Washington University in St. Louis School of Law

Washington University in St. Louis
Washington University Open Scholarship

Scholarship@WashULaw

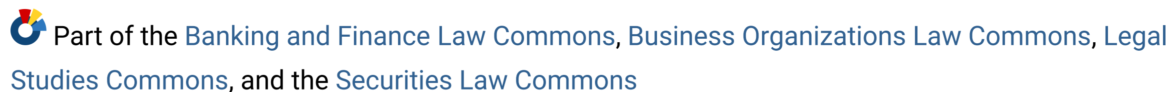
Law School

2006

Obligations of Financial Advisers in Change-of-Control Transactions: Fiduciary and Other Questions

Andrew F. Tuch
Washington University in St. Louis School of Law, andrew.tuch@wustl.edu

Follow this and additional works at: https://openscholarship.wustl.edu/law_scholarship


Part of the Banking and Finance Law Commons, Business Organizations Law Commons, Legal Studies Commons, and the Securities Law Commons

Repository Citation

Tuch, Andrew F., "Obligations of Financial Advisers in Change-of-Control Transactions: Fiduciary and Other Questions" (2006). *Scholarship@WashULaw*. 427.
https://openscholarship.wustl.edu/law_scholarship/427

This Article is brought to you for free and open access by the Law School at Washington University Open Scholarship. It has been accepted for inclusion in Scholarship@WashULaw by an authorized administrator of Washington University Open Scholarship. For more information, please contact digital@wumail.wustl.edu.

Non-commercial viewing, copying, printing and/or distribution or reproduction of this article or any copy or material portion of the article is permitted on condition that any copy or material portion thereof must contain copyright notice referring "Copyright 2006 Lawbook Co t/a Thomson Legal & Regulatory Limited." Any commercial use of the article or any copy or material portion of the article is strictly prohibited. For commercial use, permission can be obtained from Lawbook Co, Thomson Legal & Regulatory Limited,PO Box3502, Rozelle NSW 2039. www.thomson.com.au

Obligations of financial advisers in change-of-control transactions: Fiduciary and other questions

Andrew Tuch*

Recent regulatory action by the Australian Securities and Investments Commission has focussed widespread attention on whether, in Australia, a financial adviser to a party in a change-of-control transaction (such as a takeover) is obliged to avoid being in positions of conflict with the interests of that party. Because financial advisers in these transactions are typically investment banks, the integrated structure of which may make conflicts of interest inevitable, such an obligation is likely to pose difficult challenges for the investment banking industry. The question is complicated by two apparently inconsistent standards being applied: the fiduciary obligation to avoid conflicts and the statutory obligation under the Corporations Act 2001 (Cth) to manage conflicts. This article considers whether a financial adviser is, and should be, obliged to avoid conflicts in this context and, in doing so, attempts to reconcile the apparent inconsistency between these standards.

INTRODUCTION

Investment banks routinely advise clients in change-of-control transactions.[1] In performing this function, an investment bank is considered to act as a financial adviser to its client and its services are commonly referred to as financial (or corporate) advisory services.[2] Its clients are companies, other institutions or governments. The provision of financial advisory services, a core investment banking function, is a lucrative source of fees and is costly to clients. It provides a basis on which investment banks are compared and compete.[3] Moreover, just as the advice of lawyers is a sine qua non of the successful execution of a change-of-control transaction, so too is the financial advice of an investment bank: no party would seriously contemplate such a deal without a financial advisor by its side.

* BCom (Hons), LLB (Hons) (Qld), LLM (Harv); Solicitor of the Supreme Court of New South Wales, Member of the New York Bar, Solicitor of the Supreme Court of England and Wales; Lecturer, Faculty of Law, The University of Sydney. My thanks to Professor Len Sealy, Dr Michael Tuch, Professor Peter Watts and Mila Cerecina for providing comments or valuable insights on earlier drafts. I also thank a number of investment bankers, including Peter Hunt and Jeremy Mead, for help in describing practices in the investment banking industry. Any errors are my own.

[1] The term "change-of-control transaction" is used compendiously to cover many corporate transactions, including takeovers, schemes of arrangement, divestitures, spin-offs, privatisations and leveraged buyouts. For a broad description of some of these activities, see Greenhill & Co Inc, Form S-1 Registration Statement filed with the Securities and Exchange Commission on 11 March 2004, pp 44- 45; The Goldman Sachs Group Inc, Form 10-K (Annual Report) for the fiscal year ended 25 November 2005, filed with the United States Securities and Exchange Commission (hereinafter referred to as the "Securities and Exchange Commission") p 5; Merrill Lynch & Co Inc, Form 10-K (Annual Report) for the fiscal year ended 30 December 2005, filed with the Securities and Exchange Commission, pp 22, 31-32; Morgan Stanley, Form 10-K (Annual Report) for the fiscal year ended 30 November, 2005, filed with the Securities and Exchange Commission, pp 3, 4.

[2] The expression "corporate advisory services" appears to be commonly used in Australia, although the expression "financial advisory services" is more widely used internationally: see, eg Geisst C, *Investment Banking in the Financial System* (Prentice Hall, 1995) p 191; The Goldman Sachs Group Inc, Form 10-K (Annual Report), n 1; Morgan Stanley, Form 10-K (Annual Report), n 1, p 3; *Higgins v New York Stock Exch Inc* 10 Misc 3d 257 (2005); *Walton v Morgan Stanley & Co* 623 F 2d 796 (2d Cir 1980); cf Hayes S and Hubbard P, *Investment Banking: A Tale of Three Cities* (Harvard Business School Press, 1990) p 129.

[3] See, eg Jury A, "Frontrunner in Bid-dollar Stakes", *The Australian Financial Review* (28 September 2006) p 64; Platt G, "Best Investment Banks", *Global Finance* (1 June 2006); "Merger Monday: A Windfall for Bankers", *Dow Jones Business News* (27 June 2006); Horowitz J, "Moving the Market: Lehman Climbs Advisory Ranks – Investment Bank's Status as an M&A Player Grows Following Latest Deals", *The Wall Street Journal* (9 May 2006).

In recent decades investment banks have grown considerably in size and expanded their global reach.[4] In doing so, they have responded to the internationalisation of capital markets, regulatory changes and client forces. They are typically large public companies whose business is diversified on both product and geographic lines. Referred to as integrated investment banks, financial services conglomerates or global investment banks, they represent concentrations of vast economic power. With this evolution of its organisational form has come an increased risk that an integrated investment bank will face a conflict of interest – being in a position where a conflict or overlap exists between the interests of its client, on the one hand, and either its self-interest or the interests of another client, on the other hand. Against this backdrop the regulation of conflicts of interest assumes great significance and is a sensitive issue for the industry.

Two sources potentially impose conflict-of-interest obligations on investment banks. Fiduciary doctrine may impose an obligation to avoid conflicts, in the absence of informed client consent. In addition, the *Corporations Act 2001* (Cth), as amended to reflect reforms proposed by CLERP 9,[5] requires many investment banks (as financial services licensees) to have in place adequate arrangements to manage conflicts of interest. No specific legislative, regulatory or judicial guidance exists as to whether in one important context – the provision of financial advisory services on change-of-control transactions – investment banks are obliged to avoid conflicts with the interests of their financial advisory clients, in a manner consistent with the fiduciary standard, or are only required to satisfy another, perhaps less onerous, requirement of "conflict management". This article considers whether financial advisers do and should owe fiduciary obligations in this context. It also attempts to reconcile any inconsistency between the fiduciary and statutory obligations by suggesting that where the obligations co-exist, the statutory obligation requires the licensee to avoid conflicts of interest where the fiduciary obligation requires this.

The article will consider the business structure of the integrated investment bank and the potential it creates for conflicts of interest; explain the nature of financial advisory services and the factual relationship that exists between investment banks and the clients to whom these services are provided; consider the fiduciary and statutory obligations of investment banks when faced with conflicts in providing these services; and compare the contours of these obligations, and attempt to reconcile the apparent inconsistency between them.

THE INTEGRATED INVESTMENT BANK: STRUCTURE AND POTENTIAL FOR CONFLICTS

The forebears of investment banks were great banking dynasties, formed around powerful American and European families such as JP Morgan, Lehman, Rothschild and Warburg. In recent decades, investment banks have supplemented their traditional functions of providing financial advisory services and underwriting with myriad other financial products and services. These include securities and derivatives trading on behalf of clients, investment research,[6] financing,[7] asset management, equities and derivatives trading on the firm's own account (also known as proprietary trading) and principal investing (which includes private equity operations).[8] Through separate divisions or business segments (which do not necessarily correspond to separate corporate entities within a corporate group)

[4] For a description of investment banks, see Tuch A, "Investment Banks as Fiduciaries: Implications for Conflicts of Interest" (2005) 29 MULR 478 at 484-486.

[5] In 1997 the Australian federal government initiated the Corporate Law Economic Reform Program (CLERP). The most recent stage of the program, referred to as CLERP 9, was implemented by the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth). This statute introduced reforms to the regulation of financial services providers.

[6] Investment research involves providing fundamental research on companies, industries, economies, currencies, commodities and portfolio and quantitative strategy. See The Goldman Sachs Group, Inc Form 10-K (Annual Report), n 1, p 12.

[7] Financing includes project finance, infrastructure finance, structured finance, syndicated loans, securitisation, corporate lending, leasing and trade finance: International Banks and Securities Association of Australia, *Economic and Social Impacts of Investment Banking in Australia* (2004) p 1.

[8] Private equity operations typically involve a firm using its funds (to which private investors may have contributed), acting alone or as part of a consortium of private equity investors, to acquire publicly traded companies and take them "private", with

 © LAWBOOK CO.

they offer multiple products and services to a substantial number of clients in major financial centres worldwide, acting as either principal or agent.[9] Financial advisory services are a single aspect of these business operations.

The banking label may be a misnomer for these organisations since banking typically involves accepting deposits from and lending money to the retail public. Investment banks traditionally have not performed this function, although today many do provide finance to their corporate clients. In this article, organisations that perform the typical banking function are referred to as commercial banks, although the distinction has become blurred in some cases as commercial banks have begun venturing into traditional investment banking territory.[10]

This description of the business structure of the integrated investment bank is necessarily general, with different firms offering different ranges of services and their units functioning with varying degrees of operational autonomy. At the same time, it is fair to say that the structure of an integrated investment bank provides opportunities – and perhaps also incentives – for it to prefer the interests of one client over those of another or even to prefer self-interest over that of a client. In their regulatory filings, many investment banks acknowledge the increased risk of conflict created by their organisational structure,[11] and it has been said that conflicts of interest are an inevitable consequence of the integrated business model or even inherent in it.[12]

The integrated investment bank is thus fertile ground for potential conflicts of interest. As with law firms, the advisory function of an investment bank may give rise to conflicts when incompatible interests are served. For example, in *Darvall v North Sydney Brick & Tile Co Ltd (No 2)* (1989) 16 NSWLR 260 (discussed in more detail below) an investment bank provided financial advisory services to a company for which a takeover offer had been made and, simultaneously, assisted its managing director to make a competing takeover offer for it without fully disclosing this to the company's other directors.

Unlike law firms whose business is generally restricted to an advisory function, the integrated business structure of an investment bank provides myriad additional ways in which a firm's interests may collide with those of its advisory client. Examples abound. Consider the investment bank in *Walton v Morgan Stanley & Co* 623 F 2d 796 (2d Cir 1980) which, shortly after purchasing shares on its own account in a company for which a takeover offer had been made by a third party, allegedly urged its financial advisory client to make a higher, competing bid for that company.[13] More recently, in *Higgins v New York Stock Exch Inc* 10 Misc 3d 257 (2005), an investment bank, which held a significant shareholding in one company, advised both that company and another company to a merger agreement.[14]

the purpose of reorganising them for a trade sale or sale to the public through an initial public offering. The acquisitions are usually highly leveraged. For examples of the range of products and services provided by integrated investment banks, see The Goldman Sachs Group Inc, Form 10-K (Annual Report), n 1, pp 4-12; Morgan Stanley, Form 10-K (Annual Report), n 1, pp 3-9; initiating process in proceedings in the Federal Court of Australia between Australian Securities and Investments Commission and Citigroup Global Markets Australia Pty Ltd (NSD 651/2006); Tuch, n 4 at 486.

[9] See Geisst, n 2, pp 14, 205; Hayes and Hubbard, n 2, p 2.

[10] Some commercial banks have changed in this way by buying and building investment banking divisions: Augar P, *The Greed Merchants: How the Investment Banks Played the Free Market Game* (Penguin Books, 2005) p 31.

[11] See, eg The Goldman Sachs Group Inc, Form 10-K (Annual Report), n 1, p 23: "As we have expanded the scope of our business and our client base, we increasingly have to address potential conflicts of interest, including those relating to our proprietary activities."

[12] As to conflicts being inevitable or inescapable, see Goode R, *Conflicts of Interest in the Changing Financial World* (Institute of Bankers, 1986) p xv; Law Commission, United Kingdom, *Fiduciary Duties and Regulatory Rules* (1992) Consultation Essay No 124 at [1.1], [2.2] and [3.1] (hereafter *Fiduciary Duties Consultation Paper*); DeMott DA, *Fiduciary Obligation, Agency and Partnership: Duties in Ongoing Business Relationships* (West Publishing Company, 1991) p 671. As to conflicts being inherent, see, eg Maiden M, "When Bankers Collide", *The Age* (3 June 2006).

[13] The case report suggests that the investment bank purchased the shares as principal, on its own account. Although the firm's "arbitrate department" purchased the shares, the transaction appears to be proprietary trading by the firm.

[14] Aggrieved shareholders of one of the companies alleged that directors breached their duties to the company by approving the retention of the investment bank to provide financial advisory services. The shareholders alleged that "the directors were aware

Similarly, in the recent attempted takeover of the London Stock Exchange – the company that operates the eponymous stock exchange – an investment bank advised on two ill-fated bids, made successively, by Deutsche Boerse AG and Macquarie Bank Ltd.[15] It was subsequently reported that the investment bank itself held a substantial shareholding in the LSE and thus stood to gain further from the takeover interest in the company.[16] A rival investment bank then represented Nasdaq Stock Market Inc on its proposed bid for the LSE, even though the bank's United Kingdom brokerage operations included the LSE as a major client. This investment bank subsequently withdrew from representing Nasdaq because of the apparent conflict.[17]

As these examples demonstrate, the range of services offered by integrated investment banks, their broad client base and the different capacities in which they act, create a significant risk that they may be in a position where a conflict exists between or among its clients' interests or between its own interests and those of a client. Many such conflicts will remain outside the public domain.[18]

This contemporary description of the investment banking industry as one in which conflicts are ubiquitous sits uneasily with the core investment banking function of being financial adviser to corporate management. It is this function, this article later asserts, that provides a basis for the imposition of the fiduciary obligation to avoid conflicts.

FINANCIAL ADVISORY SERVICES: THE ADVISER-CLIENT RELATIONSHIP

The parties involved in a change-of-control transaction will invariably call upon an investment bank or, increasingly in Australia, at least two investment banks to provide financial advisory services. The investment bank will be part of a team or "working group" of advisers, which will typically include lawyers, accountants and public relations experts. The description in this part of the article of the nature of financial advisory services and the financial adviser-client relationship, which is necessarily in broad terms, reflects current practices of major investment banks in Australia.[19]

An investment bank may be engaged as financial advisor in various ways. At the time a transaction arises or is proposed, a bank may be engaged to advise on that transaction or a number of related transactions. Alternatively, it may be engaged under a general mandate to advise a company in the event that a particular transaction arises in future. A company whose management considers it to be a takeover target, for example, will often engage an investment bank on this basis as part of its defence strategy. Such an arrangement may be in place for months or even years before the contemplated transaction occurs.

Variations exist in market practices on the timing of engagement letters. Where an investment bank is engaged at the time a transaction arises or is proposed, it may begin advising on an informal basis. It may be several days or weeks later that the relationship is formalised by an engagement letter being executed. This delay may be because the investment bank is waiting for their client to become "comfortable" with the relationship before documenting it in this way. In other instances, however, the adviser and its client will execute the contract at the outset of the relationship.

---

that [the investment bank] was simultaneously providing services to [the other company] from the engagement letter, and further due diligence would have revealed the extent of [the investment bank's] stock holdings in [that company]": *Higgins v New York Stock Exch Inc* 10 Misc 3d 257 (2005) at 285.

[15] "Goldman, Adviser on Losing LSE Bids, May Gain From Nasdaq Offer", *Bloomberg.com* (16 March 2006).

[16] See "Goldman, Adviser on Losing LSE Bids, May Gain From Nasdaq Offer", *Bloomberg.com*, n 15. It was suggested that the increase in value of LSE shares may not in fact represent profit for Goldman Sachs since, of the shares owned by it, some or all may have been held as a hedge against derivatives sold to clients.

[17] Anderson J, "A Cold Shoulder in London Makes the Juices Run for Deal Financiers in New York", *New York Times* (14 March 2006).

[18] *The Economist* recently observed as follows: "At the same time as [an investment bank] represents a firm, it could be shopping it for sale, attempting to buy it itself, or competing for an acquisition on behalf of another client. Occasionally – but only occasionally – these roles become so apparent that the conflict becomes public": "Behind the brass plate", *The Economist* (29 April 2006) p 70.

[19] This part of the article has benefited significantly from a number of recent interviews conducted by the author with investment bankers with substantial experience in advising on change-of-control transactions.

The form of the engagement letter will also vary from deal to deal. Typically, it will be based on the investment bank's standard form of agreement and will describe in broad detail the nature and scope of the services to be performed, provide for indemnities in favour of the bank and specify the bank's fee structure. While the fee structure will vary from deal to deal, an investment bank will be inflexible in negotiating any changes to its model indemnities.

Such is the importance of corporate relationships to an investment bank that it will rarely quarrel with its client over the negotiation or subsequent interpretation of an engagement letter. In some cases, such as where either party subsequently considers the fee structure to be unreasonable, the terms will be renegotiated. Typically, the dealings will at all times be amicable. It is rare for an investment bank to sue its client to recover its fees, there appearing to be only a single instance in either Australia or England of such a dispute.[20]

Each party to a change-of-control transaction will be separately advised, with the prevailing notion of a transaction – between the various advised parties – being one of partisanship, much as in the adversarial litigation context.[21] This can be attributed to the high media profile that a transaction attracts, being in part due to speculation prior to the public announcement and to a recognition that amicable commercial dealings can quickly deteriorate. As a consequence, it has become almost an article of faith that each client or "side" will have its "own" advisers, each of which will be advising in the interests of the client, rather than acting for itself.[22]

During the course of the transaction, the relationship between an investment bank and its client involves close and frequent contact. Advice, ideas, information and documents will be candidly exchanged. While the investment bank's role may encompass providing some tangible, identifiable work product – such as materials for board consideration, letters of advice or valuation analyses – in the usual course, much of its advice will be undocumented. Almost all of it will remain confidential. The investment bank will have access to non-public information about its client, including highly sensitive material revealing the client's competitive vulnerabilities. In fact, corporate information will be made available to the investment bank almost without restriction, this being considered necessary for it to perform its advisory role. Rarely will the investment bank be required to enter into a confidentiality agreement inrespect of this information.

The role of the financial adviser will involve performing all or many of the following activities: advising as to the merits and wisdom of entering into the proposed transaction, including identifying the associated risks; providing valuation analyses for the proposed transaction; evaluating and recommending financial and strategic alternatives; advising on the timing and structure of the transaction, the amount and form of consideration, and the effect of the transaction on the client's share price and business operations; analysing and advising on potential financing for the transaction, including advising on complex instruments such as interest rate and currency hedging derivatives; assisting in implementing the transaction and preparing an offering document or other materials, as required; briefing financial media in order to influence, or at least inform, their reporting of the transaction; and assisting in negotiating and consummating the proposed transaction.[23] The financial

[20] See *Salomon Smith Barney Australia Corporate Finance Pty Ltd v Allgas Energy Ltd* [2001] QSC 072.

[21] For a discussion of the prevailing notion of partisanship in the adversarial legal system, see Dal Pont GE, *Lawyers' Professional Responsibility in Australia and New Zealand* (LBC Information Services, 2001) p 73.

[22] As to the delicate ethical issues that can arise where investment banks or law firms represent both sides on a transaction (a practice referred to as "dual representation"), see Alberts BS and Thompson S, "Ethics Issues Faced by Lawyers and Investment Bankers in Mergers and Acquisitions: A Problem Approach and Report of Panel Discussion" (2000) 54 U Miami L Rev 697 at 704-705, 731-732. Where dual representation has occurred (see, eg Holson LM, "It Takes 2 to Merge but One Firm to Give Advice", *New York Times* (13 June 1998), the adviser appears to have obtained the informed consent of both clients.

[23] See various Securities and Exchange Commission reports, n 1 and n 2; Skully MT, *Merchant Banking in Australia* (Oxford University Press, 1986) pp 150-151; and Breen Haire M, "The Fiduciary Responsibilities of Investment Bankers in Change-of-Control Transactions: In Re Daisy Systems Corp" (1999) 74 *NYU Law Review* 277 at 287-288. This list has also been informed by recent interviews with investment bankers.

adviser's role thus constitutes much more than "number crunching"; it involves using financial acumen, exercising judgment and applying expertise acquired by training and experience to further the interests of a client.

The financial adviser's role involves more than behind-the-scenes advice. In many transactions, the financial advisers of the parties involved will meet together – in the absence of their clients and legal advisers – for an "informal dialogue" to gauge terms on which the clients may be willing to transact. They will act with the full knowledge of and on instructions provided by their clients, to whom they will subsequently report in full. These discussions can be particularly useful where the parties have publicly adopted an adversarial stance.

A party's working group, particularly its financial and legal advisers, will work closely together during a transaction and will be involved in almost every facet of the matter. At critical stages the client and its financial and legal advisers will often occupy a single physical working space. The roles of these advisers will often become inseparable in the sense that a client's decision regarding its next step will require the expertise of both and the advice of each often depends on that of the other, resulting in an integration of their roles. Accordingly, information will be disclosed to advisers as a group almost without distinction, and the client's decisions will be formed with input from its financial and legal advisers.

While an "integrated team approach" is adopted for the transaction, the investment bank invariably leads the team. It will arrange the meetings, set the timetable for decisions and provide the strategic or tactical advice that will often be of overriding importance in determining the client's conduct. Its remuneration will reflect this role and will far exceed that of the other advisers (including the lawyers). It will also be associated publicly with its client's position: the financial press will typically identify each party with its financial adviser, but rarely mention the other advisers. To adopt industry parlance, it is the investment bank that "runs the deal".

One distinctive feature of Australian practice is that investment banks very rarely engage their own legal advisers for the transaction. In contrast, for transactions in Europe and the United States, particularly those with cross-border elements, an investment bank will almost invariably engage its own legal advisers who will be closely involved in the transaction. Accordingly, each party will have a number of law firms associated with its team, these firms having been engaged by the principal or its financial advisers. Investment banks are considered to do this to ensure that their favoured counsel monitor the deal and can have some level of influence on its progress and also perhaps because of the greater regulatory complexity associated with these transactions.

The fee structure of an investment bank generally entails its fee being calculated as a percentage of the value of the transaction. This reflects the prevailing notion that financial advice of investment banks can, and often does, influence the "pricing" of transactions. As an example, a particularly robust defence of a company that is the target of a proposed takeover can substantially increase its "exit price" – the price for which it is ultimately sold. Based on this method of remuneration, it is not uncommon for an investment bank to earn tens of millions of dollars in fees for advising on a single transaction.[24] In some cases, such as where the engagement letter is executed in advance of a transaction as part of a company's defence strategy, the agreement will provide that the investment bank be paid a "success fee" to be negotiated in good faith between the parties at the conclusion of the transaction. When an engagement is terminated, however, whether due to the cancellation of a transaction for market reasons or otherwise, a firm may earn small or no fees and may be unable to recoup the costs it has incurred.[25]

[24] "Telstra: Canberra's Last Hurrah", *The Australian Financial Review* (Sydney, 24-28 March 2005) p 80. A number of examples are provided, including the transaction involving the Australian companies Woolworths Ltd and Australian Leisure and Hospitality Group (ALH) in 2004 for which ALH's adviser reportedly earned $40 million in financial advisory fees.

[25] Greenhill & Co Inc, Form S-1 Registration Statement, n 1, p 8.

Financial advisory services are highly lucrative[26] and are a visible and high-status aspect of the operations of integrated investment banks.[27] These operations are seen as underscoring a firm's ability to advise top corporate management and as a measure of a firm's connections and influence, which are important to the industry as a whole.[28] They are, however, but one function of an integrated investment bank, with the consequence that the firm, even though operating through separate divisions, may be in a position of conflict with the interests of its financial advisory client. The obligations of a firm in responding to conflicts under general law and under statute are considered below.[29]

THE PROVISION OF FINANCIAL ADVISORY SERVICES: THE FIDUCIARY QUESTION

Theoretical orientation

Although contention exists,[30] twin judicial approaches can be discerned for determining the incidence of fiduciary obligations in non-conventional relationships[31] – such as between an investment bank and its financial advisory client. The first involves investigating a factual relationship for particular features or indicia that courts have endorsed for identifying fiduciary character. These include the existence of an undertaking by a person (the fiduciary) to act in the interests of another person (the principal);[32] a relationship of trust and confidence;[33] vulnerability to another's power or vulnerability necessitating reliance;[34] power by a person (the fiduciary) to affect the interests of the other person in a real or practical sense;[35] and a reasonable expectation that a person (the fiduciary) will act in the interests of another in and for the purposes of a relationship.[36]

[26] Geisst, n 2, p 10; Hayes and Hubbard, n 2, p 133.

[27] Geisst n 2, p 200.

[28] Geisst n 2, p 200.

[29] The discussion of fiduciary obligations in the next section is based on and further develops material in Tuch, n 4.

[30] As to the "notoriously intractable" nature of identifying fiduciary relationships, see, eg Weinrib EJ, "The Fiduciary Obligation" (1975) 25 U of T LJ 1 at 5.

[31] Non-conventional relationships are those not accepted or established as fiduciary in character.

[32] *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 96-97; *Bristol and West Building Society v Mothew* [1998] Ch 1 at 16-19; [1996] 4 All ER 698.

[33] *Bristol and West Building Society v Mothew* [1998] Ch 1 at 16-19; [1996] 4 All ER 698; *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 69, citing *Tate v Williamson* (1866) LR 2 Ch App 55 at 61; *Coleman v Myers* [1977] 2 NZLR 225 at 325. See also Millett, Sir P, "Equity's Place in the Law of Commerce" (1998) 114 LQR 214 at 219, stating that the relationship of trust and confidence "arises whenever one party undertakes to act in the interests of another or where he places himself in a position where he is obliged to act in the interests of another".

[34] *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 142; *Mabo v Queensland (No 2)* (1992) 175 CLR 1 at 200-201; *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504 at 521; 133 ALR 1. Millett, *Equity's Place in the Law of Commerce*, n 33, p 219. The author describes this as a fiduciary relationship "of influence", the defining characteristic of which is vulnerability.

[35] *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 96-97. Justice Mason here appears to have cited all three features as common to fiduciary relationships: "The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interest of another person in the exercise of a power or discretion which will affect the interests of that other person in the legal or practical sense. 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."

[36] *Hughes Aircraft Systems International v AirServices Australia (No 3)* (1997) 76 FCR 151 at 237; 146 ALR 1; *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504 at 521; 133 ALR 1; *Glandon Pty Ltd v Strata Consolidated Pty Ltd* (1993) 11 ACSR 543; *Doolan v Dare* [2004] FCA 682; Finn PD, *The Fiduciary Principle* in Youdan T (ed), *Equity, Fiduciaries and Trusts* (Carswell, 1989) p 46; cf Mason A, "The Place of Equity and Equitable Doctrines in the Contemporary Common Law World: An Australian Perspective" in *Equity, Fiduciaries and Trusts* (Waters DWM (ed), 1993, Carswell) at 11. For other characteristics, see also *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 at 220 and Glover J, *Equity, Restitution and Fraud* (LexisNexis Butterworths, 2004) Ch 2.

The final criterion, which was propounded by Professor (now Justice) Finn, has also been regarded as a unifying theory of fiduciary principle that explains its pervasive reach.[37] It is accorded particular emphasis in this article because it carries doctrinal legitimacy (having received some measure of judicial acceptance[38]) and assists in the practical application of basic doctrine to varying relationships and facts when taken together with other fiduciary identifying features.[39] It also provides a normative basis for assessing whether the extension of fiduciary principles to the relationship in question is justified. According to the reasonable expectations criterion, a fiduciary relationship arises where, within the scope of the relationship in question or in respect of a particular matter, a person can be reasonably expected to act in the interests of another in and for the purposes of the relationship.[40] What must be shown "is that the actual circumstances of a relationship are such that one party is entitled to expect that the other will act in his interests".[41]

The second approach is to apply analogical reasoning to a core of relevant cases and established fiduciary relationships to consider the fiduciary character of the relationship in question.[42] Since the making of analogies requires courts to have regard to similarities in terms of the features identifying fiduciary character, this approach is clearly related to the first.

Before proceeding, two limitations of the "reasonable expectations" criterion deserve attention. One weakness, as Professor DeMott has observed, is that no reasonable expectation of loyalty may be formed even in circumstances where the principal would be entitled to expect loyalty.[43] This is because the criterion implicates the "probabilistic projections" of the principal as to whether the alleged fiduciary will in fact act loyally, with the result that no reasonable expectation will arise where the principal has "some basis to doubt whether [an alleged fiduciary] will fulfill that expectation".[44] For example, the expectation may not arise by reason only of a history of disloyal conduct by an alleged fiduciary in circumstances where the principal would be entitled to expect loyalty. The criterion of a "justifiable expectation" of loyalty, propounded by Professor DeMott, overcomes this deficiency.[45] For the purposes of this article, however, which involve attributing fiduciary character to a category of relationship, rather than to a particular relationship between individual parties, it is submitted that no significant difference exists between the two criteria in their application.

The other weakness is that, alone, the reasonable expectations criterion fails to adequately explain the *form* of fiduciary obligations, which is proscriptive in nature – prohibiting conduct without

---

[37] See Shepherd JC, *The Law of Fiduciaries* (Carswell, 1981) pp 51-91, Flannigan R, "The Boundaries of Fiduciary Accountability" (2004) 83 *Canadian Bar Rev* 35 at 54-61 and Conaglen M, "The Nature and Function of Fiduciary Loyalty" (2005) 121 LQR 452 at 455, fn 17.

[38] *Hughes Aircraft Systems International v AirServices Australia* (No 3) (1997) 76 FCR 151 at 237; 146 ALR 1; *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504 at 521; 133 ALR 1; *Glandon Pty Ltd v Strata Consolidated Pty Ltd* (1993) 11 ACSR 543 at 556-557, *Doolan v Dare* [2004] FCA 682. Significantly, Justice Finn also appears to have endorsed the approach of applying the "reasonable expectations" criterion with other criteria (see *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504 at 521; 133 ALR 1) and his scholarship influenced the development of Anglo-Australian fiduciary doctrine generally: see, eg *Bristol and West Building Society v Mothew* [1998] Ch 1 at 18; *Sinclair Investment Holdings SA v Versailles Trade Finance Limited* [2005] EWCA Civ 722 at [9]; *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 at 215, 219; *Breen v Williams* (1996) 186 CLR 71 at 92 fn 69, 93 fn 73, 95 fn 83, 113 fn 161, 126 fn 198.

[39] See *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 at 219.

[40] *Hughes Aircraft Systems International v AirServices Australia* (No 3) (1997) 76 FCR 151 at 237; 146 ALR 1; *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504 at 521; 133 ALR 1; Finn, "The Fiduciary Principle", n 36, p 46.

[41] Finn, "The Fiduciary Principle", n 36, p 46.

[42] See *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 96; Glover, n 36, at [2.8]-[2.10]; and DeMott, n 12, pp 2-3.

[43] DeMott DA, "Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences" (2006) 48 *Ariz L Rev* (forthcoming).

[44] DeMott, n 43.

[45] According to Professor DeMott, the "defining or determining criterion should be whether the plaintiff (or claimed beneficiary of a fiduciary duty) can demonstrate a justifiable expectation of loyal conduct on the part of an actor and whether the actor's conduct contravened that expectation." DeMott, n 43.

informed consent, rather than compelling it.[46] According to Richard Nolan, additional explanatory power is furnished by a consideration of the practicability ex ante of stipulating (or having the law imply) specific constraints on a person's conduct – an exercise that will depend on the nature of the task in question and its amenability to assessment.[47] For example, the managerial role of the company director may be performed in "many different, unobjectionable ways" and "it is exceptionally difficult to stipulate [ex ante] specifically for the conduct to be undertaken" by the director, without abolishing managerial freedom.[48] To avoid the chilling effect on entrepreneurial activity that imposing strict duties of care and skill would have and to avoid the uncertainty of application that imposing broad prescriptive duties would involve, Nolan asserts, the law has responded by imposing fiduciary obligations that proscribe conduct that would jeopardizs performance of the task in question.[49] This approach is consistent with Professor Worthington's suggestion that fiduciary obligations should be imposed where parties' interests are not adequately protected by obligations imposed in contract, tort and unjust enrichment.[50] The approach also informs an assessment of whether a reasonable expectation of loyalty exists for purposes of answering the fiduciary question.

Identification of the fiduciary relation: The "analogical core"

Anglo-Australian law has long recognised that fiduciary obligations may arise in the relationship between an adviser and its client or customer.[51] However, according to Professor Finn, courts "have resiled from fettering useful jurisdictions" by formulating exhaustive rules in respect of these relationships.[52] At the same time, more recent cases have endorsed features for identifying fiduciary character in respect of financial or investment advisory relationships and these decisions serve as an "analogical core" for the purposes of considering the fiduciary question in the context under consideration in this article.

Stockbroking firm and client

A stockbroking firm that provides investment advice to its client has been held to owe fiduciary duties to that client. In *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 a prospective investor sought advice from a firm of stockbrokers about share investment opportunities. An employee of the firm advised the investor to deposit his funds with the stockbroking firm until an opportune time arose to buy shares. The investor did so, unaware that the firm was in a precarious financial position. Just months later the firm became insolvent and the investor's funds were lost. He sought compensation from the fidelity fund of the stock exchange, alleging for this purpose that a fiduciary relationship existed between himself and the stockbroking firm.

The High Court declined to award compensation from the fidelity fund for reasons relating to the terms of the statute creating it. In his reasoning, Justice Brennan regarded a primary issue as being whether, in advising the client on the investment of his money, the stockbroking firm was in the

[46] See *Maguire v Makaronis* (1997) 188 CLR 449 and *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 1 at 46-47.

[47] Nolan RC, "The Legal Control of Directors' Conflicts of Interest in the United Kingdom: Non-Executive Directors Following the Higgs Report" (2005) 6 *Theoretical Inquiries in Law* 413 at 422.

[48] Nolan, n 47 at 422-423.

[49] Nolan, n 47 at 423. Although Nolan refers to English law, the response of Australian law – to impose fiduciary obligations that are proscriptive rather than prescriptive – is the same.

[50] Professor Worthington has argued that fiduciary obligations should exist "[w]hen self-denial is *necessary* to achieve the purpose of a relationship" and relevant to this question is whether the "parties' interests are adequately protected by obligations imposed in contract, tort, unjust enrichment and so forth". See Worthington S, "Fiduciaries: When is Self-denial Obligatory?" (1999) 58 *Cambridge LJ* 500 at 506-508.

[51] See *Hadid v Lenfest Communications Inc* [1999] FCA 1798 at [817] ("advisers may, and often do, have fiduciary obligations: the typical case is the solicitor or estate agent (but the principle extends to other advisers …) engaged to advise in relation to transactions concerning, or the management of, particular property") and Sealy LS, "Fiduciary relationships" [1962] *Cambridge LJ* 69 at 69-72.

[52] Finn PD, *Fiduciary Obligations* (Law Book Co, 1977) p 170.

position of a fiduciary.[53] In addressing this issue, he noted that in respect of another function commonly performed by stockbrokers, the buying and selling of shares, a fiduciary relationship had been held to arise between the firm and client.[54] However, the question of the existence of fiduciary duties had to be determined according to the particular function being performed by the broker in the case – providing investment advice. Brennan J stated the law in the following terms:

> Whenever a stockbroker or other person who holds himself out as having expertise in advising on investments is approached for advice on investments and undertakes to give it, in giving that advice the adviser stands in a fiduciary relationship to the person whom he advises.[55]

Since these features were present, the relationship between the stockbroking firm and client was fiduciary in nature. Justice Brennan explained that the stockbroking firm, by failing through its representative to tell its client "fully and truthfully what they knew about their financial position and to warn him … that it was unwise to lend the money", failed to discharge its fiduciary obligations.[56]

Bank and customer

The relationship between a (commercial) bank as lender and its customer as borrower is not an accepted category of fiduciary relationship. However it may be fiduciary in character where some "special feature" exists – in association with the lending of funds – such as the giving of advice.[57] In considering this question, courts have adopted a similar analysis to that adopted in *Daly v Sydney Stock Exchange*. In *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390 the Full Federal Court considered the fiduciary character of the relationship between a commercial bank and two of its customers. It found that the bank owed fiduciary obligations to the customers whom it had advised about a proposed investment in a hotel business. The customers had limited business experience and had been accustomed, over a period of many years, to seeking the bank manager's advice about financial matters.

The bank advised the customers that the proposed investment was a good one and was preferable to a number of other investments which they were considering. The investment proved to be a poor one and the customers sought relief from the bank on grounds which included that it had breached fiduciary obligations owed to them. Relying on *Daly*, the court found that the fiduciary relationship existed because of the expectation that the bank had created in the customers. It explained that:

> A bank may be expected to act in its own interests in ensuring the security of its position as lender to its customer but it may have created in the customer the expectation that nevertheless it will advise in the customer's interests as to the wisdom of a proposed investment. This may be the case where the customer may fairly take it that to a significant extent his interest is consistent with that of the bank in financing the customer for a prudent business venture. In such a way the bank may become a fiduciary and occupy the position of what Brennan J [in *Daly*] has called "an investment adviser".[58]

The bank's self interest in the transaction (the provision of finance) did not prevent fiduciary obligations from arising. The court explained that a relationship may be fiduciary even where the adviser has a manifest personal interest in the transaction, provided that the customer "may fairly take it that to a significant extent his interest is consistent with that of the [adviser]".[59] A complete alignment of interests between the adviser and customer is not required, as was the situation in this

---

[53] *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 at 384.

[54] *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 at 384.

[55] *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 at 385.

[56] *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 at 385-386.

[57] *Golby v Commonwealth Bank of Australia* (1996) 72 FCR 134 at 136. See also PD Finn "Conflicts of Interest and Professionals" in *Professional Responsibility* (Papers presented at University of Auckland, 28-29 May, 1987) p 14.

[58] *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390 at 391 (Davies, Sheppard and Gummow JJ) (citations omitted).

[59] *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390 at 391.

 © LAWBOOK CO.

case. It was also significant to the court that the parties could not be properly described as acting in a commercial transaction at arm's length and each with the assistance of fully independent professional advice.[60]

As for the content of the fiduciary obligation, the court explained that "[n]ot only must the fiduciary avoid, without informed consent, placing himself in a position of conflict between duty and personal interest, but he must eschew conflicting engagements."[61] Since the vendor was also a customer of the bank and the bank had failed to obtain the customers' fully informed consent to this arrangement, the bank breached its fiduciary obligation by not avoiding the position of conflict.[62]

Although citing *Daly* as authority, the Federal Court did not refer to the features of holding out and undertaking that the High Court expressly referred to as giving rise to the fiduciary relationship.[63] Furthermore, the "expectation" criterion referred to by the Federal Court has no apparent basis in *Daly*. It would appear, instead, to be a reference to Professor Finn's "reasonable expectations" criterion.

Commonwealth Bank of Australia v Smith may be contrasted with two subsequent decisions. The first is *Grubic v Commonwealth Bank of Australia* [1993] Aust Contract Rep ¶90-033, in which the failure of a bank to provide financial advice to its customer was decisive in the court finding that no fiduciary relationship existed between them. The customer had entered into a financial arrangement with a company, which involved the company borrowing funds from the bank and the customer and his wife giving a personal guarantee for repayment of the loan. The company defaulted and the bank sought to enforce the guarantee.

In considering the customer's argument that the bank had undertaken to act as his financial adviser and had thereby become a fiduciary, the Full Court of the Supreme Court of South Australia observed on the basis of *Smith* that, although not an accepted fiduciary category, the relationship between a bank and customer may be fiduciary where the bank "has given financial advice or has acted in a way that creates in the customer the expectation that it will provide financial advice as to the wisdom of a proposed investment".[64] The court found, however, that the bank had provided the customer with no financial advice and had "very carefully chosen not to allow itself to be in a position of giving advice" to the customer.[65] The commercial sophistication of the client (being "an experienced and very successful businessman")[66] was a factor, along with others, supporting this finding. In any case, the court asserted, "[t]here was no relevant respect in which [the customer] needed or sought financial advice" from the bank.[67] Accordingly, no fiduciary relationship arose.

A second basis for its decision was the court's finding that the bank "always dealt at arm's length with [the customer]".[68] This was relevant as:

> the fact that the arrangement between the parties was of a purely commercial kind and that they had dealt at arm's length and on an equal footing has consistently been regarded as important, if not decisive, in indicating that no fiduciary duty arose.[69]

The second contrasting decision is *Finding v Commonwealth Bank of Australia* [2001] 1 Qd R 168, a case also involving a bank allegedly providing both advice and finance to a longstanding

---

[60] *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390 at 391.

[61] *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390 at 392.

[62] *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390 at 392.

[63] *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 at 385.

[64] *Grubic v Commonwealth Bank of Australia* [1993] Aust Contract Rep ¶90-033 at 89, 726.

[65] *Grubic v Commonwealth Bank of Australia* [1993] Aust Contract Rep ¶90-033 at 89, 727.

[66] *Grubic v Commonwealth Bank of Australia* [1993] Aust Contract Rep ¶90-033 at 89, 727.

[67] *Grubic v Commonwealth Bank of Australia* [1993] Aust Contract Rep ¶90-033 at 89, 727.

[68] *Grubic v Commonwealth Bank of Australia* [1993] Aust Contract Rep ¶90-033 at 89, 727.

[69] *Grubic v Commonwealth Bank of Australia* [1993] Aust Contract Rep ¶90-033 at 89, 727 (citing as authority *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 70 and 119).

customer. This was for the purchase of a hotel business that the bank was selling as a mortgagee exercising power of sale. The bank failed to disclose the poor state of the business and that it had been valued at substantially less than the contract price. However, the Queensland Court of Appeal held that no fiduciary relationship existed between the bank and its customer. Unlike in *Smith*, the bank had not assumed the role of financial adviser and the customer had not placed faith in the bank as adviser: he had decided to buy the business before approaching the bank. Neither the longstanding relationship between the parties, nor the dual roles the bank performed (as vendor and financier) furnished a sufficient basis on which to found a fiduciary relationship.[70]

Corporate adviser and client

Fiduciary relations may arise where a company describing itself as a "corporate adviser" or "merchant bank" provides investment advice to its client. In *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd)* (2001) 19 ACLC 1006 joint venturers, acting through an agent, undertook to provide "corporate and financial advice" to their client, Aequitas, a company that proposed to raise capital from outside investors. Services that were contracted for included advice relating to the structure of the client, the raising of equity finance (including by private placement to selected investors or by pubic securities offering) and investments to be made, such as the purchase of shares in another company or of other assets.[71]

Justice Austin asserted that the "fiduciary relationship between financial adviser and client arises because the financial adviser, having held itself out as an adviser on matters of investment, undertakes a particular financial advisory role for the client" (citing *Daly* as authority).[72] The advice provided on the transaction in question was "'financial advice' of the kind that Brennan J had in mind [and] extended to corporate advice as well".[73] Although not explaining the difference between "financial advice" and "corporate advice", it is evident from the judgment that, together, they encompass those activities that were contracted for by the parties. In any case, the difference does not matter for purposes of the existence of a fiduciary relationship because:

> there can be no material difference … between an arrangement for the provision of financial advice and an arrangement for the provision of corporate advice, since in both cases the adviser undertakes to act in the interests of the client and not solely in the adviser's own interests, and the client is in a position of vulnerability.[74]

It is evident from his reasons that Austin J equated "financial advice" with "investment advice", which was the expression in fact used by Brennan J in *Daly*.[75]

Justice Austin concluded as follows:

> Having held the joint venture out as having expertise in corporate advising, and having undertaken through their agent … to provide corporate advice to Aequitas, the joint venturers stood in a fiduciary relationship to Aequitas.[76]

The joint venturers

> were obliged as fiduciaries to avoid placing themselves in a position in which their duty to provide corporate advice to Aequitas conflicted, or there was a real sensible possibility that it may conflict, with their personal interest, in the absence of full disclosure to and consent by Aequitas.[77]

[70] *Finding v Commonwealth Bank of Australia* [2001] 1 Qd R 168 at 173.

[71] See *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd)* (2001) 19 ACLC 1006 at [68]-[86].

[72] *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd)* (2001) 19 ACLC 1006 at [307].

[73] *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd)* (2001) 19 ACLC 1006 at [310].

[74] *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd)* (2001) 19 ACLC 1006 at [310], citing *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 (Mason J), as authority.

[75] *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 at 385.

[76] *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd)* (2001) 19 ACLC 1006 at [309].

[77] *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd)* (2001) 19 ACLC 1006 at [321].

 © LAWBOOK CO.

The Privy Council's decision in *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 also involved an adviser described as a "merchant bank". It had been approached by the plaintiffs for assistance in raising finance for the purchase of an island off New Zealand's east coast. An initial meeting was held at which the plaintiffs disclosed confidential details of its purchase proposal. The adviser provided an engagement letter, setting out the terms on which its services would be provided, but withdrew it several weeks later when the plaintiffs had not executed it. When the adviser subsequently represented another potential purchaser of the island, the plaintiffs brought proceedings alleging breach of the fiduciary obligation of loyalty owed to the plaintiffs.

The Privy Council held that no fiduciary relationship existed between the adviser and the plaintiffs. Stating its reasons succinctly, it asserted that "there was no mutuality giving rise to the undertaking or imposition of a duty of loyalty".[78] More specifically, the merchant bank "did not undertake any obligation, either expressly or implicitly, to act on behalf of [the plaintiffs]", nor did it have authority, actual or ostensible, to do so.[79] The plaintiffs "never accepted the existence of a relationship [with the merchant bank], the benefits of which it now claims for itself", and the stage had not been reached whereby it could be said that "either an informal arrangement had come into existence or a continuing course of conduct between the parties had been undertaken which could give rise to the fiduciary relationship".[80] The Privy Council said that the relationship never "extended beyond one created by and limited to the giving and receipt of confidential information".[81]

The decision demonstrates that the imparting of confidential information, while indicative of fiduciary character (because it points towards a relationship of trust and confidence), is an insufficient criterion by itself. Without explicitly stating what more will be required, the Privy Council nevertheless provided guidance by invoking a "legitimate expectations" criterion that echoes the Finn formulation already discussed. It asserted that the duty alleged to exist

> encaptures a situation where one person is in a relationship with another which gives rise to a legitimate expectation, which equity will recognise, that the fiduciary will act not to utilise his or her position in such a way which is adverse to the interests of the principal.[82]

More recently, in *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 a majority of the High Court approved the observations of the trial judge that, in determining whether the adviser (a firm of accountants) owed fiduciary obligations to its client, it was relevant whether the adviser had advised on the transaction – a takeover by one company of another. The majority opinion approved of the "approach" of the trial judge, who concluded that the adviser had not acted in the capacity required to give rise to fiduciary obligations.[83] The judge did so after finding that there was "no evidence to suggest that the [adviser] gave any advice, or made any representation to, [its client] about the efficacy or wisdom of the takeover" and that there was no evidence suggesting "that the [adviser] advised, or even suggested to [its client], that the takeover … be undertaken".[84] Implicit in the reasoning of the majority is that advice on the "efficacy or wisdom of a takeover" is "advice in the relevant sense for the purpose of liabilities as a fiduciary".[85]

The Federal Court decision of *Hadid v Lenfest Communications Inc* [1999] FCA 1798 also bears on the fiduciary question involving a financial adviser and its client. The matter involved business dealings for satellite pay television licences that were allocated by the Australian government in the

[78] *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 at 600.

[79] *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 at 600.

[80] *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 at 600.

[81] *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 at 600.

[82] *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 at 598.

[83] *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 at 197.

[84] *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 at 197.

[85] *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 at 197.

© LAWBOOK CO.

1990s. The applicant alleged that Bain, an investment bank,[86] owed fiduciary obligations in respect of its involvement in the proposed securities offering by an alleged joint venture, which included the applicant. The purpose of the venture was to raise funds to purchase the licences. Bain was introduced to the applicant as a prospective securities underwriter and proposed an indicative timetable for the securities offering. From time to time Bain also offered general views to the applicant relating to the proposed securities offering and financial market conditions, and at one point provided a letter expressing views as to the feasibility of a securities offering on particular terms. The applicant alleged that Bain assumed fiduciary obligations to him and to the joint venture, which it breached by subsequently advising parties with interests adverse to those of the applicant.

With apparent reference to *Daly*, the applicant alleged that fiduciary obligations arose because Bain had "held itself out as having special skill in providing financial and investment advice and knew, or ought to have known, that [the applicant] relied on [a representative of Bain] to provide full and frank advice".[87] It argued that Bain acted as both underwriter and financial adviser and not simply as underwriter. The applicant did not allege that fiduciary obligations arose in respect of "underwriting" alone. Bain asserted that no fiduciary obligations arose since it had repeatedly made it clear that it would not accept an advisory role in the circumstances. It is apparent that the parties and the court regarded "underwriting" as excluding any financial advisory aspect.

Justice Lehane found that Bain had not provided financial advice and instead, had expressed views "gratuitously, no doubt in the hope that [it] would be rewarded, ultimately, by being appointed underwriter".[88] In fact, Bain's views, including those expressed in its letter, were "little more than a 'pitch' for an underwriting role – stressing the strength and credentials of Bain".[89] Even the indicative timetable that Bain provided was part of the "pitch", rather than "advice in any usual sense of the word".[90] Justice Lehane acknowledged that "advisers may, and often do, have fiduciary obligations".[91] But this was not such a case; a commercial party had openly pursued an interest of its own and, in the course of so doing, had given advice, or offered opinions, "in a promotional, non-binding or relatively casual way" and the law did not extend to impose fiduciary obligations in these circumstances.[92] Justice Lehane denied that fiduciary obligations were owed by Bain to the applicant or to the alleged joint venture.

It is implicit in Justice Lehane's reasons that the provision of financial advice in a securities underwriting context may furnish a basis for the imposition of fiduciary obligations. However, he was not required to decide this question since no such advice had been provided. Significantly, it was the absence of financial advice that provided the basis of the court's decision, not the commercial context of the transaction or the apparent financial sophistication of the parties involved.

In *Darvall v North Sydney Brick & Tile Co* a company for which a takeover offer had been made (the target) appointed an investment bank to advise on its response. The target's board recommended that shareholders support a competing bid for the company, to be made by its managing director, and enter into a joint venture agreement with Chase Corporation Ltd to develop a valuable tract of land owned by the target company. While advising the target, the investment bank also allegedly advised the managing director on his takeover bid, and assisted him to obtain a loan from Chase on terms that

[86] The firm was described in the case as a financial advisory firm. Since its business included the traditional investment banking functions of underwriting the issue of corporate securities and providing financial advisory services (see Geisst, n 2, p 2), it can properly be regarded as an investment bank.

[87] *Hadid v Lenfest Communications Inc* [1999] FCA 1798 at [793].

[88] *Hadid v Lenfest Communications Inc* [1999] FCA 1798 at [814].

[89] *Hadid v Lenfest Communications Inc* [1999] FCA 1798 at [814].

[90] *Hadid v Lenfest Communications Inc* [1999] FCA 1798 at [815].

[91] *Hadid v Lenfest Communications Inc* [1999] FCA 1798 at [817], referring to Finn PD, "Fiduciary Law and the Modern Commercial World" in McKendrick E (ed), *Commercial Aspects of Trusts and Fiduciary Obligations* (Clarendon Press, 1992).

[92] *Hadid v Lenfest Communications Inc* [1999] FCA 1798 at [817].

 © LAWBOOK CO.

were "particularly advantageous".[93] The court was satisfied that Chase would not have made the loan to the managing director unless the target had entered into the joint venture arrangement,[94] it being apparent that the joint venture represented a prized commercial opportunity to Chase. The other target directors were not informed that the managing director's takeover offer was being financed by Chase.

Mahoney JA stated that the investment bank "was in a position of possible conflict" with the interests of its client, the target,[95] by acting for the managing director to secure the loan from Chase. Mahoney JA explained:

> At the risk of over simplification, there was the potential that, to the extent that favourable terms were obtained by the [investment] bank for [the managing director], to that extent less favourable terms would be obtained by it for the company in the joint venture arrangements.[96]

However, the evidence did not "warrant the conclusion that there was an actual conflict, in the sense that the company's interests were sacrificed to those of [the managing director]".[97] This matter had not been explored at trial, Mahoney JA explained, and he therefore did not pursue it.

Significantly, the plaintiff does not appear to have raised the fiduciary question[98] and no members of the court discussed the issue. However, Mahoney JA regarded the adviser as having a duty to draw to the attention of the target directors "the possibility of conflicts between the interests of [the managing director] in his take-over offer and the interests of the company in its joint venture arrangements", among other things.[99] It is unclear whether the basis for this duty is tort or implied contract.

Although the fiduciary question was not raised, the case provides a valuable description of the advisory role of an investment bank and the significance of the fiduciary question in this context. It also demonstrates the difficulties involved in identifying the tortious and contractual duties owed by investment banks and thus, perhaps, the lack of protection from conflicts afforded to financial advisory clients outside fiduciary doctrine.

Solicitor and client

The solicitor-client relationship differs from those previously considered because solicitors are not obliged to provide financial advice,[100] nor generally expected to do so. Further, their advisory function has a distinctive quality: as court officers, at least in contentious matters, solicitors are regarded as instrumental in maintaining the public perception of integrity of the legal profession and the administration of justice,[101] a role not performed by investment banks. The advice they give to a client is also privileged from disclosure. However, like the relationship between investment banks and financial advisory clients, it has a contractual basis provided by a retainer or engagement agreement. Similarly, as discussed earlier, solicitors will typically work alongside investment bankers on financial advisory transactions. Clients will ordinarily engage both a law firm and an investment bank to form an integrated working group, and the advisers will be involved with the client on almost every facet of the transaction. The group will work closely together, often in the same physical working environment

[93] The loan was made on a non-recourse basis, meaning that the managing director was to be under no personal liability for its repayment. See *Darvall v North Sydney Brick & Tile Co Ltd (No 2)* (1989) 16 NSWLR 260 at 310, 311, 315.

[94] *Darvall v North Sydney Brick & Tile Co Ltd (No 2)* (1989) 16 NSWLR 260 at 316.

[95] *Darvall v North Sydney Brick & Tile Co Ltd (No 2)* (1989) 16 NSWLR 260 at 319.

[96] *Darvall v North Sydney Brick & Tile Co Ltd (No 2)* (1989) 16 NSWLR 260 at 319.

[97] *Darvall v North Sydney Brick & Tile Co Ltd (No 2)* (1989) 16 NSWLR 260 at 319.

[98] In fact, it is not clear how an allegation that the investment bank breached a fiduciary duty to avoid conflicts would have assisted the plaintiff – a minority shareholder – who had made a competing takeover bid for the target. The plaintiff was seeking, among other things, a court order setting aside the joint venture agreement entered into by the target.

[99] *Darvall v North Sydney Brick & Tile Co Ltd (No 2)* (1989) 16 NSWLR 260 at 320.

[100] *Krambousanos v Jedda Investments Pty Ltd* (1996) 64 FCR 348 (affd (1997) 74 FCR 138); Dal Pont, n 21, pp 90-96.

[101] See *Blackwell v Barroile Pty Ltd* (1994) 51 FCR 347. See also Dal Pont, n 21, p 204.

for extended periods. Information will be exchanged among them almost without distinction. While the nature of advice that each adviser provides differs, a close analogy between the relationships does exist in this context.

Synthesis of decisions

It is evident from these cases that fiduciary obligations may be imposed in a commercial context on a party in a relationship of confidence, where an incident of the relationship is the giving of financial or investment advice. In particular, the relationships of stockbroking firm and client, bank and customer, corporate adviser and client, and analogous relationships, may be fiduciary in character where the firm or other adviser holds itself out as an expert in financial or investment matters and undertakes to provide advice of that nature to the client or customer.[102] Also apparent in each fiduciary relationship, although not always expressly mentioned by the court, is trust or confidence reposed in the adviser, giving it some measure of influence over the other party in respect of a transaction of significance to that party.[103]

The cases also demonstrate the importance for fiduciary identification purposes of the existence of an expectation of loyal conduct. In *Arklow Investments* this was expressed as a "legitimate expectation" as to the adviser's loyalty, while in *Smith* it was formulated simply as an "expectation" of loyal conduct. Both are apparent references to Professor Finn's "reasonable expectations" criterion, according to which a fiduciary relationship arises where, in respect of a particular matter, a person can be reasonably expected to act in the interests of another in and for the purposes of the relationship. However, it is unclear whether, by substituting legitimacy for – or, indeed, by omitting – the qualification of reasonableness, a different criterion was intended. This may be unlikely given the profile of Professor Finn's scholarship and, in any case, the criteria substantially overlap. Moreover, in many circumstances there may be no distinction between these formulations and the "undertaking" requirement, invoked in *Daly*, since an undertaking to advise by the alleged fiduciary may create the "fiduciary expectation" on the part of the person to whom the undertaking has been made.[104] Indeed, in *Smith* the Full Federal Court apparently saw the "fiduciary expectation" requirement as grounded in the *Daly* decision.

It follows from applying the reasonable expectations criterion that fiduciary obligations may be owed to a financially sophisticated client as even it may reasonably expect loyal conduct from its adviser. Such a client may rely on its adviser for information and advice, particularly in the context of a significant transaction for the client, and thus be considered vulnerable for purposes of fiduciary characterisation.[105] This is not to say that a client's sophistication may not be relevant to the factual question of whether an adviser provided financial advice (in *Grubric v Commonwealth Bank of Australia* it was relevant in this way), but only that it will not otherwise be an obstacle to the existence of fiduciary obligations. The cases demonstrate this. In *Aequitas* – where fiduciary obligations were owed – the client was in all likelihood as sophisticated as the adviser.[106] Even in cases where fiduciary

---

[102] *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 at 385; *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd)* (2001) 19 ACLC 1006 at [307].

[103] The absence of confidence reposed in the adviser appears to have been a primary reason for the absence of fiduciary obligations in *Finding v Commonwealth Bank of Australia* [2001] 1 Qd R 168.

[104] See Finn, n 91, p 9, fn 18 and Sin KF, *The Legal Nature of the Unit Trust* (Clarendon Press, 1997) p 163.

[105] See Law Commission, *Fiduciary Duties Consultation Paper*, n 12, at [2.4.6] (observing that, for purposes of fiduciary characterisation, "vulnerability can be shown by factors such as dependence upon information and advice, the existence of a relationship of confidence and the significance of a particular transaction for the parties" and citing *Coleman v Myers* [1972] 2 NZLR 225 at 325).

[106] In *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd)* (2001) 19 ACLC 1006, the adviser and client had similar levels of sophistication since at least two directors or senior officers were common to both entities. In any case, it is extremely difficult for a court to assess the financial sophistication of a client. Even companies whose management have experience of change-of-control transactions would be unsophisticated in comparison to an investment bank whose business it is to regularly advise on such transactions.

 © LAWBOOK CO.

obligations did not arise – including *Pilmer v Duke Group Ltd*, *Arklow Investments Ltd v Maclean* and *Hadid v Lenfest Communications Inc* – the courts did not cite a client's apparent sophistication as a barrier to fiduciary character.

The nature of the advice provided is also significant to the fiduciary question. As *Hadid* also demonstrates, investment advice or financial advice (which expressions are used synonymously in the cases) must be provided in order for the fiduciary relationship to be established in this context. Justice Lehane's analysis proceeded on the basis that no fiduciary relationship would arise without the provision of such advice by the investment bank. The giving of what Austin J in *Aequitas* referred to as "corporate advice" may also invoke fiduciary obligations, it being regarded as not materially different in terms of fiduciary obligation from financial advice.[107]

In none of the cases have courts explicitly discussed what constitutes corporate, financial or investment advice for purposes of identifying fiduciary character. These expressions, while capturing advice of broad scope, are far from nebulous. In *Daly*, the advice related to how or where to invest available funds for financial return and in *Smith* the advice related to weighing up competing investment opportunities and the wisdom of investing in a particular transaction, this involving the assessment of the contract price and funding options. In *Aequitas*, the advice broadly related to investment opportunities (which included buying shares of another company) and raising funds for or financing those opportunities; more specifically, it related to the structure of the client, the merits and structure of a securities issue to raise funds and the relative merits of a number of investment opportunities for those funds. Taken together, the advice in question may be broadly described as advice on the merits and other aspects of raising funds (either privately or publicly, by either debt or equity instruments) and of investing or spending those funds; or, in other words, as relating to the wisdom or merits of entering into a particular investment and its alternatives, to financing and timing considerations and to documenting and implementing the investment decision. Characterising the nature of advice in this way is consistent with the High Court's approach in *Pilmer*, which implicitly recognised that advice "about the efficacy or wisdom of [a] takeover" (itself a form of investment by the bidder) may provide a basis for fiduciary characterisation.[108]

Such advice clearly has the capacity to affect the interests of the client and cannot be provided by applying a methodology or by "number crunching". It is strategic advice in the sense that it requires the exercise of judgment and the application of financial acumen to assist a person lacking these attributes (in relative terms) to make what can broadly be described as investment decisions. Moreover, the advice requires regard to be had to the individual circumstances and objectives of the client and will vary according to those considerations.

The decision in *Hadid* also demonstrates that no fiduciary relationship can be founded on advice or information of a promotional, non-binding or relatively casual nature given for the purpose of obtaining an instruction to act as a financial or investment adviser.[109] The decision in *Arklow Investments* can be explained on this basis since any advice that was provided by the merchant bank at the initial meeting appears to have been of this nature and thus incapable of giving rise to fiduciary obligations.

Imparting confidential information to the adviser is evidence of the existence of a relationship of trust and confidence and will also point towards the existence of a fiduciary relationship. Out of that confidence will naturally grow influence on the part of the adviser, another feature of the relationship. But imparting confidential information, without more, is insufficient to found a fiduciary relationship, as the decision in *Arklow Investments* also demonstrates.

The scope of the consequent fiduciary obligations is confined to the giving of advice of the requisite type. In *Daly*, the question was framed as whether, "in advising its client", the stockbroking

[107] *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd)* (2001) 19 ACLC 1006 at [310].

[108] *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 at 197.

[109] See *Hadid v Lenfest Communications Inc* [1999] FCA 1798 at [817]. An adviser in these circumstances may still owe a duty of confidence to its client in respect of the information received by it: at [818].

firm was in the position of a fiduciary.[110] Accordingly, fiduciary obligations will be imposed "to the extent of the advice"[111] or only in respect of the advisory aspect or dimension of the relationship. It follows that fiduciary obligations may not be owed in respect of other aspects of the relationship,[112] assuming of course that aspects of a relationship can be discretely identified.

In summary, in order for an investment bank providing financial advisory services to owe fiduciary obligations to its client, it must be established that the relationship is one of confidence and involves the provision of financial or investment advice by a party holding itself out as expert in those matters. Broadly speaking, the advice must relate to the wisdom or merits of entering into a particular investment and financial arrangements related to it. Moreover, the client must have a reasonable expectation of loyal conduct of its adviser, and this expectation may arise where the adviser has undertaken to provide advice of the requisite nature.

Contractual techniques to displace or modify fiduciary obligations

Parties may contractually displace fiduciary obligations or, if they arise, modify their content and scope. They may also exclude liability in the event of fiduciary breach.[113] While the limits on the effectiveness of these techniques are not explored here, it is apparent that contractual variation could not permit a fiduciary to act fraudulently or dishonestly, for example to benefit the fiduciary or third parties at the expense of the principal.[114]

Despite the amenability of fiduciary obligations to contract, the fiduciary question remains important for a number of reasons. First, the parties to a transaction may choose not to contract around fiduciary obligations. Indeed, in none of the cases considered above did the parties do so. Second, where parties merely intend by contract to modify (rather than to displace) fiduciary obligations, the question of whether their relationship is fiduciary remains significant. It is also valuable for commercial parties to know whether fiduciary obligations would arise in the absence of contractual variation or displacement in order to know their "default" position and the utility to be gained from negotiating the issue at all. Finally, since the engagement letter between an investment bank and its financial advisory client may be executed after the investment bank has begun providing financial advisory services, the investment bank may be subject to fiduciary constraints in negotiating the terms of that agreement. This is discussed below.

Existence and parameters of fiduciary relationship: Applying the law

Limitation of analysis

The analysis in this article necessarily involves attributing fiduciary character to a category of relationship – that between an investment bank and its financial advisory client – rather than to a relationship between particular, identified parties. A limitation of this is that the category cannot be described with the same degree of precision as can a specific relationship. However, this limitation is

[110] *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 at 384.

[111] Glover, n 36, at [2.67].

[112] A person may be a fiduciary in one or more activities but not in others: see, eg *New Zealand Netherlands Society "Oranje" Inc v Kuys* [1973] 1 WLR 1126 at 1130; *Phipps v Boardman* [1967] 2 AC 46 at 127; *Birtchnell v Equity Trustees Executors & Agency Co Ltd* (1929) 42 CLR 384 at 408; *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 98.

[113] See Tuch, n 4 at 500-503.

[114] Acting fraudulently or dishonestly is equated with conduct that benefits a fiduciary or others at the expense of the principal. See *Armitage v Nurse* [1998] Ch 241 at 251 (Millett LJ asserted that a trust exemption clause could not exclude liability for fraud or dishonesty and that "[i]f [a trustee] acts in a way which he does not honestly believe is in [the beneficiaries'] interests then he is acting dishonestly … A trustee who acts with the intention of benefiting persons who are not the objects of the trust is not the less dishonest because he does not intend to benefit himself"); Hayton D, "The Irreducible Core Content of Trusteeship" in Oakley AJ (ed), Trends in Contemporary Trust Law (Clarendon Press, 1996) p 58 ("an exemption from liability for breach of the duty to act in good faith cannot have effect, because that would empty the area of obligation so as to leave no room for any obligation. A trustee will not be acting in good faith if he acts fraudulently or dishonestly i.e. to benefit himself or third parties at the expense of the beneficiaries"); and Law Commission, United Kingdom, *Trustee Exemption Clauses*, Consultation Paper No 171 (London, 2003).

 © LAWBOOK CO.

reduced if it is accepted that the relationship between investment banks and their financial advisory clients is well-established and stable enough across firms and clients so as to be capable of description with sufficient precision to enable an informed assessment of its fiduciary character. The description of adviser-client relationship discussed earlier in the article supports this contention. It follows that, except for any individual transaction that departs from this description, it is possible to draw analogies from recognised fiduciary relationships to this one and to determine the presence or absence of the features identified in the relevant cases as giving rise to fiduciary obligations.

Existence of fiduciary relationship

This article considers the relationship between the investment bank (or relevant entity in a group of companies)[115] and its financial advisory client. If the relationship is fiduciary in character, any resulting fiduciary obligations will be owed by the firm (or relevant entity), being an incorporated entity, rather than by individual bankers or other employees.[116]

As explained above, considering the question involves reasoning analogically from previous cases and established relationships, drawing upon judicially-endorsed features identifying fiduciary character, and emphasising to the "reasonable expectations" criterion.

Previous cases and established relationships

At a broad level, the financial advisory role of investment banks is analogous to that provided by stockbroking firms, banks and the corporate advisers described in the cases discussed above. Since stockbroking (or retail brokerage) services are also often provided by investment banks, the analogy, in terms of the identity of parties, is close. Furthermore, these relationships, like that between an investment bank and its financial advisory client, are vertical in the sense that any fiduciary duties will be owed in one direction only – to the client.

More significantly, the relationship under consideration entails giving investment or financial advice that corresponds closely to the advice which, in the cases discussed above, supported the imposition of fiduciary obligations. This advice related to the wisdom or merits of entering into a particular investment and its alternatives, to financing and timing considerations, and to documenting and implementing the investment decision. It was strategic and involved exercising judgment and applying financial acumen. In *Aequitas*, for example, advising a company on purchasing shares of another company constituted financial advice for the purposes of fiduciary analysis. Such investment or financial advice is the very essence of financial advisory services in change-of-control transactions.

But for purposes of fiduciary analysis, is the relationship between an investment bank and its financial advisory client distinguishable from the adviser-client relationships in these cases? Two points can be made. First, the former relationship may involve greater complexity: the investment bank's role may include dimensions falling outside the scope of financial or investment advising such as lending funds or underwriting a securities offering by the client to finance the transaction; and the advice itself may require expertise that reflects greater experience or more specialised training. Second, the financial advisory client will often be commercially sophisticated since its management will typically be involved, on a daily basis, in financial affairs.

As to the first point, it is clear that a party may be a fiduciary in one or more of its activities, but not in others,[117] so the multi-faceted role of the banker presents no barrier to fiduciary obligations arising. Also, if the advisory function of the investment banker involves greater expertise, this would only emphasise the difference in expertise between an adviser and its client and thus the client's reliance on its adviser for information and advice. Similarly, the commercial sophistication of a client presents no barrier to fiduciary responsibility. It is enough that clients be vulnerable and reliant, according to the cases. This is likely to be so in the financial advisory context: few investment banks

[115] For purposes of this analysis, it is assumed that the investment bank and the relevant entity providing financial advisory services are one and the same.

[116] For a discussion of the possible accessorial liability of these individuals, see below, "Remedial Consequences of Breach and Accessorial Liability".

[117] See n 112.

would deny having superior financial expertise and judgment to that of their clients by virtue of their experience of regularly advising on these transactions. Finally, it is noteworthy that the same clients are owed fiduciary obligations by solicitors in this context.

The task of identifying precisely when a fiduciary relationship is formed is difficult. The relationship will arise at least from the time an engagement letter is executed. At that point the undertaking to advise would exist or the close relationship, involving the investment bank advising and the client disclosing confidential information and reposing trust, would give rise to a reasonable or justifiable expectation by the client of loyalty from the adviser.

In many cases identifying the point in time will not be necessary since a court will be concerned only with whether the obligations existed at the time of the alleged conflict. But the question may be significant where, for example, the parties have attempted to displace or vary fiduciary obligations in an engagement letter, which was signed after the advising relationship began. If fiduciary obligations pre-existed the letter, the adviser would have been subject to them at the time of negotiating the terms of the letter.

Fiduciary obligations may arise in the absence of a contractual undertaking by the adviser to advise in its client's interests. This follows from the assertion above that a fiduciary relationship will exist where a client reasonably expects loyalty from its adviser. Moreover, if an undertaking is required for fiduciary characterisation, as Brennan J suggests in *Daly*, it need not be contractual: in *Arklow Investments* the Privy Council recognised that an undertaking may be given "implicitly",[118] even though it found that none existed; and in *Commonwealth Bank of Australia v Smith*, where fiduciary obligations did arise, no contractual undertaking was present. Scholars agree that no contractual undertaking is required for fiduciary characterisation.[119] This supports the contention that fiduciary obligations may pre-exist the engagement letter.

In this context, a United States perspective is informative: in the lawyer-client relationship, where the contract between the parties is entered into "beyond a reasonable time after the [fiduciary] has begun to represent the client in the matter" the lawyer has the burden of showing that the terms of the contract and the circumstances of its making are "fair and reasonable to the client".[120] A rationale for this heightened standard is that "[a] client might accept such a contract because it is burdensome to change lawyers during a representation" or "might hesitate to resist or even to suggest changes in new terms proposed by the lawyer, fearing the lawyer's resentment or believing that the proposals are meant to promote the client's good".[121] The same rationale may support the assertion of a financial advisory client that its adviser breached fiduciary obligations when negotiating the terms of the letter by failing to obtain its informed consent to conflicts of interest existing during the negotiations.

The timing of the fiduciary relationship is important in another context as well: where an investment bank advises the bidder in a proposed takeover. This role will often begin when the bidder's takeover proposal is tentative and will involve the integrated investment bank purchasing shares in the target company for the bidder, in accordance with instructions. The timing of fiduciary obligations is important since they will constrain self-interested conduct of the investment bank. Once the obligations arise, even another Chinese wall insulated arm of the firm may be prevented from being in a position of conflict with the client's interests. So, for example, in the absence of the client's informed consent, a firm would breach obligations as a fiduciary if its proprietary trading arm purchased a stake in the target that would block the proposed takeover.

[118] *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 at 600.

[119] See Finn, n 52 at [467] ("[A fiduciary] is, simply, someone who undertakes to act for or on behalf of another in some particular matter or matters … It is immaterial whether the undertaking is or is not in the form of a contract"); see also Sealy, n 51 at 76.

[120] See *Restatement (Third) of The Law Governing Lawyers*, §18(1)(2000). My thanks to Professor Deborah DeMott for drawing to my attention this issue in the context of the relationship between underwriters and their issuer clients and to the United States legal position described in the text accompanying this footnote.

[121] *Restatement (Third) of The Law Governing Lawyers*, §18(1)(2000), comment *e*.

 © LAWBOOK CO.

If the investment bank were simply executing instructions to buy shares in the target for the proposed bidder – without also providing financial advice – no fiduciary obligations would arise to constrain the firm's self-interested conduct. Similarly, if the advice given during this stage of the proposed transaction were for the purpose of seeking to secure a financial advisory role if the transaction proceeds, no fiduciary relationship would arise.[122] But if it were performing a financial advisory role, fiduciary obligations might arise – even if no engagement letter had been signed. The client will reasonably expect loyalty at some point, and the adviser will then be prohibited from serving incompatible interests, in the absence of the client's informed consent.

Reasonable expectations and policy justification

Powerful reasons exist for a client (or, more specifically, for its corporate management) to reasonably expect loyalty from the investment bank providing it with financial advice. First, the context is significant: change-of-control transactions are matters of great strategic significance to a company and its management. Such transactions will almost invariably influence a company's value, as measured by its share price (assuming it is a public listed company) and, as a consequence, its capacity to borrow funds or raise capital. Corporate management is often at risk of being displaced, heightening the significance of a transaction for a client. Furthermore, since these transactions often pit a client against an adversary (or at least against a party or parties with divergent interests), a notion of partisanship prevails among each party and its advisers. Accordingly, in almost no recorded instance has an investment bank represented opposing parties on a transaction.[123]

Second, the existence of such an expectation is supported by the close analogy between the counselling role of a law firm and the financial advisory role of an investment bank in this context. During a transaction the client will divulge to its advisers confidential and sensitive information about its strategic direction, vulnerabilities and other matters for the purpose of receiving advice and thereby be vulnerable to the misuse of this information. Investment banks and law firms will be integrated into their client's working group for the transaction and be involved in almost every facet of the transaction. The advice of each adviser will necessarily both reflect and shape the advice of the other. As with its legal advisers, the client will rely on and trust its financial advisers – indeed the trust implicit in the advisory role is reflected in its being a measure of an investment bank's connections and influence, which are regarded as important to the industry as a whole.[124] To contend in these circumstances that an investment bank – but not the legal advisers – may legitimately pursue self-interest or third-party interest within the scope of the transaction is implausible; the financial advisory client can – indeed, in the circumstances, must – reasonably expect that the investment bank will provide faithful service in and for the purpose of the transaction. Even allowing for the unique role of legal advisers in the administration of justice, it would be an odd state of affairs for the law to demand undivided loyalty from them only.

Third, the advice itself – regarding the structure, terms and timing of the proposed transaction, price and form of any consideration offered and proposed uses of funds – are matters of central importance to the success or otherwise of an offering from a business perspective. Related to this is that the imbalance in expertise and knowledge between the investment bank and its client makes it likely, if not inevitable, that the client's management will depend heavily on this advice.

Fourth, the factors identified above by Nolan also justify the existence of a reasonable expectation of loyalty by the financial advisory client.[125] To begin with, the nature of the financial advisory role means that it can be performed in any one of a number of unobjectionable ways. This makes it impracticable ex ante for the client to stipulate with clarity (or for the law to imply) specific constraints on the investment bank's conduct. Also, the investment bank's task involves the exercise of judgment and application of financial expertise, which are attributes that clients will lack relative to

[122] See *Hadid v Lenfest Communications Inc* [1999] FCA 1798 at [816].

[123] The case of *Higgins v New York Stock Exch Inc* 10 Misc 3d 257 (2005) provides a counter-example. A single investment bank represented both parties to a change-of-control transaction after obtaining each party's informed consent. See also n 22.

[124] Geisst, n 2, p 200.

[125] See Nolan, n 47.

the investment bank, making it difficult ex post for many clients to assess an investment bank's performance. Also, *Darvall v North Sydney Brick & Tile Co* demonstrates that courts have not clearly articulated the duties – tortious or implied contractual – owed by an investment bank to its financial advisory client. Nolan asserts that, for reasons of efficiency and practicality, the law responds in these circumstances by imposing an obligation of loyalty that is expressed in proscriptive terms.[126] For the present purpose, however, it is contended that these circumstances help to explain why a financial advisory client can reasonably expect loyalty from its adviser.

Finally, due to the visibility and widespread community consequences of these transactions, the relationship in question has public dimensions. The intermediary function performed by investment banks is, after all, integral to the efficient operation of the financial system.[127] Permitting investment banks to have interests conflicting with that of their clients would likely erode community confidence in the integrity and utility of the relationship and in the financial markets generally. The client assured of fiduciary protection would be encouraged to disclose confidential information openly and candidly to its adviser, an essential requirement for effective representation on these transactions. Also, requiring conflict avoidance would militate against temptations to act disloyally that may be created by an investment bank's fee structure, which typically rewards it in proportion to the value of a consummated transaction (and sometimes not at all if the transaction is terminated).

A compelling case thus exists for regarding the relationship between an investment bank and its financial advisory client as giving rise to fiduciary obligations. It may also be said, based on the normative proposition that a fiduciary relationship should exist where the reasonable expectations criterion is satisfied, that fiduciary obligations in this context *should* be owed.

Parameters of the fiduciary obligation to avoid conflicts

The parameters – or content and scope – of any fiduciary obligations owed by an investment bank to its financial advisory client will be determined by the terms of any contract underlying the relationship.[128] As discussed above, such a contract may vary or displace the existence of fiduciary obligations.[129] Fiduciary obligations are proscriptive in nature – prohibiting conduct by a fiduciary rather than compelling it – for the purpose of exacting from the fiduciary (in this case the investment bank) a standard of undivided loyalty.[130] Twin obligations will ordinarily arise: without fully informed consent, the fiduciary must avoid conflicts of interest and must not obtain any unauthorised profit from the fiduciary relationship.[131] Although the two obligations overlap,[132] this article focuses on whether the former obligation arises.

The question is whether, in the absence of contractual modification, equity will impose on an investment bank the duty to avoid positions of conflict with the interests of its financial advisory client. In considering this question it is relevant that courts will mould fiduciary obligations to the character of the particular relationship[133] and, in so doing, may take into account the commercial

[126] Nolan, n 47 at 423.

[127] Geisst, n 2, p 1.

[128] See *Henderson v Merritt Syndicates Ltd* [1995] 2 AC 145 at 206.

[129] See text under heading "Contractual techniques to modify and displace fiduciary obligations", above.

[130] See *Maguire v Makaronis* (1997) 188 CLR 449 and *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 1 at 46-47.

[131] *Breen v Williams* (1996) 186 CLR 71 at 113, 137-138.

[132] This is because a person who makes an unauthorised profit from his or her fiduciary position has usually, but not always, placed self-interest ahead of the interest of the person to whom the duty is owed and thereby also breached the duty to avoid conflicts. See *Boardman v Phipps* [1967] 2 AC 46 at 123. See also Austin RP, "Fiduciary Accountability for Business Opportunities" in Finn PD (ed), *Equity and Commercial Relationships* (The Law Book Company Limited, 1987) pp 141, 146 and Dal Pont GE, "Conflicts of Interest: The Interplay Between Fiduciary and Confidentiality Law" Australian Mining and Petroleum Law Association Yearbook (2002) at 584.

[133] *United Dominions Corporation Ltd v Brian Pty Ltd* (1985) 157 CLR 1 at 11; 60 ALR 741 at 747, citing *Birtchnell v Equity Trustees, Executors and Agency Co Ltd* (1929) 42 CLR 384 at 407-409.

 © LAWBOOK CO.

context in which a relationship is situated or a transaction takes place.[134] Indeed, the United Kingdom Law Commission has expressed the view – in a far broader context than the current one – that "the classic formulation of fiduciary obligations needs to take account of the way modern commercial organisations are organised and regulated".[135]

Consider three issues in this regard. The first is whether, because of the structure of the integrated investment bank or its function as financial adviser, there exists in the contract with a financial advisory client an implied term that attenuates the parameters of fiduciary obligations. The Privy Council decision of *Kelly v Cooper* [1993] AC 205 provides two bases for limiting fiduciary obligations in this way. In particular, where a fiduciary relationship arises out of a contract, the fiduciary obligations may be limited – such that certain conflicts of interest are not prohibited – where either the client knows that the fiduciary "acts and intends to act" in a way that will place it in a position of conflicting interests or where the fiduciary could only perform its function by being in a position of conflicting interests.[136] The bases substantially overlap.

In *Kelly*, the Privy Council implied into the contract between real estate agents and the plaintiff (a client of the agents) a term that permitted the agents to act on other transactions for clients whose interests conflicted with the plaintiff's. The court explained that the plaintiff was "well aware" that the agents would be acting in such a position of conflict[137] and observed that "estate agents must be free to act for several competing principals otherwise they will be unable to perform their function".[138] A term allowing the agents to perform their function was implied into the contract, even though the function would inevitably give rise to conflicts of interest.

Applying these considerations to the present context, the question is whether the financial advisory function can only be performed by allowing conduct that would otherwise be a breach of the duty to avoid conflicts.[139] This question is broad-ranging because of an integrated investment bank's multiple roles. To start with, the financial adviser's function is not analogous to that of the real estate agent: unlike the parties to a real estate transaction, each party to a change-of-control transaction will be separately advised. It may also be observed that the Privy Council's approach provides no support for permitting an investment bank to engage in activities undertaken at a firm's discretion and in its financial self-interest in a manner placing it in a position of conflict with its financial advisory client.

[134] The "commercial reality" has influenced courts in shaping the fiduciary obligations of nominee directors. See, eg *Levin v Clark* (1962) 80 WN (NSW) 485; [1962] NSWR 686, *Re Broadcasting Station 2GB Pty Ltd* [1964-65] NSWR 1648, *Berlei Hestia (NZ) Ltd v Fernyhough* [1980] 2 NZLR 150 at 165-166.

[135] Law Commission (UK), *Fiduciary Duties Consultation Paper*, n 12 at [6.16]. The broader context is the financial services industry generally, rather than any particular relationship such as the one considered in this article – that between a financial adviser and client. But the context is potentially more specific since the Law Commission's statement in the text above was directed at situations where inconsistency or mismatch exists between a fiduciary obligation and regulatory rule. Whether such inconsistency exists in the relationship being considered in this article is discussed further below. The Law Commission's report pre-dates the reported conflicts of interest at integrated investment banks during the technology boom in the United States and elsewhere at the turn of this century, which led to the statutory changes discussed at "Provision of financial advisory services: The statutory question", below. As to these events, see Augar, n 10; Office of New York State Attorney General, *Office of New York State Attorney General Eliot Spitzer, Merrill Lynch Stock Rating System Found Biased by Undisclosed Conflicts of Interests* (Press Release, 8 April 2002) http://www.oag.state.ny.us/press/2002/apr/apr08b_02.html viewed 12 August 2006; Fisch JE and Sale H, "The Securities Analyst as Agent: Rethinking the Regulation of Analysts" (2003) 88 *Iowa Law Review 1035*.

[136] *Kelly v Cooper* [1993] AC 205 at 214. In *Bolkiah (Prince Jefri) v KPMG* [1999] 2 AC 222 at 235 Lord Millett suggested that the decision in *Kelly v Cooper* rested on the client's consent: the client was taken to consent to the agents acting for competing clients. Similarly, Lord Millett said clients of auditing firms "are taken to consent to their auditors acting for competing clients, though they must of course keep confidential the information obtained from their respective clients" (at 235). Even if one accepts that a fiduciary relationship exists between an auditor and its client, it is difficult to see how simultaneously providing auditing services to separate clients could breach an obligation to avoid conflicts. Significant industry differences prevent parallels being drawn between the auditing context and that under consideration in this article.

[137] *Kelly v Cooper* [1993] AC 205 at 215.

[138] *Kelly v Cooper* [1993] AC 205 at 214.

[139] The other basis for implying such a term – the client's knowledge – can only be addressed in the context of a particular relationship involving individual parties and so is not explored further here.

Much proprietary trading and principal investing by investment banks would fall into this category. Where a firm trades or invests its own money as principal in a transaction that has no connection to a service it is providing to a client, it strains credulity to suggest that the activity is "necessary" – in the sense intended by the Privy Council – for performing the financial advisory function or investment banking functions more broadly.[140]

Second, what is the commercial context in which the financial advisory relationship is situated and how are investment banks organised? Courts should exercise caution in answering these questions. Modern investment banks innovate rapidly, their business mix shifting as they search out ever-more lucrative business opportunities.[141] This reflects the nature of the markets in which they operate as well as the incentives produced by their employee remuneration structures and by publicly reporting their financial results. In recent years, for example, many investment banks have come to rely heavily for their revenue on private equity operations and proprietary trading.[142] But this experience has not been uniform, as is illustrated by the recent experience of Morgan Stanley, one of the world's leading investment banks. In 2004 it divested its private equity arm amid concerns that conflicts of interest would arise from competing with clients for takeover opportunities.[143] Other investment banks adopted the same course.[144] In September 2006, however, the firm announced that it would return to this business,[145] possibly in response to the significant private equity returns being achieved by investment banks that did not divest these operations.

In view of this rapid industry change and the varying approaches adopted by investment banks, it is unlikely that a snapshot of current investment banking practices will have enduring benefit for identifying the commercial context in which the financial advisory relationship is situated or how firms are organised. Indeed, judicial attempts to mould fiduciary obligations according to what may be described as "commercial reality" is likely to add to regulatory uncertainty for investment banks.

Third, whatever changes may have occurred in the industry, it is another matter whether clients' expectations of their advisers have adapted. One recent observable trend on the part of clients is to engage more than one financial adviser on a transaction.[146] Where one adviser is an integrated investment bank, it is not unusual for the other to be an independent advisory firm, an investment bank that largely restricts its activities to providing financial advisory services (its business structure thus diminishing the prospect of conflicts of interest). Indeed, independent firms are often retained to

[140] An example of proprietary trading (as the expression is commonly understood) that is connected to a service being provided to a client is where shares are purchased on the investment bank's own account as a hedge against derivatives sold to a client.

[141] See Thal Larsen P, "Banks Face Big Test to Keep Clients", *Financial Times* (31 May 2006): "[In the past five years] investment banks have expanded into other areas, partly by using their own capital. Proprietary trading is now a significant source of income for many investment banks while some … have also become prominent private equity investors."

[142] It has been suggested that "[h]istorically low interest rates and relatively calm markets in the last few years have allowed a new type of firm to flourish, one that acts primarily as a trader and only secondarily as a traditional investment bank, underwriting securities and advising on mergers". Note also that "many investment banks now do more trading than all but the biggest hedge funds"; "[w]hat's more, [investment] banks are jumping into the realm of private equity, spending billions to buy struggling businesses as far afield as China that they hope to turn around and sell at a profit. With $25 billion of capital under management [Goldman Sachs'] private equity arm itself is one of the largest buyout firms in the world." See Thornton E, et al, "Inside Wall Street's Culture of Risk", *Business Week Online* (12 June 2006), p 52. See also Rosenbush S, "Investment Banks Jockey for Position", *Business Week Online* (30 June 2006) (reporting that trading operations are providing a rising share of bank's profits).

[143] "Banks and buyouts: Follow the money", *The Economist* (14 October 2006), p 82; Morgan Stanley, "Morgan Stanley Appoints Stephen Trevor and Alan Jones as Co-Heads of Newly Established Private Equity Business Within its Asset Management Division", *Press Release* (26 September 2006); Werdigier J and Cimilluca D, "Morgan Stanley Risks M&A Fees by Emulating Goldman Sachs's LBO's", *Bloomberg.com* (9 October 2006).

[144] See, eg Dai S, "Goldman Sachs Raises $10B Mezzanine Fund", *Dow Jones Newswires* (30 September 2006): "Many [investment banks have] gotten out of [private equity] altogether in an effort to avoid angering buyout shops, who are some of their biggest fee-generating clients."

[145] "Banks and buyouts: Follow the money", *The Economist* (14 October 2006), p 82.

[146] Maiden M, "When Bankers Collide", *The Age* (3 June 2006). The following comment is attributed to Mr John Wylie: "The fact is, the model the client increasingly prefers is a big bank with a boutique bank [independent advisory firm] side by side: clients feel that both types of organisations bring something to the party."

 © LAWBOOK CO.

provide "a counterpoint to the advice of integrated firms".[147] Whether this trend reflects weakened expectations of integrated firms as financial advisers is doubtful – certainly the firms themselves would strongly resist any suggestion that their standard of loyalty is any weaker than that of their "independent" rivals. Instead, the development may reflect concern by clients about the ability of integrated firms to meet the expected standard of loyalty, although this is a harsh assessment. In any case, it would be an odd state of affairs if the business structure or organisational nature of an investment bank attenuated its obligation of loyalty (either because the structure represented the commercial context to which fiduciary obligations yielded or because clients had diminished expectations of loyalty of such firms) since that could result in it owing a less exacting standard of conduct than its co-adviser on the same transaction.

As to the parameters of the obligation imposed on financial advisers, the guidance provided by existing case law is most instructive. In *Commonwealth Bank of Australia v Smith*, the obligation of the adviser – itself a financial services conglomerate – was to "avoid, without informed consent, placing [itself] in a position of conflict between duty and personal interest"[148] and in *Aequitas*, the obligation was similarly expressed as prohibiting positions of conflict between duty and personal interest "in the absence of full disclosure to and consent by" the client.[149] Considering the three issues discussed above and taking into account the reasonable expectations of undivided loyalty of the financial advisory client, a fiduciary obligation to avoid conflicts of interest, in the absence of informed consent, arises in the relationship between a financial adviser and its client on a change-of-control transaction. This is unsurprising since the "distinguishing obligation" or "core liability" of a fiduciary is the obligation to demonstrate "single-minded loyalty" to the person to whom the duty is owed.[150]

Overlap with duty to protect confidential information

In many contexts, an action for breach of the duty to protect confidential information offers an alternative to an action for breach of fiduciary duty.[151] After all, the underlying rationale for both duties is the same – namely, to intervene in cases of breaches of trust and confidence.[152] While the duty to protect confidential information will be owed by the investment bank in the context in question,[153] there will be circumstances where the actions are not substitutes. For example, the fiduciary obligation may be breached even where no "actual or threatened misuse of that information" has occurred, which must be made out for protection of confidential information.[154] The possible conflict in *Darvall*, described above, is such a case. Another distinction is that, while the use of Chinese walls and other measures such as undertakings can be effective to prevent what would

[147] Augar, n 10 at 32. According to Thomson Financial, a research firm, independent advisory firms advised on 55% of the 20 largest merger transactions announced in 2005: "Boutique banks: Niche market", *The Economist* (26 August 2006), p 58.

[148] *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390 at 392.

[149] *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd)* (2001) 19 ACLC 1006 at 1065.

[150] *Bristol and West Building Society v Mothew* [1998] Ch 1 at 18.

[151] Glover, n 36 at [4.58], [6.6]-[6.17] and see, eg *United Pan-Europe Communications NV v Deutsche Bank AG* [2000] 2 BCLC 461.

[152] Parkinson P, *The Principles of Equity* (2nd ed, Lawbook Co, 2003) at [207], [1016]. The duty to protect confidential information prohibits persons who receive information of a confidential nature in what the law regards as circumstances of confidence from making unauthorised use of that information. Glover, n 36 at [6.10].

[153] The relationship between an investment bank and its financial advisory client is a situation where this duty arises: this would appear to be implicit in the decision of *Mannesman AG v Goldman Sachs International* (unreported, High Court of Justice of England and Wales, Chancer Division, Lightman J, 18 November 1999).

[154] *Corrs Pavey Whiting & Bryne v Collector of Customs (Vic)* (1987) 14 FCR 434. In comparison, fiduciary principles may apply where there is no misuse of confidential information: *Oceanic Life Ltd v HIH Casualty & General Insurance Ltd* (1999) 10 ANZ Insurance Cases 61-438.

otherwise be a breach of confidence,[155] they will not always protect a fiduciary from breaching his or her duty to avoid conflicts[156] – a significant consideration in the context of investment banking where the use of Chinese walls is widespread.[157]

The importance of the fiduciary question is also supported by the observations that less stringent remedies are traditionally available against defaulting recipients of confidential information than against defaulting fiduciaries[158] and that fiduciary law requirements are increasingly imported into tests of whether a confidence should be protected.[159]

Remedial consequences of breach and accessorial liability

A distinctive remedial regime applies for breach of fiduciary obligation. The fiduciary is required to account for any profits or make good any losses arising from the breach.[160] Other remedies include a decree that benefits are held on constructive trust for the party to whom the duty was owed[161] and an injunction to restrain the breach.[162] In the case of an investment bank providing financial advisory services in breach of its obligation to avoid conflicts, a client would most likely seek an injunction to restrain the breach or an account of any profits made in breach of the obligation.

Individual bankers and other employees of the firm may also be exposed to liability. These individuals may be subject to the equitable remedies that are available against the fiduciary where they

---

[155] The wall will be effective where it eliminates any real risk of disclosure of confidential information: *Bolkiah (Prince Jefri) v KPMG* [1999] 2 AC 222 at 237. Information barriers will be effective provided the court is satisfied on the basis of clear and convincing evidence that all effective measures have been taken to ensure that no disclosure of the confidential information will occur: at 237-238. This analysis has been embraced in Australia: eg *Newman v Phillips Fox* (1999) 21 WAR 309 at 315 and *Bureau Interprofessionnel Des Vins De Bourgogne v Red Earth Nominees Pty Ltd (t/as Taltarni Vineyards)* [2002] FCA 588. See Tuch A, "Contemporary Challenges in Takeovers: Avoiding Conflicts, Preserving Confidences and Taming the Commercial Imperative" (2006) 24 C&S LJ 107.

[156] The view of the United Kingdom Law Commission is that, as a matter of law, Chinese walls do not afford the type of protection that is needed for a firm to carry on its functions with the degree of assurance that the wall is intended to provide: Law Commission (UK), *Fiduciary Duties Consultation Paper*, n 12 at [4.5.25]; see also Law Commission, *Fiduciary Duties and Regulatory Rules* (1995) Report No 236 ("Fiduciary Duties Report") at [2.16] and [7.15]. Professor Finn has observed that "Chinese walls are not a loyalty engendering device … and they simply do not address the vice which inheres in a concurrent adverse representation. They provide no substitute for the informed consent requirement of the duty of loyalty". He has also doubted the assertion that "a wall between the separate parts of the firm acting for the several parties produces, in effect, separate representations for them" since it does "not overcome the institutional interest in the firm of retaining both clients and of carrying the matter to its completion." (See Finn, *Conflicts of Interest and Professionals*, n 57, pp 36-37). The same doubt as to the effectiveness of a Chinese wall would exist in the case where it separates one part of a firm that is acting for a client and another part that is acting (on the firm's own account) contrary to that client's interests.

Chinese walls may be effective in some transactions where, on the basis of the decision in *Kelly v Cooper* [1993] AC 205, there is an express contractual term between the firm and client limiting the scope of fiduciary obligations and giving effect to Chinese walls. Such a contractual term might provide that the firm uses Chinese walls and that the client is not entitled to any information which the actual member of the firm with whom he or she deals does not have in his or her possession: Law Commission (UK), *Fiduciary Duties Report* at [3.34]. The Law Commission observes (at [3.34]), however, that "where Chinese walls are used to manage conflicts, such express terms may be insufficient on their own to avoid liability for breach of a firm's duty not to put itself in a position where its own interests conflict with those of the customer, or where it owes conflicting duties to another customer, since they neither disclose expressly the fact that such conflicts may exist, nor seek to vary those duties".

[157] A survey by United Kingdom Law Commission of England and Wales indicated that Chinese walls are very widely used in organisations offering financial services: Law Commission (UK), *Fiduciary Duties Consultation Paper*, n 12 at [4.5].

[158] Glover, n 36, p 309.

[159] Glover, n 36, p 309.

[160] See *Tang Man Sit (Deceased) v Capacious Investments Ltd* [1996] AC 514; [1996] 2 WLR 192; [1996] 1 All ER 193 and *Warman International Ltd v Dwyer* (1995) 182 CLR 544.

[161] See, eg *Timber Engineering Co Pty Ltd v Anderson* [1980] 2 NSWLR 488.

[162] See, eg *Marks and Spencer Group plc v Freshfields Bruckhaus Deringer* (unreported, 3 June 2004, CA (Civ Div).

 © LAWBOOK CO.

induce or assist in the breach of obligation by the fiduciary.[163] This accessorial liability of the individual may arise even though he or she owed no fiduciary obligation to the client and even where the fiduciary is an incorporated entity.[164] While judicial views have diverged on the touchstone of liability – namely whether dishonest assistance or knowing assistance by the individual is required[165] – it is tolerably clear that the active and knowing participation by an individual banker or other employee in the breach by the investment bank of its fiduciary obligation would expose him or her to accessorial liability.[166]

Summary

This part of the article has considered whether, under general law, investment banks providing financial advisory services are obliged to avoid conflicts of interest. Investment banks do hold themselves out as experts in providing financial advisory services and do undertake to provide those services. Furthermore, advice that constitutes financial advisory services is the very type of work that has founded the existence of a fiduciary relationship in case law commencing with the decision in *Daly*. Also, in view of the circumstances of the relationship, a reasonable expectation exists that an investment bank will act in its client's interests for purposes of the transaction and there are compelling public policy reasons supporting this position. It may also be said, based on the normative proposition that a fiduciary relationship should exist where the reasonable expectations criterion is satisfied, that fiduciary obligations in this context *should* be owed.

It follows that, in the absence of informed client consent, an investment bank is obliged under general law to avoid positions where, in providing financial advisory services, its interests or duties conflict with the interests of its financial advisory clients.

PROVISION OF FINANCIAL ADVISORY SERVICES: THE STATUTORY QUESTION

Financial services licence obligations

This part considers the content of the statutory conflicts management obligation (referred to as the "statutory obligation") and its application to integrated investment banks that provide financial advisory services. Inserted into the *Corporations Act 2001* (Cth) by the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth) (CLERP 9 Act), the obligation came into force on 1 January 2005 and is part of a licensing regime for providers in Australia of financial services.[167] The obligation requires licensees to "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 … in the provision of financial services as part of [their] financial services business".[168]

---

[163] See *Barnes v Addy* (1874) LR 9 Ch App 244 at 251; *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373; *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504 at 523; 133 ALR 1; *Royal Brunei Airlines Sdn Bhd v Tan Kok Ming* [1995] 2 AC 378; Dal Pont GE and Chalmers DRC, *Equity and Trusts in Australia and New Zealand*, (2nd ed, LBC Information Services, 2000) pp 971-973.

[164] *Royal Brunei Airlines Sdn Bhd v Tan Kok Ming* [1995] 2 AC 378 at 389-392.

[165] The more recent view appears to be that dishonesty, objectively determined, is required. See *Royal Brunei Airlines Sdn Bhd v Tan Kok Ming* [1995] 2 AC 378 at 389-392; *Hancock Family Memorial Foundation Ltd v Porteous* (1999) 151 FLR 191 at 208-209; 32 ACSR 124; Dal Pont and Chalmers, n 163 at 971. See also, for support of the requirement of "knowing assistance", *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373; Glover, n 36, at [8.14]-[8.18]. As to the controversies existing about the appropriate touchstone of liability, see *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504 at 523; 133 ALR 1.

[166] See *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373 at 397. Furthermore, these individuals may be similarly liable where they participate in a breach of the duty of confidence. See Meagher RP, Heydon JD and Leeming MJ, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (4th ed, Butterworths, 2002) at [41-035], [41-110].

[167] *Corporations Act 2001* (Cth), s 911A(1). See Pt 7.6 of the Act for the licensing regime.

[168] *Corporations Act 2001* (Cth), s 912A(1)(aa). See also Australian Securities and Investments Commission, Policy Statement 181, *Licensing: Managing Conflict of Interest* [PS 181] at [PS 181.16].

The obligation is imposed on those required to be licensed, being persons who carry on a "financial services business" in Australia,[169] which means a business of providing "financial services" as defined in the Act.[170] Many integrated investment banks provide these services and thus are required to hold licenses.[171] However, this is not to say that the provision of financial advisory services, as described above in the discussion of the adviser-client relationship, constitutes "financial services" for the purposes of the licensing regime, an issue discussed below.

The obligation supplemented a number of existing obligations owed by licensees, including the obligation to provide financial services "efficiently, honestly and fairly".[172] This sets a standard of conduct for licensees to act having regard to the dictates of efficiency, honesty and fairness.[173] While a licensee's conduct in responding to any situation of conflicts of interest is relevant to determining whether the efficiency obligation has been met,[174] the addition of a new obligation in different terms which specifically address conflicts of interest suggests that legislature did not intend the new obligation to be given the same meaning as the existing one. Indeed, the terms of the obligations indicate that neither their content nor scope is identical. This is not to doubt that the same conduct may breach both obligations or that case law interpreting the efficiency obligation may assist with interpreting the other, but to assert that the new obligation is independent and that the interpretation of its terms must reflect this.

The qualification in the conflicts management obligation that the conflicts arise "wholly, or partially" in relation to financial services activities is significant. According to the Explanatory Memorandum for the CLERP 9 Act, the obligation applies to conflicts "other than those that occur wholly outside the financial services business of the licensee or its representative".[175] Two categories of conflicts would be caught by the obligation, the Explanatory Memorandum explains. The first – conflicts wholly within the financial services business – encompasses both "conflicts [arising] within one area of the financial services business" and conflicts "across different areas of the [financial

[169] *Corporations Act 2001* (Cth), s 911A(1).

[170] *Corporations Act 2001* (Cth), s 761A. A person "provides a financial service" by performing any one of a number of activities listed in s 766A(1), including (a) providing financial product advice, (b) dealing in a financial product and (c) making a market for a financial product.

[171] The broad and diverse range of products and services offered by the integrated investment bank typically includes activities that, for purposes of the licensing regime, constitute providing a "financial service": see *Corporations Act 2001* (Cth), s 766A(1). For example, investment banks commonly will deal in a financial product (s 766A(1)(b)) and make a market in a financial product (s 766A(1)(c)): see Tuch, n 4.

[172] *Corporations Act 2001* (Cth), s 912A(1)(a).

[173] *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 at 672: "[T]he group of words 'efficiently, honestly and fairly' must be read as a compendious indication meaning a person who goes about their duties efficiently having regard to the dictates of honesty and fairness, honestly having regard to the dictates of efficiency and fairness, and fairly having regard to the dictates of efficiency and honesty."

[174] In *Re Saxby Bridge Financial Planning Pty Ltd and Australian Securities and Investments Commission* (2003) 46 ACSR 286 at [293]-[310] evidence of a conflict of interest by a licensee, while relevant, was not sufficient to persuade the Administrative Appeals Tribunal that the licensee had not performed, or would not perform, its duties "efficiently, honestly or fairly." In *Re Campbell and Australian Securities and Investments Commission* (2001) 37 ACSR 238 and *Re Foster and Australian Securities and Investments Commission* (1999) 57 ALD 779, evidence of the licensee's conduct in response to conflicts of interest was sufficient to demonstrate that the licensee had not acted "efficiently, honestly and fairly". It is apparent from these cases that this efficiency obligation provides limited guidance to a licensee about precisely how to respond when faced with a conflict of interest (and whether conflict avoidance was required). In contrast, the court in *RJ Elrington v Corporate Affairs Commission (SA)* (1989) 1 ACSR 93 at [38] suggested that the efficiency obligation required a licensee to avoid conflicts: "[T]he [licensee] has failed to perform its duties efficiently, honestly and fairly. The [licensee] has a duty to act in the best interests of its clients and it should not have put itself in a position where its own interests and those of its clients conflicted. It did this. In this regard the dealings were neither honest nor fair. It is clearly in the public interest that a [licensee] which is prepared to put its own interests before that of its clients should not be allowed to continue to deal." In light of other cases and giving overriding effect to the terms of the efficiency obligation itself, it is unlikely that it can be equated with an obligation to avoid conflicts.

[175] Commonwealth, Parliament, *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 Explanatory Memorandum* (CLERP 9 Explanatory Memorandum) at [5.597].

 © LAWBOOK CO.

services] business".[176] The second – conflicts partially within the financial services business – encompasses "conflicts between something within the financial services business and something outside the financial services business".[177] Excluded from the scope of the obligation, according to the Explanatory Memorandum, are "conflicts outside the financial services business", being conflicts "where a factor outside the financial services business gives rise to a conflict with another factor outside the same financial services business".[178]

The statute was not intended to require the management of all conflicts involving the operations of a licensee, but only management of those conflicts with the required connection to activities of the licensee relating to its provision of financial services. In the context of an integrated investment bank, the obligation would apply to conflicts between its duty to a client or customer to whom it is providing financial services (as defined in the statute) and either first, its self-interest or second, its duty to, or the interests of, another client or customer, whether or not the investment bank is providing financial services to it. To put it another way: the statute requires that arrangements be in place to manage any conflict with a duty to, or the interests of, a client or customer to whom financial services are provided (being a client of the firm's financial services business). This would capture a conflict between, on the one hand, that duty or those interests and, on the other hand, either first, the firm's self-interest in undertaking an activity (within or outside its financial services business) or second, any duty to, or the interests of, a client to whom the firm does or does not provide financial services. For example, the statute will regulate conflicts arising between the interests of customers to whom an investment bank provides independent research reports (being an activity within its financial services business) and a duty to or the interests of a corporate lending client (corporate lending being an activity outside its financial services business).[179]

The Explanatory Memorandum describes legislature's regulatory approach as being "principles-based",[180] involving the imposition of a broad standard of conduct rather than the prescription of specific rules.[181] This approach demonstrates that more concern was shown for the higher compliance costs and reduced flexibility associated with specific rules than the "greater clarity and certainty" they would have offered.[182] Under the approach, it was envisaged that licensees would have "primary responsibility for determining the processes and procedures necessary to ensure compliance" with the obligation[183] and would be assisted in this regard by guidance from the Australian Securities and Investments Commission (ASIC).[184]

Application to financial advisory services

At issue here is whether the provision of financial advisory services by an investment bank on a transaction constitutes providing "financial services" under the statute.[185] Although the licensing regime is wide-ranging, it appears that in many – but not all – instances, providing these services will not constitute "financial services".

[176] CLERP 9 Explanatory Memorandum, n 175 at [5.599] (Category 1).

[177] CLERP 9 Explanatory Memorandum, n 175 at [5.599] (Category 2).

[178] CLERP 9 Explanatory Memorandum, n 175 at [5.599] (Category 3).

[179] According to the CLERP 9 Explanatory Memorandum, n 175 at [5.599], "publishing research in a client newsletter" is within a licensee's financial services business (see Category 1) and "corporate lending" is outside a licensee's financial services business (see Category 3).

[180] CLERP 9 Explanatory Memorandum, n 175 at [5.598].

[181] See CLERP 9 Discussion Paper, *Corporate Disclosure: Strengthening the Financial Reporting Framework* (18 September 2002), pp 118-119.

[182] According to the CLERP 9 Discussion Paper, prescribing specific rules of conduct to manage conflicts would have produced "greater clarity and certainty for licensees about how they should manage and disclose relevant conflicts of interest and a more consistent standard across the industry", but would have imposed higher compliance costs and reduced the flexibility of licensees in deciding how to comply with the obligation (pp 118-119).

[183] See CLERP 9 Discussion Paper, p 119.

[184] CLERP 9 Explanatory Memorandum, n 175 at [5.598].

[185] *Corporations Act 2001* (Cth), s 761A.

The *Corporations Act* defines providing financial services as meaning any of the following:[186]

(a) providing financial product advice;
(b) dealing in a financial product;
(c) making a market for a financial product;
(d) operating a registered scheme;
(e) providing a custodial or depository service; or
(f) engaging in conduct of a kind prescribed by regulations.

In many cases the provision of financial advisory services will not constitute any of the activities in paragraphs (a) to (e), taking into account the statutory meanings of each and the licence obligations imposed in respect of them.[187] However, in some transactions, particularly those of considerable size or significance, the provision of financial advisory services may encompass advising on products designed to mitigate risks associated with transactions, including interest rate and currency risks;[188] this will likely constitute "providing financial product advice". Accordingly, for many investment banks, the likelihood that they may provide such advice in the course of providing financial advisory services will make it advisable that they hold financial services licences and thereby owe the conflicts management obligation.

Whatever one's view on this question, it is clear that the activities that constitute providing financial services set out above[189] will be provided by an integrated investment bank (for example, providing independent research reports),[190] which will therefore be required to hold a licence "covering the provision of [those] financial services".[191] Correspondingly, even where the provision of financial advisory services does not constitute the provision of "financial services" for the purposes of the licensing regime (and so is considered outside the licensee's financial services business), conflicts involving that aspect of an integrated investment bank's business may be subject to the statutory conflicts management obligation because, as discussed above, conflicts arising "partially" in relation to financial services activities of a licensee are within its scope.

Meaning of conflict management obligation and co-existence with fiduciary obligation

The expression "management of conflicts of interest" is nowhere defined in the statute and it is not one on which Australian or English courts appear to have opined. However, the Explanatory Memorandum indicates that complying with the obligation will encompass "ensuring that there is adequate disclosure of conflicts to investors … [and requiring] internal policies and procedures for preventing and addressing potential conflicts of interest that are robust and effective".[192] This suggests, as does the ordinary meaning of the word "management" (being the act of handling, controlling, administering or dealing tactfully with),[193] that the obligation is not a fixed standard. Moreover, the reference to "adequate" arrangements suggests that the arrangements must be suited to the particular circumstances of each conflict situation. This interpretation of the obligation is consistent with the legislative approach of imposing a broad principle – rather than providing specific rules or prescribing or proscribing particular conduct – to regulate licensee responses to conflicts. The

[186] *Corporations Act 2001* (Cth), ss 761A and 766A(1).

[187] Furthermore, no exemption appears to apply; in particular, s 911A(2)(g) does not apply since the Australian Prudential Regulation Authority (APRA) does not regulate the financial advisory operations of investment banks.

[188] See, eg The Goldman Sachs Group Inc, Form 10-K (Annual Report), n 1, p 5.

[189] *Corporations Act 2001* (Cth), s 766A(1).

[190] See CLERP 9 Explanatory Memorandum, n 175 at [5.599] (Category 1).

[191] *Corporations Act 2001* (Cth), s 911A(1). The obligations of licensees apply only in respect of the "financial services covered by the licence" and so the investment bank would not be subject to those obligations in respect of its financial advisory services operations.

[192] CLERP 9 Explanatory Memorandum, n 175 at [5.597].

[193] According to the *Chambers Dictionary* (Edinburgh, 2000), "management" means the art or act of managing, and the transitive verb "manage" means (selectively) to handle, to conduct, to control, to administer and to deal tactfully with.

© LAWBOOK CO.

conflict management obligation is thus one of variable content: the adequacy of arrangements required to discharge it will vary according to the nature of the conflict and other circumstances.

An important further question is whether the obligation will require conflict avoidance in some cases, consistent with the fiduciary standard, or will in all cases be satisfied by conduct falling short of this, such as some combination of disclosure and internal controls. Leaving aside for the time being ASIC's guidance on this question, two points can be made. The first is that the reference (above) in the Explanatory Memorandum to "preventing" conflicts suggests that the legislature intended to prohibit some conflicts, and correspondingly, that in some circumstances licensees may discharge the statutory obligation only by avoiding a position of conflicting interests.[194]

Second, it is possible to conceive of circumstances where any conduct of a licensee falling short of conflict avoidance would be a response so unreasonable that the legislature could not have intended it to satisfy the statutory obligation. Consider three examples. Take as the first an investment bank (to which the statutory obligation applies) that is retained by Company X to advise on its proposed acquisition of Company Y, a company known to have entrenched management resistant to ceding control. Could the investment bank simultaneously advise Company Y on its defence? While the duty to protect confidential information would preclude the same individual bankers from also acting for Company Y, it would not prevent a different team within the firm from acting for Company Y where an effective Chinese wall eliminated any real risk of disclosure of confidential information from one team to the other.[195] Ignoring any fiduciary obligations that may exist and assuming the consent of Company X is not obtained (which the company is at liberty to withhold), could this arrangement, or any other arrangement, be considered to manage the obvious conflict for the purposes of the statutory obligation such that the firm could represent both sides on the transaction?

Once advisers learn that their counterparts on the transaction are colleagues (as they inevitably would when the deal is publicly announced), their ability to act vigorously in their client's interests would be compromised and damage would likely result to public confidence in the integrity of financial markets. In these circumstances, the statutory obligation could only require conflict avoidance, meaning that the firm would fail to discharge its statutory obligation by adopting any arrangement other than declining Company Y's instruction.

Second, consider whether the same investment bank, while advising Company X on its proposed bid for Company Y, could – through a separate, Chinese wall-insulated division of the firm (such as its private equity arm) – prepare and make a competing bid by the investment bank itself for Company Y?[196] Leaving aside any existing fiduciary obligations and the question of informed consent (which again could be withheld), it is contended that no arrangement that sustains this state of affairs would discharge the statutory obligation. Indeed, the statutory obligation would be little more than an empty legislative gesture were it not to require conflict avoidance in this instance.

Third, consider the related situation of the investment bank which, while advising Company X on its proposed takeover of Company Y, purchases through its proprietary trading division a stake in Company Y that could block Company X's proposed takeover (again assuming no breach of the duty of confidence). The legislature could not have intended to leave an investment bank free to engage in such conduct.

ASIC's policy guidance supports this view that the statutory obligation has variable content and may require conflict avoidance.[197] The guidance indicates to the marketplace how ASIC will interpret the law that it has responsibility for administering, without having the force of law. ASIC asserts that

[194] See CLERP 9 Explanatory Memorandum, n 175 at [5.597].

[195] See *Bolkiah (Prince Jefri) v KPMG* [1999] 2 AC 222 at 237.

[196] In view of the greater significance that the private equity operations of investment banks have assumed in recent years as revenue drivers of these banks, the possibility of an investment bank competing with its client for an investment cannot be regarded as fanciful: see, eg Thornton E, et al, "Inside Wall Street's Culture of Risk", *Business Week Online* (12 June 2006); "Goldman Sachs: Behind the Brass Plate", *The Economist* (29 April 2006) p 70.

[197] Australian Securities and Investments Commission (ASIC), Policy Statement 181, *Licensing: Managing Conflict of Interest* [PS 181], [PS 181.21].

arrangements to manage conflicts will be "measures, processes or procedures" that control, avoid or disclose conflicts[198] and will depend on the "nature, scale and complexity of the licensee's business".[199] It explains that many conflicts of interest may be managed by a combination of internal controls and disclosures,[200] but that other conflicts "have such a serious potential impact on a licensee or its clients that the only way to adequately manage [them] will be to avoid them".[201] In the latter case, mere disclosure or the existence of internal controls will not satisfy the statutory obligation.[202] Accordingly, measures falling short of putting an end to the conflict, including the use of Chinese walls, will not necessarily discharge the statutory obligation.

It is doubtful that the requirement that the arrangements be "in place" would narrow the operation of the statutory obligation. That is, it is unlikely that a licensee that simply has adequate arrangements *in place*, rather than also applying them to each conflict, would discharge the obligation. Otherwise, the obligation would be ineffective in addressing "a general unease in Australia about … the management of conflicts of interest when providing financial services", referred to in the Explanatory Memorandum.[203] Correspondingly, the statutory obligation may be breached where the arrangements in place are inadequate or where there is some defect in their application to a particular conflict of interest.

Finally, nothing in the statute or related materials suggests that the statutory regime for regulating conflicts of interest was intended to vary or displace the general law obligations of licensees. Instead, as ASIC has observed, the statutory and general law conflict-response obligations may co-exist.[204] Determining how they co-exist gives rise to difficult questions, such as how to resolve the apparent inconsistency between an obligation requiring conflict avoidance and another requiring conflict management. Whether in fact an inconsistency exists between the obligations is considered in the next section.

FIDUCIARY AND STATUTORY CONFLICT RESPONSE OBLIGATIONS: RECONCILING APPARENT INCONSISTENCIES

An inconsistency exists if the statutory obligation may be discharged by measures – such as the use of Chinese walls – that do not also discharge the fiduciary obligation to avoid conflicts. Since the use of Chinese walls is unlikely to satisfy the fiduciary obligation where a conflict of interest exists,[205] an inconsistency arises if their use is taken to be an arrangement that satisfies the statutory obligation. Nothing in the statute suggests that an investment bank that discharges the statutory obligation is immune from penalty under general law; thus, if this inconsistency exists, an investment bank may have discharged its statutory obligation but nevertheless be in breach of its fiduciary obligation.

The real question is, what conduct (or "arrangements", to use the statutory expression) does the statutory obligation require of an investment bank providing financial advisory services? This article asserts that courts must have regard to fiduciary doctrine in answering this question. More specifically, it asserts that the statutory obligation requires conflict avoidance where fiduciary doctrine imposes that obligation – where, on the facts, a fiduciary relationship exists between the licensee and its client such that the licensee is obliged to avoid positions of conflict. Arrangements adequate for conflict management in this situation are those that, in the absence of informed client consent, put an end to the conflict.

---

[198] ASIC, n 197, [PS 181.32].

[199] ASIC, n 197, [PS 181.10].

[200] ASIC, n 197, [PS 181.27].

[201] ASIC, n 197, [PS 181.42].

[202] ASIC, n 197, [PS 181.42].

[203] CLERP 9 Explanatory Memorandum, n 175 at [5.594].

[204] See ASIC, n 197, [PS 181.5], [PS 181.19].

[205] See n 156 and surrounding text.

 © LAWBOOK CO.

This approach reconciles the apparent inconsistency between the obligations. It is consistent with legislature's intention that the statutory obligation would respond to general concerns about both conflicts of interest in the financial services industry[206] and (it is reasonable to infer) the adequacy of the existing regime for dealing with them. The approach also promotes clarity by looking to fiduciary doctrine for guidance about when the statutory obligation requires conflict avoidance. It draws upon doctrine that expresses how a society, as represented by courts, may wish to regulate the conduct of persons in important relationships.[207] In doing so, the approach maintains public confidence in the integrity and utility of these relationships.[208] It also recognises that, in introducing the statutory obligation, legislature did not intend to require of licensees a less onerous standard of conduct than they already owed.

An opposing position was suggested by the United Kingdom Law Commission – that the fiduciary obligation might yield to an inconsistent regulation.[209] In the Australian context, this view is unconvincing. To start with, the content of the statutory obligation is broad and unspecific; requiring fiduciary doctrine to accommodate it would contribute to regulatory confusion. Moreover, it would be a remarkable (and unintended) consequence of introducing a statutory obligation to address concerns about conflicts of interest if it attenuated fiduciary obligations and thereby eroded the protections available to and the reasonable expectations of loyalty of financial advisory clients.

None of this is to assert that the statutory and fiduciary obligations are coextensive in their scope of operation. The fiduciary obligation may arise in specific circumstances, such as those discussed in this article. In contrast, the statutory obligation has a far broader operation, since it is imposed on a licensee that provides financial services, whether or not the licensee is acting in a fiduciary capacity. It is contended, however, that where a financial adviser acting on a change-of-control transaction is subject to both obligations, they are coextensive in content.

This approach does not give the statutory obligation a restrictive operation since it accommodates the principle that no fiduciary breach arises where a client has provided informed consent to a conflict. Such consent would be an "adequate arrangement" for the purposes of the statute. In contrast, contractual techniques for varying or displacing the fiduciary obligation may not be "arrangements" under the statute, although this will depend on their form. Accordingly, where these techniques prevent a fiduciary breach from occurring, it may be that a licensee nevertheless breaches the statutory obligation.

The approach suggested in this article is consistent with ASIC's guidance that some conflicts must be avoided, but may run counter to the regulator's instruction that the statutory obligation requires avoidance of conflicts that have "a serious potential impact on a licensee or its clients".[210] This is because the judicial approach for determining the incidence of fiduciary obligations takes no account of the impact of a conflict.[211]

Finally, a comparison of the remedies available to a financial advisory client under the statutory and fiduciary regimes reveals an important distinction.[212] Overlap in the remedial regimes does exist:

[206] See CLERP 9 Explanatory Memorandum, n 175 at [5.592]-[5.597].

[207] See Finn, n 36, pp 3, 26, 27, 42.

[208] See Finn, n 36, pp 3, 26, 27, 42.

[209] The United Kingdom Law Commission explained that where an inconsistency exists between a regulatory rule and fiduciary obligation, courts should and (although the question is not free from doubt) probably will take account of the rule in determining the content of the fiduciary obligation. See Law Commission (UK), *Fiduciary Duties Report*, n 156, at [11.13] and Part XIV; Law Commission (UK), *Fiduciary Duties Consultation Paper*, n 12, Parts V and VI.

[210] ASIC, n 197, [PS 181.42].

[211] See the discussion of the fiduciary question above (text accompanying n 29 onwards).

[212] It is clear that ASIC may enforce the statutory obligation. A separate question, not considered here, is whether ASIC has power under the *Australian Securities and Investments Commission Act 2001* (Cth) to intervene where an investment bank has breached its fiduciary duty to a client. Whatever the answer to this question, the reconciliation offered in this article for the apparent inconsistency between the fiduciary and statutory obligations suggests that the existence (and thus the breach) of a fiduciary obligation will be relevant where ASIC is enforcing the statutory obligation.

generally speaking, the client may seek an injunction or damages for breach by the adviser of either of its obligations – fiduciary or statutory.[213] At the same time, an account of profits will be available only for breach of the fiduciary obligation. This remedy protects the interests of a client by deterring its adviser from being swayed by considerations of personal interest and from actually misusing its position for personal advantage.[214] This distinction reinforces the fiduciary character of the relationship between an investment bank and its financial advisory client since without the existence of fiduciary obligations a client's interests may not be "adequately protected" in the relevant sense.[215]

CONCLUSION

Integrated investment banks regularly provide financial advice to parties in change-of-control transactions. This article has considered the business structure of these firms and the potential it creates for conflicts of interest to occur with the interests of financial advisory clients. It is against this backdrop that obligations of investment banks to respond to conflicts of interest assume great significance. The analysis in this article indicates that, from both positive and normative perspectives, compelling arguments exist for regarding the relationship between an investment bank and its financial advisory client as fiduciary in character such that the obligation to avoid conflicts arises.

Investment banks may also be subject to the statutory obligation to have in place adequate arrangements for the management of conflicts of interest, an obligation apparently inconsistent with the fiduciary obligation. The content of the fiduciary obligation will inform the content of the statutory obligation, this article has argued, with the result that where both obligations apply to an investment bank providing financial advisory services, the statutory obligation will require conflict avoidance where that response is obliged by fiduciary doctrine. This approach to resolving the apparent inconsistency is consonant with the purpose of the legislation that introduced the statutory obligation. It also promotes regulatory certainty and prevents the fiduciary protections and reasonable expectations of financial advisory clients being eroded by interpreting the statute in another way.

[213] It is likely that a financial advisory client could seek an injunction or damages under *Corporation Act 2001* (Cth), s 1324 for conduct that contravened or would contravene the statutory obligation in s 912A(1)(aa). This is because the client would be a "person whose interests have been, are or would be affected by the conduct" for purposes of s 1324(1).

[214] See *Chan v Zacharia* (1984) 154 CLR 178 at 198-199; (1984) 53 ALR 417.

[215] Whether fiduciary obligations arise may turn, in part, on whether parties' "interests are adequately protected by obligations imposed in contract, tort, unjust enrichment and so forth": Worthington, n 50.

 © LAWBOOK CO.