstances where such conflict exists or has existed."

In *Hospital Products Ltd v United States Surgical Corp* above at 103, Mason J also referred to Sir Frederick Jordan's observation and noted that:

> "the fiduciary's duty may be more accurately expressed by saying that he is under an obligation not to promote his personal interest by making or pursuing a gain in circumstances in which there is a conflict or real or substantial possibility of a conflict between his personal interests and those of the persons whom he is bound to protect ..."

That formulation places emphasis upon the fiduciary's conduct in making or pursuing a gain, and not merely upon his or her occupying a position where a conflict or potential conflict exists.

In *Pilmer v Duke Group Ltd (in liq)* above at 199, the plurality of the High Court formulated the no conflict rule as follows:

> "the fiduciary is under an obligation, without informed consent, not to promote the personal interests of the fiduciary by making or pursuing a gain in circumstances in which there is 'a conflict or a real or substantial possibility of a conflict' between personal interests of the fiduciary and those to whom the duty is owed ... Similar reasoning applies where the alleged conflict is between competing duties, for example, where a solicitor acts on both sides of a transaction."

The significance of taking advantage of a conflict

The conflict rule has a strict application at least in the sense that, if a transaction has occurred in conflict of interest, a fiduciary cannot displace the breach by asserting the fairness of the transaction or that it was in the beneficiary's best interests or that the fiduciary was not acting with subjective dishonesty.[18] However, there are different approaches to Sir Frederick Jordan's observation in the case law, which have in turn been the subject of academic commentary.[19]

At first instance in *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 39 WAR 1; 70 ACSR 1 [2008] WASC 239 at [4503]–[4504], Owen J observed that:

> "It is the promotion of the personal interest that equity finds abhorrent … Generally speaking, liability arises not from the mere existence of a conflict of interest but from the pursuit of personal interest by, for example, actually entering into a transaction in which the relevant contract exists, or the actual receipt of personal benefit in circumstances of such conflict … The mischief is not so much being in a position of conflict but rather in pursuing that conflict."

On the other hand, in *Agricultural Land Management Ltd v Jackson (No 2)* [2014] WASC 102; (2014) 98 ACSR 615 ("*Agricultural Land Management*"), Edelman J had to determine whether a breach of the conflict rule was established where it had not been shown that directors actually preferred their own interests. His Honour observed (at [266]–[267]) that the conflict rule will extend to situations involving a "potential" for personal interest to be preferred or for breach of duty to one principal in the case of conflict in duties owed to different principals, and treated the reference to a "counsel of prudence" as relating to the profit rule or liability to account rather than the scope of the duty against conflict of interest. His Honour also noted (at [268]) that:

> "In contrast, when focus is directed to the prohibition against a fiduciary placing himself or herself in a position of conflicting duties there are many authorities which emphasise that the underlying duty upon the fiduciary is not circumscribed by whether *actual* advantage has been taken or whether the fiduciary has actually pursued the conflict."

His Honour held that a "potential conflict" arose where those directors had caused Agricultural Land Management, as purchaser, to buy property from another company of

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[18] M Scott Donald, "Managing the Possibility of Conflict" (2015) *Australian Superannuation Law Bulletin* 89.

[19] R Teele Langford, "Directors' Duties: Conflicts, Proactive Disclosure and s 181 of the Corporations Act" (2015) 33(3) *C&SLJ* 205; R Teele Langford & I M Ramsay, "Directors' conflicts: Must a conflict be pursued for there to be a breach of duty?" (2015) 9 *J Eq* 281.

which they were also directors. As Edelman J noted, there was a plain conflict in that transaction, because Agricultural Land Management's interest as purchaser was to undertake the transaction at the lowest price and the other company's interest as vendor was to undertake it at the highest price. The defendants there sought to avoid a finding of breach of the rule against conflict of interest on the basis that that breach would only arise if a fiduciary pursued or preferred his or her personal interest, referring to the observation of Owen J in *Bell Group (No 9)* to which I referred above. It seems to me that this case could properly be characterised as involving acting in conflict of interest, in the sense referred to by Sir Frederick Jordan, because the directors in that case had in fact authorised entry into a transaction in circumstances where their duties to the two parties to it were in fact in conflict in that transaction.

I adopted Sir Frederick Jordan's approach in *Re Colorado Products Pty Ltd (in prov liq)* [2014] NSWSC 789; (2014) 101 ACSR 233 ("*Colorado Products*"), in a case concerning an allegation of conflict of interest affecting a director. No reference had been made to *Agricultural Land Management* in submissions in that case. The Court there had to consider allegations of breach of, inter alia, a shareholders agreement, general law and statutory duties. The alleged breaches arose in circumstances where the parties had structured their business such that a director of the company which imported bathroom and laundry products into Australia was also the controller of the company which manufactured them in China and of another company which leased the company's business premises to it. That structure gave rise to inherent conflicts of interest, since a manufacturer's or lessor's interests (most obviously, as to pricing and timeliness of payment) will often not coincide with those of its distributor or lessee.

The plaintiffs alleged that that director preferred her own interests to those of Colorado Products in respect of a number of matters. That points to the practical likelihood that, in most cases, questions of conflict of interest will not arise in the abstract, but in circumstances that a director is suggested to have preferred another's interest to the company's interest. In that case, I held that the first breach alleged to have arisen from the director occupying a directorship of several companies was not established. That holding does not depend upon any principle that a director can only breach the rule against conflict of interest if he or she pursues a competing interest, since several authorities indicate that being a non-executive director of competing companies will not necessarily breach the no conflict rule.[20] The same result would follow from a narrowing of fiduciary duties to the extent that the parties had deliberately established a structure which involved the director being a director of both Colorado Products and the manufacturer of the goods it sold and the lessor of the premises it occupied. Another alleged breach was that the director had caused the manufacturer to require payment of particular invoices rather than extending the terms for payment. That breach raised the question whether the scope of the director's fiduciary duty had been narrowed, where the parties had established a structure in which she was both a director of the manufacturer and Colorado Products.

On the other hand, a claim for diversion of business to a competing entity succeeded, on the basis that that conduct involved a breach of fiduciary duty. The plaintiffs succeeded in establishing a right to equitable compensation or an account of profits on that basis.

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[20] *On the Street Pty Ltd v Cott* (1990) 3 ACSR 54 at 61; *Streeter v Western Areas Exploration Pty Ltd (No 2)* (2011) 278 ALR 291; 82 ACSR 1; [2011] WASCA 17 at [69]; *Re Colorado Products* above at [360].

One commentator has suggested the reference to a "real or substantial possibility of a conflict" by Mason J in *Hospital Products Ltd v United States Surgical Corp* above at 103, and by the High Court in *Pilmer v Duke Group Ltd (in liq)* above, excludes the approach suggested by Sir Frederick Jordan.[21] Dr Teele Langford and Professor Ramsay read Sir Frederick Jordan's observations as directed to the scope of an account of profit and point to the fact that other remedies are available for a breach of the no conflict rule, including equitable compensation or an order avoiding a transaction.[22] There is, of course, a difficult question as to how one might establish the measure of equitable compensation in circumstances that a director had been in a position of conflict, but not acted so as to advance that conflict. They also point to a further question, whether acting in a position of breach of conflict (or, as they describe it, "pursuit" of the conflict) involves actually taking advantage of the conflict or simply acting where the conflict exists.[23] The latter approach obviously allows a wider scope for the protective function of fiduciary duties.

I express no view as to which approach is correct, to the extent they differ, which may one day be a matter for an appellate court. I do note, first, that Sir Frederick Jordan's emphasis on whether a fiduciary took advantage of a conflict may be closer to the statutory approaches to conflicts which I will consider below. Second, the wider approach, emphasising whether there is a real and sensible possibility of conflict, may better protect beneficiaries' interests and may be more consistent with the protective purpose that is often attributed to fiduciary duties. Third, there will often be little practical difference between the two approaches, because circumstances in which a person is in a position of conflict, but does not take advantage of it, may also be cases where there was either no real or substantial possibility of conflict or where the terms or structure of the relationship had involved a narrowing of the relevant duty or which do not result in litigation.

The overlap with statutory duties – directors' duties

A company director is a traditional, status-based, fiduciary.[24] In *Manildra Laboratories Pty Ltd v Campbell* [2009] NSWSC 987 at [57], McDougall J summarised the content of fiduciary duties applicable to a director as not to obtain a personal benefit by use of the fiduciary's position or from an opportunity or knowledge gained by the fiduciary by reason of that position; an obligation to avoid conflict, or a real or substantial possibility of conflict, between the company's interests and the fiduciary's own interests and interests of or duties owed by him or her to others; and an obligation to account to the company for any benefit or gain obtained by him or her in breach of those duties. Those observations were approved by Wigney J in *SBA Music Pty Ltd v Hall (No 3)* [2015] FCA 1079 at [21].

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[21] J Campbell, "Fiduciary Relationships in a Commercial Context", Sydney Law School, Legal Studies Research Paper, No 14/26. Note, however, that Mason J referred to Sir Frederick Jordan's approach with apparent approval in *Hospital Products*, so he plainly did not see it as inconsistent with his approach.
[22] R Teele Langford & I M Ramsay, "Directors' conflicts: Must a conflict be pursued for there to be a breach of duty?" (2015) 9 *J Eq* 281 at 286.
[23] R Teele Langford & I M Ramsay, "Directors' conflicts; Must a conflict be pursued for there to be a breach of duty?" above at 287–8.
[24] For a sample of the academic literature, see RP Austin, "Fiduciary Accountability for Business Opportunities" in PD Finn (ed), *Equity and Commercial Relationships*, 1987; WMC Gummow, "The equitable duties of company directors" (2013) 87 *ALJ* 753; JD Heydon, "Are the Duties of Company Directors to Exercise Care and Skill Fiduciary?" in S Degeling and J Edelman, *Equity in Commercial Law* (2005) at 187–237; M Pearce, "Company directors as 'super-fiduciaries'" (2013) 87 *ALJ* 464; R Teele Langford, *Directors' Duties: Principles and Application*, 2014.

At general law, a director owes an equitable duty to act in good faith in the company's best interests. There is an important open issue, which I note but will not address further, as to whether that duty is a fiduciary duty, which is important to liability for knowing assistance and knowing receipt in respect of a breach of it.[25] Section 181(1) of the *Corporations Act* overlaps with the general law duty to act in good faith and for proper purposes and requires a director or other officer of a corporation to exercise his or her powers and discharge his or her duties in good faith in the best interests of the corporation, and for a proper purpose.

Section 182(1) of the *Corporations Act* prohibits a director, secretary, officer or employee of a corporation from improperly using his or her position to gain an advantage for himself or herself or someone else or cause detriment to the corporation, and that section reflects the fiduciary obligation of a director under the general law.[26] I summarised the relevant principles in respect of that section in *Colorado Products* above at [432]–[433] as follows (omitting several authorities):

> "Section 182(1) of the *Corporations Act* prohibits a director, secretary, officer or employee of a corporation from improperly using his or her position to gain an advantage for himself or herself or someone else or cause detriment to the corporation. An objective standard is to be applied in determining what amounts to an 'improper' use of position, and impropriety is established by 'a breach of the standards of conduct that would be expected of a person in the position of the alleged offender by reasonable persons with knowledge of the duties, powers and authority of the position and the circumstances of the case' …"
>
> It is not necessary that the relevant director gain an advantage for himself or herself or cause a detriment to the company in order to establish a contravention of the section: *Chew v R* [1992] HCA 18; (1992) 173 CLR 626 at 633 per Mason CJ, Brennan, Gaudron and McHugh JJ. An objective test was also applied to determine whether this section was contravened in *Holyoake Industries (Vic) Pty Ltd v V-Flow Pty Ltd* above and, in *Hydrocool Pty Ltd v Hepburn (No 4)* [2011] FCA 495; (2011) 279 ALR 646, Siopsis J followed *R v Byrnes*, above, in holding that impropriety for the purposes of this section was objective and did not require subjective knowledge of impropriety and followed *Chew v R*, above, in holding that a contravention could be established although the desired object was not achieved. …"

Section 183 of the Corporations Act in turn prohibits a director or officer or employee of a corporation from improperly using information to gain an advantage for themselves or someone else or cause detriment to the corporation. A director, officer or employee may act "improperly" within the scope of s 183 although he or she does not intend to act dishonestly.[27] Impropriety may be established by an abuse of the power or authority

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[25] *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No 3)* [2012] WASCA 157; (2012) 44 WAR 1; see also *Netglory Pty Ltd v Caratti* [2013] WASC 364 at [345]ff (observing that it may be incorrect, on the current state of Australian authorities, to characterise a breach of positive duties by a director, such as duties to act in good faith and in a company's interests and for proper purposes as a breach of fiduciary duty).

[26] In *R v Byrnes* (1995) 183 CLR 501 at 516–518, the plurality of the High Court observed that the reference to "improper" in a predecessor section to s 182 of the *Corporations Act* would be interpreted by reference to a director's fiduciary obligations at general law, and that a conscious breach of those obligations would amount to impropriety; see also *Manildra Laboratories v Campbell* above at [131]; *Landmark Underwriting Agency Pty Ltd v Kilborn* [2006] NSWSC 1108 at [71]; *SBA Music Pty Ltd v Hall (No 3)* [2015] FCA 1079 at [28].

[27] *Chew v The Queen* (1992) 173 CLR 626 at 640; *Kwok v R* (2007) 64 ACSR 307 at [80]; *SBA Music Pty Ltd v Hall (No 3)* above at [31].

conferred on the director or officer, and the test for impropriety is objective.[28] Conduct will be improper if it involves a breach of the standards of conduct that would be expected of a person in the director's position by reasonable persons with knowledge of the duties, powers and authority of the position and the circumstances of the case, including its commercial context.[29]

Recent examples of the application of ss 182 and 183 of the *Corporations Act* in claims for breach of the no conflict and no profit rules include *Colorado Products* above and *Investa Properties Pty Ltd v Nankervis (No 7)* [2015] FCA 1004; (2015) 109 ACSR 465 (involving a claim against a senior employee).

Conflicts of interest in the financial services industry

I turn now to conflicts of interest in the financial services industry, which are addressed both by fiduciary principles and a complex statutory regime. Several forms of duty relating to conflicts of interest exist in this context:

Nature of duty	**Source and application**
Duty to avoid a real and sensible conflict of interest	General law - will often apply to financial advisers as fact-based fiduciaries, unless excluded
Duties to act efficiently, honestly and fairly and to manage conflicts of interests	*Corporations Act* ss 912A(1)(a), 912A(1)(aa) - will apply to Australian financial services licence holders (but not directly to representatives or advice providers)
"Best interests" duties	*Corporations* Act s 961B - will apply to providers of financial advice to retail clients[30]
Duty to prioritise client interests	*Corporations Act* s 961J - will apply to providers of financial advice to retail clients[31]

The result of the general law and regulatory regime is that there can be situations where only a statutory duty applies, for example, where a relationship between an adviser and a client is not fiduciary, or a fiduciary duty is excluded, or the relevant conduct is not within the scope of any fiduciary duty. There can also be cases where both fiduciary and statutory duties apply, for example, where a fiduciary duty is not excluded or not effectively excluded and the relationship is an advisory relationship with a retail client.

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[28] *R v Byrnes* (1995) 183 CLR 501 at 512, 514–515; *SBA Music v Hall* at [32]–[33].
[29] *Doyle v Australian Securities and Investments Commission* (2005) 227 CLR 18 at [35]; *SBA Music Pty Ltd v Hall (No 3)* above at [35].
[30] A similar duty applies to superannuation trustees and directors of corporate trustees under the *Superannuation Industry (Supervision) Act* 1993 (Cth) ss 52(2)(c), 52A(2)(c).
[31] Similar duties apply to superannuation trustees and directors of corporate trustees and to life insurers and their directors under *SIS Act* s 52(2)(d), s 52A(2)(d) and *Life Insurance Act* 1995 (Cth) ss 32(1)(b), 48(2)(b).

Fiduciary duties of financial intermediaries

Some participants in the financial services industry, particularly trustees, owe fiduciary duties because they fall within recognised traditional fiduciary categories. Other participants in the financial services industry who are not status-based fiduciaries, such as financial advisers, may owe a fiduciary duty on the facts of the particular relationship. Several cases have recognised the possibility that the relationship between financial advisor and client may give rise to fiduciary duties.[32]

Several cases deal with allegations of breach of fiduciary duty against financial intermediaries. The decision in *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35; 62 ACSR 427 ("*ASIC v Citigroup*"*)* involved an allegation that an investment bank (Citigroup) had breached a fiduciary duty to a takeover bidder (Toll) by allowing its proprietary trading desk to continue trading in shares in the target (Patrick) after it was mandated as adviser to Toll in the Patrick takeover. Jacobson J (at [282]–[286]) noted (at [325]–[330]) that pre-contractual dealings between Citigroup and Toll contained the indicia of a fiduciary relationship of adviser and client, including that Citigroup was providing advice as to the wisdom and merits of the transaction; was using its financial acumen, judgment and expertise to further Toll's interests, had a close working relationship with Toll, and had emphasised its abilities and its commitment to the transaction in its pitch to be retained by Toll; and the size of its fees. However, ASIC's claim for breach of fiduciary duty failed because a mandate letter between Citigroup and Toll had successfully excluded the fiduciary duty.[33]

In *Wingecarribee Shire Council v Lehman Bros Australia Ltd (in liq)* [2012] FCA 1028, a group of municipal councils brought representative proceedings against the defendant (formerly known as Grange Securities Limited ("Grange")) in respect of the sale of synthetic collateralised debt obligations ("SCDOs"). The councils claimed, among other things, that Grange acted in breach of fiduciary duty owed to the councils as their investment adviser or portfolio manager. Rares J observed (at [732]) that a fiduciary "such as a financial adviser" will be subject to the no conflict and no profit rule. His Honour did not specifically distinguish between the fiduciary duty applicable in a traditional fiduciary relationship, such as agency, and the ad hoc fiduciary duty which may arise in non-traditional arrangements, typically involving an undertaking to act in

[32] *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390; [1991] FCA 375; *Aequitas Ltd v Sparad No 100 Pty Ltd (formerly Australian European Finance Corp Ltd)* (2001) 19 ACLC 1006; [2001] NSWSC 14; *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35; 62 ACSR 427 at [282]–[286], [325]–[330]; *Wingecarribee Shire Council v Lehman Bros Australia Ltd (in liq)* (2012) 301 ALR 1; [2012] FCA 1028 at [732]; *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, on appeal in *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445; [2014] FCAFC 65. For a sample of the academic literature, see JE Fisch & HA Sale, "The securities analyst as agent: Rethinking the regulation of analysts" (2003) 88 *Iowa L Rev* 1035; A Tuch, "Investment Banks as Fiduciaries: Implications for Conflicts of Interest" (2005) 29 *Melb U L Rev* 478; A Tuch, "Obligations of financial advisors in change-of-control transactions: Fiduciary and other questions" (2006) 24 *C&SLJ* 488; JE Fisch "Fiduciary duties and the analyst scandals" (2007) 58 *Ala L Rev* 1083*;* V Battaglia, "Dealing with Conflicts: The equitable and statutory obligations of financial services licensees" (2008) 26 *C&SLJ* 483; K Lindgren, "Fiduciary duty and the Ripoll Report" (2010) 28 *C&SLJ* 435; P Hanrahan "The relationship between equitable and statutory 'best interests' obligations in financial services law" (2013) 7 *J Eq* 46; M Scott Donald "Regulating for fiduciary qualities of conduct" (2013) 7 *J Eq* 142; P Latimer "Protecting the best interests of the client" (2014) 29 *AJCL* 8; S Degeling and J Hudson, "Fiduciary obligations, financial advisers and FOFA" (2014) 32 *C&SLJ* 527.

[33] The result is vigorously criticised in PD Finn, "Fiduciary Reflections" (2014) 88 *ALJ* 127 and, in response, equally vigorously defended in A Eastwood & L Hastings "A response to Professor Finn's 'Fiduciary Reflections'" (2014) 98 *ALJ* 314.

the interests of the other party.[34] His Honour held that Grange had breached the no conflict rule by reason of a conflict between its duty to give sound financial advice to, or make investment decisions on behalf of, the councils and an undisclosed interest in earning large fees or profits in sales of SCDOs.

In *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, Jagot J dealt with claims and cross claims arising from the sale of complex structured financial products titled “Constant Proportion Debt Obligations” (“CPDOs”). The defendants were Local Government Financial Services Pty Ltd (“LGFS”), an Australian financial services licensee that had acquired the CPDOs and onsold them to local councils; ABN Amro, an investment bank that had designed and distributed the products; and Standard & Poor’s (“S&P”), a credit rating agency that had been retained by ABN Amro to rate the products. The products were rated “AAA" by S&P and marketed with S&P's consent on that basis. The councils again brought, among other things, claims for breach of fiduciary duty against LGFS. Jagot J held that a fiduciary relationship existed and that LGFS had breached the prohibition on conflict of interest by reason of the undisclosed commercial pressures upon it to distribute the products in order restore the success of its business. That finding should arguably be treated as confined to an interest in the sale of the products which is out of the ordinary course, here because of the extent of the then pressures on LGFS’s business. The Full Court of the Federal Court (Jacobson, Gilmour and Gordon JJ) largely dismissed an appeal from that decision in *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445; 99 ACSR 336; [2014] FCAFC 65.

A significant limitation of fiduciary duties as a means of regulation of financial services is that they may be excluded by contract, as they were in the *Citigroup* case, although attempts to exclude them will not always succeed, particularly in dealings with retail investors.[35] The statutory duties to which I now refer go some way to addressing that limitation.

Duties to act efficiently, honestly and fairly and to manage conflicts (s 912A(1)(a)-(aa))

Many participants in the financial services industry are required to hold Australian financial services licences and are subject to the conduct of business requirements applicable to such licensees. Section 912A(1)(a) of the *Corporations Act* requires a financial services licensee to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly. This a broad and open standard, which can be breached by a range of improper conduct.[36]

Section 912A(1)(aa) requires a financial services licensee to have in place adequate arrangements for managing conflicts of interest that arise wholly, or partly, in their financial services business.[37] There are significant differences between this duty and

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[34] *Hospital Products Ltd v United States Surgical Corp* above at 96–97; *John Alexander’s Clubs Pty Ltd v White City Tennis Club* above at 34–35 [87].
[35] S Degeling and J Hudson, “Fiduciary obligations, financial advisers and FOFA” (2014) 32 *C&SLJ* 527.
[36] *Story v NCSC* (1988) 13 NSWLR 661; 13 ACLR 225; 6 ACLC 560; *R J Elrington Nominees Pty Ltd v Corporate Affairs Commission (SA)* (1989) 1 ACSR 93; *Saxby Bridge Financial Planning Pty Ltd and ASIC* (2003) 46 ACSR 286; [2003] AATA 480, aff’d (2003) 47 ACSR 649; [2003] FCAFC 244.
[37] For discussion of this requirement, see R Baxt, A Black and P Hanrahan, *Securities and Financial Services Law*, 8th ed, [13.17]–[13.31]; G Pearson, *Financial Services Law and Compliance in Australia*, 2009, [4.3.34], [4.4], [4.4.5]–[4.4.6]; J Moutsopoulos, "Finance Industry has Duty to Manage Conflicts"

the equitable duty, including that that duty contemplates that a conflict will be “manage[d]” rather than necessarily avoided, and that duty cannot be excluded by contract although disclosure (including within the terms of the contract) may be a means of managing a conflict. In *ASIC v Citigroup*, ASIC also alleged that Citigroup did not have in place adequate arrangements for the management of a conflict between its own interests and the interests of Toll in respect of Toll’s takeover offer for Patrick and had contravened its obligation under s 912A(1)(aa) to manage that conflict of interests. Jacobson J held that the concept of ‘managing’ conflicts of interest assumes that potential conflicts will exist which must be managed by adequate arrangements rather than totally eliminated. His Honour held (at [445], [452]) that Citigroup’s arrangements as to information barriers (also known as chinese walls) and for identification and management of conflicts were adequate.

Statutory best interest duty under Future of Financial Advice reforms

Part 7.7A Div 2 of the *Corporations Act*, introduced following the global financial crisis and associated losses suffered by Australian retail investors, requires a provider of financial advice to take reasonable steps to act in the best interests of its retail client and to place the client’s interests ahead of its own when providing advice to that retail client. Section 961B(1) requires a provider of personal advice to a retail client to act in the best interests of the client when giving the advice. Section 961B(2) specifies several steps that an adviser may take in order to satisfy the best interests duty, and s 961B(2)(g) requires that, in order to comply with the best interests duty, an adviser must have:

> “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.”

On its face, and if it stood alone, that section would resemble other statutory provisions that require a person to have regard to the “best interests” of another.[38] However, the operation of s 961B(1) is affected, and to some extent displaced, by s 961B(2) since taking the steps specified in s 961B(2) is treated as compliance with the “best interests” duty specified in s 961B(1). The requirement in s 961B(2)(g) that an adviser take any other step that would reasonably be regarded as in the client's best interests presently preserves a wider scope for s 961B(2), since a step that is not specified in the previous steps set out in the section may nonetheless be reasonably regarded as being in the client's best interests.

Compliance with the statutory “best interests” duty will not, in itself, comply with the general law duty to avoid either an actual conflict of interest or a real and sensible possibility of conflict of interest. The fact that the steps specified in s 961B(2) of the *Corporations Act* were taken does not seem capable of avoiding any breach of the no conflict rule arising from the fact that advice is given in a conflicted setting. However, efforts made by advisers and their representatives to comply with the statutory standards may tend to reduce the risk of breach of the general law fiduciary duties, and

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(2005) *IFLR* 41; P Latimer, "Providing Financial Services 'Efficiently, Honestly and Fairly'" (2006) 24 *C&SLJ* 362; V Battaglia, “Dealing with conflicts: The equitable and statutory obligations of financial services licensees” (2008) 26 *C&SLJ* 483.

[38] For example, s 601FC(1)(c) of the *Corporations Act* requires a responsible entity, in exercising its powers and carrying out its duties, to “act in the best interests of the members and, if there is a conflict between the members’ interests and its own interests, give priority to the members’ interests”.

the risk of regulatory action to the extent that the relevant regulators may give particular attention to the statutory duties.

Duty to prioritise client interests

Other provisions in the *Corporations Act* adopt the concept of "prioritising" client interests, which is an alternative to, and seems to be a less demanding standard than, avoidance of conflicts of interest.

For example, s 961J of the *Corporations Act* requires a person who provides financial advice to a retail client to "give priority" to the interests of the retail client when giving advice where it knows, or reasonably ought to know, there is a conflict between the interests of the client and those of the provider, licensee, authorised representative or their associates. One commentator has pointed out that the language of this section is "open textured"[39], with the advantage that it will be capable of applying in a range of circumstances, and the corresponding disadvantage that there may be uncertainty, or at least room for factual debate, as to whether conduct gave "priority" to a client's interests in any particular case. A duty to give priority to a client's interests appears to assume the coexistence of two interests, that of the client and another interest, and to be satisfied by preferencing the client's interest while still having regard to the other interest.

Conclusion

All of this demonstrates that the question of overlap between general law fiduciary duties and the statutory duties is complex, and the extent to which general law duties may be breached by conduct that would not breach the statutory duties, or vice versa, will not always be easily answered.

[39] M Scott Donald, "Regulating for fiduciary qualities of conduct" (2013) 7 *J Eq* 142 at 147.