


2006

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Repository Citation

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Contemporary challenges in takeovers: Avoiding conflicts, preserving confidences and taming the commercial imperative

Andrew Tuch*

This article discusses contemporary legal, commercial, ethical and other issues that arise in the context of corporate takeover transactions. These transactions are of national and international economic significance, and in Australia their occurrence has reached unprecedented levels as many industries have consolidated. However, due to their complexity and the numerous parties – including deal advisers – they involve, and because of Australia’s relatively small size, the loyalties of company directors and advisers, including lawyers, are frequently tangled, creating legion opportunities for conflicted interests and breached confidences. At the same time, the high status of advising on takeovers and the financial lure they provide produce powerful incentives that inevitably inform the application of legal principles to these issues. The article adopts a hypothetical case study approach to focus on the challenges confronting the parties involved in takeovers and offers practical guidance for how they might prudently respond.

1. INTRODUCTION

Corporate takeover transactions give rise to myriad legal, commercial and ethical challenges for the companies involved and their deal advisers. In the relatively small Australian market, conflicts of interest inevitably arise, confidences are threatened and the commercial imperative must be balanced with often competing fiduciary, professional and other obligations. This article considers many contemporary challenges that arise in this context by adopting a case study approach.

The case study forming the basis of this article is hypothetical, involving the proposed strategic acquisition by one Australian Stock Exchange-listed company of another. Numerous legal and other issues, involving the companies and their deal advisers, are raised in the course of the transaction. The case study, written by the author, formed the basis of a panel discussion in the Faculty of Law at the University of Sydney in 2004.¹ This article provides a detailed analysis of the issues raised by the problem.²

The corporate takeover context was chosen for a number of reasons. First, takeovers are complex, involving both numerous advisers – including lawyers, investment bankers and valuation experts – and many areas of law, such as corporate and securities regulation, contract, fiduciary principles,

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¹ “Regulating Conflict of Interests within the Commercial Law World”, Conference by the Ross Parsons Centre of Commercial, Corporate and Taxation Law, Faculty of Law, The University of Sydney, 4 June 2004.

² Except where comments are attributed to other conference participants, the author is responsible for the discussion and analysis that follows.

confidential information and legal professional privilege. They raise recurring legal and other problems, many of which are canvassed by the case study, arising from the tangled web of loyalties³ owed by many deal advisers. These advisory firms are typically large in size, which predisposes them to more frequent opportunities to abrogate obligations to avoid conflicts and protect confidences. Second, takeover transactions are highly lucrative for deal advisers⁴ and are a common basis on which they compete and are compared.⁵ This creates powerful commercial incentives for firms to accept instructions to work on these matters, even in the face of legal or other impediments. Third, the transactions occur with increasing frequency in Australia – giving rise to substantially increased activity for clients and their advisers – as many industries have rapidly consolidated. Takeover activity in Australia is at unprecedented levels.⁶ Finally, the transactions themselves have widespread economic significance: by impacting business competition and employment, they often transform the financial and corporate landscape of industries and affect many thousands of people as customers or workers.

The case study approach adopted in this article offers valuable insights into questions that commonly arise during takeovers. Providing a hypothetical, but realistic, factual backdrop to legal questions gives scope for the application – rather than simply the statement – of relevant legal principles. It also allows great scope for discussion of the commercial, tactical and ethical considerations that, in this context especially, cannot be divorced from the law. Furthermore, since in practice many of the challenges raised by the problem are resolved or managed “behind closed doors”, there is little authoritative guidance available on prudent approaches for tackling them. The article remedies this to some extent.

The article is organised as follows. Part 2 outlines the case study by introducing the main characters and the proposed takeover transaction and then details the course of the transaction, in a chronological fashion. It also poses questions emerging from the facts. These questions, and the various legal, commercial, tactical and other considerations they raise, are discussed in Part 3. Part 4 presents conclusions. For ease of reference, Schedule 1 identifies and describes the role of each client and deal adviser involved in the hypothetical transaction.

2. HYPOTHETICAL CASE STUDY

After describing the corporate takeover proposed, this part outlines, in an incremental fashion, the course of that transaction, including the appointment of deal advisers. The unfolding facts in each sub-part raise legal and other questions that call for a response by the relevant company or adviser.

A. The proposed transaction

Sidewood Petroleum Limited (Sidewood) is a large Australian oil and gas exploration and production company that is listed on the Australian Stock Exchange (ASX). The directors of Sidewood intend to make a cash takeover bid for the shares of its smaller competitor in the oil and gas industry, Amarillo

³ I have taken this expression from Shapiro SP, *Tangled Loyalties* (University of Michigan Press, 2005). My thanks to Deborah DeMott, who urged me to read this book.

⁴ For example, in 2004 the fees earned by investment banks in Australia from advising on mergers and acquisitions was in excess of US\$500 million: “UBS grabs top spot for Australian mergers as fees hit record” (6 December 2004) *Bloomberg.com*, <http://www.bloomberg.com/> viewed 16 March 2005.

⁵ See, eg, “BHP Billiton’s WMC bid keeps the pot boiling” in “Investment Banking Special Report”, *The Australian Financial Review* (21 July 2005) p 7; “Global merger deals a boom for advisers” in “Investment Banking Special Report”, above, p 11. See also Geisst CR, *Investment Banking in the Financial System* (Prentice Hall, 1995) p 10.

⁶ See Moullakis J, “Bumper year for M&A transactions”, *The Australian Financial Review* (2 February 2005) (reporting that the value of announced merger and acquisition transactions in Australia increased by 81% from 2003 to 2004 to a record level). See also “Boom times for mergers and acquisitions”, *The Sydney Morning Herald* (16 March 2005) p 27 (reporting the result of a study by Ernst & Young that predicted merger and acquisition activity would increase further in 2005) and Lynch D, “M&A fuels KPMG division’s growth”, *The Australian Financial Review* (6 May 2005) (reporting that takeover and capital raising activity was at record levels in 2004 and was expected to remain strong in 2005). The value in 2004 of (publicly) announced mergers and acquisitions transactions exceeded US\$102 billion: see “UBS grabs top spot for Australian mergers as fees hit record”, n 4. The value of mergers and acquisitions activity worldwide in 2004 was in excess of US\$1.4 trillion: “Despite cheap dollar, Europeans seem wary of massive US acquisitions” (7 December 2004) *The Canadian Press*; <http://www.cbc.ca/> viewed 8 December 2004.

Petroleum Limited (Amarillo) that it does not already own. The Sidewood directors believe that there are substantial synergies and new business opportunities arising from the proposed transaction and think that replacing the management of Amarillo, which they regard as inefficient, would be well received by the market. At this stage, Sidewood wants to maintain the secrecy of its intentions. It proposes for the cash bid and associated transaction costs to be externally debt-funded.

Amarillo, which is also listed on the ASX, is a mid-sized company also involved in oil and gas exploration and production.

Sidewood engages the services of the investment bank Manhattan Burnham, which is the Australian branch of a New York headquartered global financial services conglomerate.

At around the same time, the General Counsel of Sidewood approaches Stella Smart, a partner in the Sydney office of the large national law firm Stone & Simpson, on the strength of her outstanding professional reputation. He explains Sidewood's proposed transaction and asks for Stone & Simpson to represent the company. The law firm has not previously represented Sidewood, but is keen to secure the new instruction. The firm is a unified partnership, provides legal services Australia-wide, and has offices in each State capital.

B. Legal adviser conflicts: Opposing former client

Before accepting the instruction, Ms Smart conducts a firm-wide conflicts search. From this she learns that a fellow partner in Stone & Simpson's Melbourne office, Gerry Smooth, represented Amarillo in a capital raising in 1999 and, in the course of that instruction, obtained confidential information about Amarillo. The other solicitors who worked on the transaction are no longer with the firm. Gerry Smooth remembers the 1999 transaction, but says that he has forgotten the details and that, in any case, any confidential information obtained by him was publicly disclosed in the prospectus, is outdated or would be impossible to identify precisely in order for court intervention to be possible.

What should Stone & Simpson do?

After considering these issues, Stone & Simpson accepts the instruction to act on the proposed transaction for Sidewood.

C. Legal adviser conflicts: Attendance at "beauty parade"

Sidewood publicly proposes to make a takeover bid for the shares it does not already own of the unsuspecting Amarillo. Almost immediately, the board of Amarillo issues a press release branding the offer "grossly inadequate and opportunistic".

After the public proposal, Amarillo approaches the venerable law firm of Fraser & Galloway for representation and Shearson Lambert for investment banking advice. Fraser & Galloway is a unified partnership, provides legal services nationwide and has offices in each State capital. Shearson Lambert is the Australian branch of a Swiss headquartered global financial services conglomerate.

Before accepting the instruction, Fraser & Galloway conducts a conflicts search. It learns that last year lawyers from its Melbourne office attended a "beauty parade" at the request of Sidewood. The transaction proposed by Sidewood then was the proposed takeover of an unidentified company fitting the description of Amarillo. Sidewood discussed the transaction in broad terms and Fraser & Galloway gave preliminary legal advice. It was not awarded the instruction (learning later that Stone & Simpson had secured the transaction).⁷

How should Fraser & Galloway respond?

After considering the relevant issues, Fraser & Galloway accepts the instruction to represent Amarillo in the proposed transaction.

D. Legal adviser conflicts: Protecting information disclosed by potential client

During Fraser & Galloway's representation of Amarillo, an executive of Tulkinghorn Industries Limited (Tulkinghorn) approaches a litigation partner of the Melbourne office of Fraser & Galloway,

⁷ This scenario is based on circumstances discussed in Hollander C and Salzedo S, *Conflict of Interests and Chinese Walls* (2000) p 17.

Fred Fullager, asking for representation in proceedings that Tulkinghorn wants to commence against Amarillo. The executive explains that Tulkinghorn will be claiming \$50 million for breach of contract and outlines the nature of the claim in broad detail. In conducting the conflicts search, Fred Fullager learns that the Corporate group in Sydney is representing Amarillo on the proposed transaction.

What should Fred Fullager do? What use, if any, should the firm make of the information about the impending lawsuit?

Fraser & Galloway declines to act for Tulkinghorn.

E. Investment bank conflicts: Opposing former client

The investment bank Manhattan Burnham is contacted by an executive of Amarillo complaining of its representation of Sidewood in the proposed transaction. The executive mentions that Manhattan Burnham previously advised Amarillo on its business combination with another company in 2001 and, in a blinding fervour of moral indignation, demands that it withdraw from representing Sidewood. The executive concedes that different personnel are now working on the proposed transaction for Sidewood.

How should Manhattan Burnham respond? More generally, in what circumstances would it be advisable to apply to remove Sidewood's investment bank for alleged conflicts of interest?

F. Investment bank conflicts: Research analyst independence

During the course of the proposed transaction, Arthur Macquarie, the head of Investment Banking at Shearson Lambert learns that analysts in the organisation's Equity Research division have drafted and propose to issue a research report to its clients about Amarillo that is highly critical of Amarillo's management.

How should the banker respond?

G. Conflict at professional services firm: Independence of expert's report

For commercial reasons, Amarillo decides to engage the services of the Corporate Finance department of Haskins Lybrand, a major professional services firm, to provide an independent expert's report for use in opposing the proposed takeover.

Some months earlier Haskins Lybrand was asked to perform a similar exercise for another company, Kravis Pickens Limited (Kravis Pickens), which was considering making a takeover bid for Amarillo. Kravis Pickens appears to have abandoned its plans.

In addition, for some years, the Bermuda branch of Haskins Lybrand has provided external auditing services for the Bermuda subsidiary of Amarillo. It provides no other auditing services for Amarillo.

How should Haskins Lybrand respond?

H. Company director conflicts: Multiple directorships

It transpires that a non-executive director is on the board of both Sidewood and Amarillo during the period under analysis.

What are the director's obligations when, as a director of Sidewood, he or she learns of the proposed transaction?

I. Company director conflicts: Legal adviser as director of client

It further transpires that one of the non-executive directors of Amarillo is a partner at Stone & Simpson, the law firm representing Sidewood.

What are the director's obligations in these circumstances?

3. ANALYSIS: LEGAL, PRACTICAL AND OTHER RESPONSES

Using corresponding headings, this part discusses the issues raised in Part 2 and suggests responses or, in some cases, a range of responses, to the challenges presented.

A. The proposed transaction

Takeovers are regulated by Ch 6 of the *Corporations Act 2001* (Cth) and the principal forum for resolving takeover disputes under the legislation is the Takeovers Panel. It is clear that Sidewood's

proposed acquisition of Amarillo must comply with these provisions. However, they are discussed only to the extent relevant to the issues raised by the case study.

B. Legal adviser conflicts: Opposing former client

Having formerly represented Amarillo in 1999, Stone & Simpson must respond to the challenge of now being instructed to represent a client, Sidewood, on a transaction clearly adverse to Amarillo's interests. In determining its response, Stone & Simpson, and Stella Smart in particular, must consider whether the fulfilment of any obligations she or her firm owes or owed to Amarillo would prevent the firm from acting. In particular, she must consider whether either or both of the obligations to avoid positions of conflict and to protect confidential information would provide a basis for Amarillo to restrain the firm from acting for Sidewood. Ms Smart must also consider whether any other basis exists for restraining the firm. These questions are considered below.

1. Immediate practical responses and commercial pressures

During the conference proceedings Barbara McDonald noted that, before responding, Ms Short must conduct a conflicts search on a firm-wide basis. Since the firm is operating as a single partnership nationwide, its response must take account of any duties owed by or information in the possession of solicitors or others at any of the firm's offices.⁸ Professor McDonald further suggested that Stella Smart not communicate with her Melbourne partner Gerry Smooth about the Amarillo transaction, since were she to become aware of any information confidential to Amarillo, she would be "contaminated" and unable to act for Sidewood.⁹ It follows that the assessment of whether Stone & Simpson should act on the proposed transaction must be made by someone at the firm who did not act for Amarillo in 1999 and will not now act for Sidewood. In making this assessment the firm will be subject to commercial pressures: the engagement will be highly lucrative and, particularly if the takeover succeeds, the new client will be a potential source of further business.

2. Fiduciary duty to avoid conflicts of interest

The relationship of solicitor and client is fiduciary in character.¹⁰ An incident of that relationship is the obligation of a solicitor to avoid positions of conflict with its client, the discharge of which obligation would prevent the solicitor, or his or her firm, from acting on a matter that is contrary to the client's interests, without informed consent.¹¹ However, the fiduciary relationship – and, necessarily, the incidental obligation – is generally regarded as terminating when the solicitor-client retainer ends.¹² In this case, since the firm's representation of Amarillo has ended,¹³ the fiduciary obligation to avoid conflicts provides no basis for Stone & Simpson to refuse Sidewood's instruction.

⁸ In *Photocure ASA v Queen's University at Kingston* (2002) 56 IPR 86 (*Photocure*), Goldberg J treated the Melbourne and Sydney offices of a national law firm as part of a single firm for purposes of applying the relevant legal principles, discussed below. It follows, for example, that when applying the principle relevant to determining the effectiveness of Chinese walls, the firm will be considered to comprise its multiple offices so that, functionally, it will constitute a single firm.

⁹ Were Stella Smart to represent Sidewood on the proposed transaction while being in possession of this information, she would be in breach of the duty to protect the confidentiality of that information. Of course, this would only be the case if the information possessed by Gerry Smooth were confidential and relevant to the proposed transaction. While this may not, in fact, be the case, it would be highly imprudent for Stella Smart to make this assessment if she also proposes to act for Sidewood.

¹⁰ See, eg, *Maguire v Makaronis* (1997) 188 CLR 449 at 463; 71 ALJR 781; 144 ALR 729; *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 68; 58 ALJR 587; 55 ALR 417; *Clark Boyce v Mouat* [1994] 1 AC 428 at 437.

¹¹ While any duty is owed by the solicitor as fiduciary personally, his or her firm is in no better position. In *Prince Jefri Bolkiah v KPMG (a firm)* [1999] 2 AC 222 at 234-235 (*Bolkiah*) Lord Millet explained that "a fiduciary cannot act at the same time for and against the same client, and his firm is in no better position". See also Thomson Lawbook Co, *Laws of Australia*, vol 15 (at 3 August 2005) 15 Equity, "15.2 Fiduciaries" [46], explaining that "a client does not instruct the individual solicitor, but rather the firm, and it is the firm as a whole which assumes the legal liability to the client".

¹² See *Bolkiah* [1999] 2 AC 222 at 235. This principle is subject to the possible continuation of a fiduciary duty of loyalty, considered below under the heading "Other Bases for Judicial Intervention – A Continuing Duty of Loyalty". Furthermore, a breach of fiduciary duty may survive termination of the fiduciary relationship to avoid a fiduciary terminating a fiduciary relationship for the purpose of exploiting opportunities of which he or she becomes aware while acting in a fiduciary capacity: *Furs v Tomkies* (1936) 54 CLR 583 at 592; 9 ALJR 419; Glover J, *Equity, Restitution and Fraud* (LexisNexis Butterworths, 2004) [6.18].

3. Duty to protect confidential information

(a) Basis for court intervention

Unlike the fiduciary duty to avoid conflicts of interest, the duty to protect confidential information continues after the solicitor's retainer has ended.¹⁴ This duty is imposed collectively on every member of a law firm, whether solicitor, clerk or support staff, who has relevant confidential information obtained during the course of a client engagement.¹⁵

The approach in Australia (and England) to determining whether the duty to protect confidential information has been breached was established by the House of Lords in *Bolkiah (Prince Jefri) v KPMG (a firm)* [1999] 2 AC 222 at 235.¹⁶ Applying this approach, former client Amarillo carries the burden of proving first, that Stone & Simpson is in possession of information that is confidential to Amarillo and to the disclosure of which it has not consented, and second, that the information is, or may be, relevant to a matter in which the firm is proposing to act for another party with an interest adverse to the former client.¹⁷ If Amarillo carries this burden, an injunction will be granted unless the firm satisfies the court that there is no real risk of disclosure of the information to those acting for the new client.¹⁸ The risk must not be fanciful or theoretical, but need not be substantial.¹⁹ Stated as a positive proposition:

a court will intervene by injunction to restrain a solicitor from acting for a new client with an interest adverse to a former client if a reasonable observer, aware of the relevant facts, would think that there was a real, as opposed to a theoretical, possibility that confidential information given to the solicitor by the former client might be used by the solicitor to advance the interests of the new client to the detriment of the old client.²⁰

It is apparent that, on these principles, it is wrong for courts to determine the question by conducting a balancing exercise.²¹ It follows that, although a party (in this case, Sidewood) may be said to have a "right" to choose its legal advisers,²² a court will nevertheless restrain a solicitor if there is a real risk of disclosure of confidential information.²³

(b) Discharge of evidential burden by former client

Amarillo's claim would be that Stone & Simpson solicitors obtained information confidential to Amarillo in the course of representing it on the 1999 capital raising that is relevant to the proposed

¹³ Even if the retainer was not terminated formally at that time, there can be little doubt that it finished when the transaction "closed" and any post-closing matters were completed. On the facts, this occurred in around 1999.

¹⁴ *Bolkiah* [1999] 2 AC 222 at 235. Lord Millett further explained that once the fiduciary relationship ends, "the solicitor has no obligation to defend and advance the interests of his former client".

¹⁵ See *Wagdy Hanna & Associates Pty Ltd v National Library of Australia* (2004) 185 FLR 367; [2004] ACTSC 75 at [18] (*Wagdy Hanna*).

¹⁶ The test has been adopted in Australia in a number of intermediate court decisions: See, eg, *Photocure* (2002) 56 IPR 86; *Waiyata Pty Ltd v New Millennium Publications Pty Ltd* [2002] FCA 98; *Bureau Interprofessionnel Des Vins De Bourgogne v Red Earth Nominees Pty Ltd (t/as Taltarni Vineyards)* [2002] FCA 588 (*Red Earth Nominees*). The approach also prevails in England: See, eg, *Koch Shipping Inc v Richards Butler (a firm)* [2003] PNLR 11.

¹⁷ See *Bolkiah* [1999] 2 AC 222.

¹⁸ *Bolkiah* [1999] 2 AC 222 at 237.

¹⁹ *Bolkiah* [1999] 2 AC 222.

²⁰ *ASIC v Rich* (2005) 190 FLR 242; [2005] NSWSC 149 at [370], citing *Carindale Country Club Estate Pty Ltd v Astill* (1993) 42 FCR 307 at 312; 115 ALR 112 (Drummond J).

²¹ See *Koch Shipping Inc v Richards Butler (a firm)* [2003] PNLR 11 at [24] at proposition (7); cf *Australian Liquor Marketers Pty Ltd v Tasman Liquor Traders Pty Ltd* [2002] VSC 324 at [25].

²² See, eg, *Macquarie Bank Ltd v Myer* [1994] 1 VR 350 at 352; *Grimwade v Meagher* [1995] 1 VR 446 at 455.

²³ Where the question is whether confidential information is entitled to protection, the court is not to conduct a balancing exercise of, say, weighing the former client's interests in protecting the information against the existing client's interest in choosing their legal representatives. See, eg, *Koch Shipping Inc v Richards Butler (a firm)* [2003] PNLR 11 at [24] at propositions (5) and (7). At the same time, there is a strong public interest in clients being able to choose their own solicitors to represent them, and courts will take into account whether there are available adequately qualified other solicitors to represent the client. See *D & J Constructions Pty Ltd v Head* (1987) 9 NSWLR 118 at 123. Bryson J observed that "[h]ere in Sydney and now there is a thriving diverse and talented legal profession and the court need not fear that a litigant who is deprived of the services of the one firm will not be able to retain adequate representation".

takeover. It is unlikely, however, that Amarillo could establish this. For reasons outlined below, questions arise as to whether any information obtained in the course of the earlier transaction remains confidential or is relevant to the proposed transaction and whether, as a practical matter, Amarillo can specifically identify the information alleged to be confidential.

(i) Confidential nature of information

If the information alleged by Amarillo to be confidential has been publicly disclosed, as Gerry Smooth alleges, it will have lost its confidential status; that is the consequence of public disclosure of confidential information.²⁴ There can be little doubt that disclosure in a prospectus, a document that is publicly available and widely distributed, would constitute public disclosure for this purpose. However, it is likely that the firm received a great volume of information in the course of acting on the capital raising, particularly during the due diligence process, much of which would not have satisfied the materiality threshold for disclosure in the prospectus. The challenge for Amarillo would be to specifically identify this information, as discussed below.

Where confidential information has been forgotten, which is another defence advanced by Gerry Smooth, it may be said that the firm no longer retains confidential information.²⁵ In the present case, however, one would expect that Amarillo will claim that Stone & Simpson possesses documents, not simply “knowledge” (which may be forgotten).²⁶ In that case, Gerry Smooth’s claim that the sole remaining lawyer at Stone & Simpson from the earlier transaction has forgotten any confidential information would not defeat Amarillo’s claim.

(ii) Relevance of any confidential information

In order to establish the relevance of the alleged confidential information, as the *Bolkiah* test requires, Amarillo might allege, for example, that in the course of the capital raising, solicitors at Stone & Simpson became aware of areas of special financial promise to Amarillo’s management that would be of critical significance to Sidewood’s valuation of Amarillo shares or became aware of Amarillo’s own takeover intentions which, if effected, would endanger Sidewood’s share of the oil and gas exploration and production market.

In any case, the relevance of confidential information will atrophy over time.²⁷ In particular, at some point, aged information must cease to be “relevant” for purposes of the test in *Bolkiah*. On the present facts, Gerry Smooth’s argument is that any confidential information in possession of the firm is now so old that it is no longer relevant to Sidewood’s proposed transaction. While this may succeed, Stone & Simpson would need to identify any confidential information – which it appears unable to do – in order to assess the merits of this argument.

(iii) Necessity for former client to identify confidential information

Whether Amarillo would be required, as a matter of law, to specifically identify the confidential information it seeks to protect is significant in light of Gerry Smooth’s assertion that it cannot do so. Conflicting judicial approaches exist. On the one hand, that a party wishing to protect confidential information must specifically identify it has been stated in a number of decisions.²⁸ For example, in *Carindale Country Club Estate Pty Ltd v Astill* (1993) 42 FCR 307; 115 ALR 112 Drummond J asserted (at 314) that “[i]t is a basic requirement that before material will be recognised as having the character of confidential information, the information in question must be identified with precision and not merely in global terms” and that this requirement “will be insisted upon even though it may

²⁴ See *Corrs Pavey Whiting & Byrne v Collector of Customs (Vic)* (1987) 14 FCR 434 at 443; 74 ALR 428; Glover, n 12, [6.18], [6.24].

²⁵ See *Red Earth Nominees* [2002] FCA 588 at [32].

²⁶ See *Wagdy Hanna* (2004) 185 FLR 367; [2004] ACTSC 75 at [45] for the distinction the court draws between knowledge and documents for purposes of protecting confidential information.

²⁷ The age of confidential information has implications for whether it is entitled to protection from disclosure. See, eg, *Red Earth Nominees* [2002] FCA 588 at [32].

²⁸ *Red Earth Nominees* [2002] FCA 588 at [20]–[26]; *Carindale Country Club Estate Pty Ltd v Astill* (1993) 42 FCR 307 at 313; 115 ALR 112; *D & J Constructions Pty Ltd v Head* (1987) 9 NSWLR 118 at 124; *Corrs Pavey Whiting & Byrne v Collector of Customs (Vic)* (1987) 14 FCR 434 at 443; 74 ALR 428.

necessitate disclosing to the court the very information the confidentiality of which it is sought to preserve by the action”²⁹.

However, in *Bolkiah* [1999] 2 AC 222 the House of Lords did not require identification of the alleged confidential information³⁰ and in recent Australian decisions the identification requirement has not been applied. In *Gugiatti v City of Stirling* (2002) 25 WAR 349; [2002] WASC 33 at [27], [45]-[50] (*Gugiatti*), the court was satisfied, on the evidence available – an affidavit from the former client stating that he provided confidential information to the solicitors and describing, in broad terms, the subject matter of that information – that confidential information relevant to the current proceeding was, on the balance of probabilities, imparted to the former solicitor. This approach was considered consistent with the approach in *Bolkiah* [1999] 2 AC 222³¹ and was also applied in *Wagdy Hanna & Associates Pty Ltd v National Library of Australia* (2004) 185 FLR 367; [2004] ACTSC 75 at [47].

It follows that Stone & Simpson’s argument that Amarillo cannot identify the alleged confidential information may not, of itself, defeat any application for restraint brought by Amarillo. At the same time, confidential information must exist to be entitled to protection. On the present facts, due to the lack of such information or to the irrelevance or public disclosure of the alleged confidential information, Amarillo will likely fail to carry its evidential burden, although, due to the relative paucity of facts available in the study, this view cannot be held with confidence. Of course, if Amarillo can discharge its burden, the burden would shift to Stone & Simpson “to show that even so there is no risk that the information will come into the possession of those now acting for [Sidewood]”³².

(c) Discharge of evidential burden by law firm

To avert the risk of disclosure, particularly inadvertent or accidental, of confidential information, law firms adopt intra-firm policies, procedures and other measures, popularly known as Chinese walls, in order to restrict information flows within a firm and thereby ensure that the duty of confidence is not breached.³³ Without the use of these structural contrivances, it is unlikely that Stone & Simpson could agree to represent Sidewood since a court will presume that “unless special measures are taken, information moves within a firm”³⁴.

Despite expressed judicial scepticism towards Chinese walls,³⁵ Australian courts in recent years have become increasingly accepting of the effectiveness of these measures for the purposes of preventing what would otherwise amount to a breach of the duty of confidence.³⁶ This changed

²⁹ See also *Corrs Pavey Whiting & Byrne v Collector of Customs (Vic)* (1987) 14 FCR 434 at 444; 74 ALR 428 and *Carindale Country Club Estate Pty Ltd v Astill* (1993) 42 FCR 307 at 314; 115 ALR 112. Compare *Belan v Casey* [2002] NSWSC 58 at [23]. An alternative approach to avoid publicly disclosing the confidential information would be to place evidence before the court in a confidential exhibit, as the former client did in *Photocure* (2002) 56 IPR 86 at [20].

³⁰ Lord Millett explained that the requirement that a former client establish that the solicitor is in possession of confidential information that is or may be relevant to the new adverse matter is not a heavy burden to discharge since the solicitor’s possession of confidential information “may readily be inferred” and its relevance “will often be obvious”: *Bolkiah* [1999] 2 AC 222 at 235. The House of Lords did not require Prince Jefri Bolkiah, the party seeking protection of confidential information, to specifically identify the alleged confidential information.

³¹ *Gugiatti* (2002) 25 WAR 349; [2002] WASC 33 at [49]-[50]. This approach also conforms to the judicial approach that gives protection to confidential information that cannot in fact be identified with precision, such as issues, tactics and strategies, in the conduct of a matter: see *Photocure* (2002) 56 IPR 86 at [28].

³² *Bolkiah* [1999] 2 AC 222 at 237.

³³ For a description of Chinese walls, see UK Law Commission, *Fiduciary Duties and Regulatory Rules* (Consultation Paper No 124, 1992) [4.5].

³⁴ *Bolkiah* [1999] 2 AC 222 at 237.

³⁵ *Red Earth Nominees* [2002] FCA 588 at [55]; *Newman v Phillips Fox* (1999) 21 WAR 309 at 323-325; *MacDonald Estate v Martin* (1991) 77 DLR (4th) 249 at 269; *D & J Constructions Pty Ltd v Head* (1987) 9 NSWLR 118 at 122-123. In *Red Earth Nominees* [2002] FCA 588, Ryan J referred to “understandable” judicial reluctance “to accept undertakings by members of staff engaged on the relevant work as adequate protection where there is a real risk of disclosure”: at [57].

³⁶ See generally *Red Earth Nominees* [2002] FCA 588; *Cubic Transportation Systems Inc v NSW* [2002] NSWSC 656; *Photocure* (2002) 56 IPR 86; *Australian Liquor Marketers Pty Ltd v Tasman Liquor Traders Pty Ltd* [2002] VSC 324. See also Willis PG, “Chinese Walls: Myth, Metaphor and Reality – Living with Fiduciary Duties in Resources Relationships”, *AMPLA Yearbook 2002*, pp 578-581.

attitude reflects what has been described as “[changes in] the nature of legal practice”³⁷ and the “modern environment” in which legal services are delivered.³⁸

Recent cases illustrate in particular that Australian courts will not insist that Chinese walls be part of the organisational structure of a firm, as the House of Lords required in *Bolkiah* [1999] 2 AC 222 at 239; this may be so where a single solicitor is alleged to be in possession of relevant confidential information about a former client. In *Gugiatti v City of Stirling* (2002) 25 WAR 349; [2002] WASC 33, a single solicitor of a firm was alleged to be in possession of confidential information (in the form of knowledge, not documents) obtained in the course of representing a former client as a member of another law firm. The former client was involved in a dispute with an existing client of that solicitor’s new firm, and the solicitor’s confidential information was alleged to be relevant to the dispute. Although a risk of disclosure existed, it could be eliminated, the court said, by requiring the solicitor and other members and employees of his new firm to undertake not to seek out or seek to make use of any confidential information. This information barrier was effective even though the firm was small, having seven partners only. The court described the case as being unusual because only one person was alleged to be in possession of confidential information (at [59]).

In *Red Earth Nominees* [2002] FCA 588 a single solicitor of a law firm was, as a result of switching law firms, in possession of confidential information (again in the form of knowledge, not documents) about a former client that was relevant to a matter involving a client of her new firm. In fact, the solicitor had been involved in representing her former client in the early stages of a dispute against her new firm’s client. Ryan J accepted the effectiveness of information barriers put in place by her new firm, even though they were established on an ad hoc basis after the conflict was drawn to the firm’s attention. The measures included personal undertakings of confidentiality; separation of personnel and resources, including computers, printers and support staff; and limiting the firm’s retainer with the existing client to absolve the firm of any obligation to disclose information about the former client (at [12]). It was relevant to the court’s decision that only one solicitor might have access to confidential information and that she was highly experienced, worked just two days per week and worked independently in a subgroup distinct from the group representing the firm’s existing client. Ryan J was satisfied that there was no risk of any relevant confidential information coming into the hands of those solicitors and support staff at the firm entrusted with the conduct of the matter for the existing client (at [60]).

At Stone & Simpson only Gerry Smooth may possess confidential information about the former matter. Presumably, documents relating to that matter have been retained by the firm which, considering the time that has elapsed, may well be in Melbourne in storage at the firm or off-site. In these circumstances, obtaining informed consent from Amarillo to act on the transaction is impractical and, indeed, would amount to a breach of the duty of confidence owed to Sidewood.³⁹ Accordingly, in order to discharge its burden, Stone & Simpson would need to rely on the use of information barriers. In these circumstances, where a firm possesses information in the person of a single solicitor only or in the form of archived documents, and assuming that Amarillo could carry its evidential burden, it is likely that a court would accept that appropriate information barriers referred to below would eliminate any real risk of disclosure to Stone & Simpson solicitors now representing Sidewood.

It would be preferable for Stone & Simpson to institute these procedures at the outset rather than after Amarillo becomes aware of Stone & Simpson’s involvement and challenges it. Better still, Stone & Simpson should have had in place these procedures, so far as relevant, as an established part of its

³⁷ *Photocure* (2002) 56 IPR 86 at [61].

³⁸ *Asia Pacific Telecommunications Ltd v Optus Networks Pty Ltd* [2005] NSWSC 550.

³⁹ What constitutes informed consent, or “fully informed consent” as it is described in some cases, is a question of fact in all of the circumstances of each case; there is no precise formula that will determine in all cases if fully informed consent has been given. See *Maguire v Markaronis* (1997) 188 CLR 449 at 466; 71 ALJR 781; 144 ALR 729, citing (at n 64) *Breen v Williams* (1996) 186 CLR 71 at 137; 70 ALJR 772; 138 ALR 259; *Bristol and West Building Society v Mothew (t/as Stapley & Co)* [1997] 2 WLR 436 at 448-449, and as to company directors, *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 at 289-290; 61 ALJR 216; 70 ALR 251; *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187 at 237-238; 14 ACSR 109.

organisational structure as far back as 1999, at the time of the earlier Amarillo transaction.⁴⁰ These procedures would include:

- quarantining any documents (electronic or otherwise) relating to the 1999 transaction and ensuring that there is no risk of them being accessed by any solicitors or other staff who will work on the proposed transaction;
- quarantining Gerry Smooth, by ensuring he will have no access to the files or documents (electronic or otherwise) concerning the proposed transaction, to any computers, printers or support staff that will be used or involved in the proposed transaction (it is convenient for this purpose that Mr Smooth is physically separated from the team for the proposed transaction);
- obtaining an undertaking from Mr Smooth not to disclose any confidential information to anyone at the firm about the 1999 matter (to the extent that he remembers any);
- limiting Stone & Simpson's retainer with Sidewood so that the firm is not obliged to disclose any confidential information in its possession that was obtained in the course of formerly representing Amarillo.⁴¹

Accordingly, obligations of confidence provide no reason for Ms Smart to decline Sidewood's instructions.

4. Other bases for judicial intervention

(a) Existence of other bases

Ms Smart must also consider whether any other basis exists for enjoining Stone & Simpson from acting for Sidewood.

Asserting that "the danger of misuse of confidential information is not the sole touchstone for intervention where a solicitor acts against a former client", Justice Brooking in *Spincode Pty Ltd v Look Software Pty Ltd* [2001] 4 VR 501 at [52] (*Spincode*) cited two other bases that may support judicial intervention in the solicitor-client relationship. First, a solicitor's continuing duty of loyalty not to act against a former client in any future or further matter related to the prior matter may justify court intervention. Second, a court has inherent jurisdiction to discipline solicitors as court officers, including in respect of their conduct towards former clients.

The recognition of additional bases for court intervention by Brooking JA in *Spincode* has been subsequently followed in Victoria⁴² and the Australian Capital Territory.⁴³ However, it was rejected by Young CJ of the Supreme Court of New South Wales, who regarded protection of confidential information as the sole basis for judicial intervention of a solicitor after his or her fiduciary

⁴⁰ See *Bolkiah* [1999] 2 AC 222 at 239.

⁴¹ The parameters of fiduciary obligations may be modified by contractual relations among parties. In *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 97 Mason J acknowledged that contracts may contain the scope of a fiduciary relationship, which must "accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them". Similarly, in *Henderson v Merritt Syndicates Ltd* [1995] 2 AC 145 at 206 Lord Brown-Wilkinson asserted that "the extent and nature of the fiduciary duties owed in any particular case fall to be determined by reference to any underlying contractual relationship between the parties". A consequence of limiting the parameters of fiduciary obligations by contract may be that impugned conduct (for example, a fiduciary placing itself in a position of conflict with its client) will not violate fiduciary obligations either because the content of the fiduciary obligations does not prohibit the conduct or because the contract occurred outside the scope of the fiduciary obligations. See Maxton LJ, "Contract and Fiduciary Obligations" (1997) 11 *Journal of Contract Law* 222 at 229. There are, however, limits on the ability of parties to negotiate to confine the parameters of fiduciary obligations. Professor Maxton observes that, in the case of status-based fiduciary relationship, such as the lawyer-client relationship, "policy seems to demand that certain fiduciary norms may not be the subject of contractual negotiation" (at 229). The precise extent to which parties may contractually modify fiduciary obligations in the context of the lawyer-client relationship is unclear. As to the effectiveness of a generalised advanced disclosure provision, with the purpose of giving the fiduciary informed consent of the client to act in what would otherwise be a breach of fiduciary duty, see UK Law Commission, "Fiduciary Duties and Regulatory Rules", Report No 236 (1995) at [3.29].

⁴² See *McVeigh v Linen House Pty Ltd & Rugs Galore Australia Pty Ltd* [1999] 3 VR 394 at 6-7 and *Sent v John Fairfax Publication Pty Ltd* [2002] VSC 429.

⁴³ *Wagdy Hanna* (2004) 185 FLR 367; [2004] ACTSC 75.

obligations have ended.⁴⁴ More recently, Bergin J of the same court distinguished the facts before her from *Spincode* and indicated that the egregious conduct of the solicitors in *Spincode* had “featured heavily” in Brooking JA’s decision.⁴⁵ A divergence of approach appears to exist between the courts of New South Wales and Victoria.

(b) A continuing duty of loyalty

The scope of any continuing duty of loyalty has been variously expressed. In *Spincode* [2001] 4 VR 501, after an extensive review of the cases, Brooking JA stated that the duty forbids a solicitor “to take up the cudgels against a former client in the same or a closely related matter” (at [52]). In *Wadgy Hanna & Associates Pty Ltd v National Library of Australia* (2004) 185 FLR 367; [2004] ACTSC 75, Higgins CJ, of the Supreme Court of the Australian Capital Territory, explained that “irrespective of the risk of disclosure of confidential information, a solicitor is bound by a continuing duty not to act against a former client in respect of any matter related to the prior matter” (at [33]).

During the panel discussion Damian Lovell referred to the difficulty of appeals of decisions involving these matters since a loss before a single judge will often result in the “deck being reshuffled”, thereby reducing the practical advantage to be gained by succeeding before an appeal court.

As Mr Lovell also noted during the panel discussion, there must be some connection between the former matter and the current one. In *Spincode* [2001] 4 VR 501 at [52], Brooking JA referred to the matters being the “same or closely related”; in *McVeigh v Linen House Pty Ltd & Rugs Galore Australia Pty Ltd* [1999] 3 VR 394 the Victorian Court of Appeal affirmed the existence of a duty of loyalty to former clients in respect of litigation arising out of the same matter. It is apparent that no connection exists between the two matters here – a capital raising by Amarillo and proposed takeover of Amarillo by another company. For this reason, no breach of continuing duty of loyalty (assuming it is considered to exist) would warrant court intervention.

(c) Inherent judicial power to control court officers

The basis of this (potential) ground is that the proper administration of justice requires that clients be confident in the expectation that solicitors will maintain their confidence and trust.⁴⁶ This would be threatened, for example, were solicitors to be permitted to change sides in a transaction. However, as with the previous ground, there is uncertainty in Australia, since *Bolkiah*, as to whether this will support an injunction to restrain a solicitor from acting against a former client.⁴⁷

Where this ground has been recently applied in Australia as a basis for curial intervention, egregious solicitor conduct has been required.⁴⁸ In *Spincode* Brooking JA indicated he would be willing to invoke the court’s inherent jurisdiction where, having regard to the whole of the solicitors’ conduct, it was “so offensive to common notions of fairness and justice that they should, as officers of the Court, be brought to heel”. In *Waiviata Pty Ltd v New Millenium Publications Pty Ltd* [2002] FCA 98 at [10], Sundberg J indicated that an unusual case would need to arise for this ground to support an injunction where there is no threatened misuse of confidential information and no breach of the solicitor’s duty of loyalty.

Were Stone & Simpson to represent Sidewood in the present case, there would be no room for the operation of these principles. There is nothing unusual or striking about a firm acting against a

⁴⁴ *Belan v Casey* [2002] NSWSC 58 at [21]. See also *British American Tobacco Australia Services Ltd v Blanch* [2004] NSWSC 70 in which Young CJ said, after reconsidering the question of whether the observations of Brooking JA applied in New South Wales, that he “[remained] of the view [he] took in *Belan v Casey*”: at [104].

⁴⁵ *Asia Pacific Telecommunications Ltd v Optus Networks Pty Ltd* [2005] NSWSC 550 at [52].

⁴⁶ *World Medical Manufacturing Corporation v Phillips Ormone & Fitzpatrick* [2000] VSC 196 at [84]; *Mark Foys Pty Ltd v TVSN (Pacific) Ltd* (2000) 178 ALR 322; [2000] FCA 1506 at [18].

⁴⁷ See *Spincode* [2001] 4 VR 501; *Newman v Phillips Fox* (1999) 21 WAR 309 at 314; *Harvey Norman Holdings Ltd v Fels & ACCC* [2002] ATPR 41-852; [2002] FCA 13 at [28]; cf *Belan v Casey* [2002] NSWSC 58 at [21].

⁴⁸ In contrast to the decisions discussed in the text below this note, the court’s approach in *Red Earth Nominees* was that where there was either no relevant confidential information or no real risk of the disclosure of any confidential information, there would be no reason for the court to consider exercising its inherent jurisdiction: *Red Earth Nominees* [2002] FCA 588 at [10].

former client five years after it represented that client on an unrelated matter and no circumstances indicative of the egregious conduct that has invoked judicial intervention in previous cases.

5. Duty of solicitor to put all information and knowledge at client's disposal

At issue is whether, assuming Stone & Simpson is in possession of relevant confidential information from previously representing Amarillo, it must put that information at Sidewood's disposal in the proposed transaction. This would raise a real practical difficulty for the firm since discharging this apparent obligation would conflict with the continuing obligation of confidence to Amarillo.⁴⁹ The basis of the apparent obligation to an existing client was explained by Megarry J in *Spector v Ageda* [1973] Ch 30 at 32 as follows:

A solicitor must be willing to put at his client's disposal not only his skill but also his knowledge, so far as is relevant; and if he is unwilling to reveal his knowledge to his client, he should not act for him. What he cannot do is to act for the client and at the same time withhold from him any relevant knowledge that he has.

Although a number of Australian cases state that solicitors owe this obligation,⁵⁰ the law on this point is exiguous. Questions exist as to the nature of the duty and the imputation of knowledge within the firm for purposes of discharging the duty. The duty referred to by Megarry J in *Spector* was, in fact, tortious, which suggests that it is wrong to regard it as a principle of law. Indeed, in *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 1 at 48; 33 ACSR 1, the New South Wales Court of Appeal interpreted the duty in *Spector* as giving rise to liability in negligence, not breach of a fiduciary obligation. Furthermore, it is doubtful that the obligation would require a solicitor to disclose all information within the knowledge of any member of his or her firm. This point has been made by recent case law in the context of large law firms: in *Re A Firm of Solicitors* [1992] QB 959 Staughton LJ (though he was in dissent in the result) explained the following (at 973):

I cannot detect ... any authority for the proposition that a large firm of many partners is obliged to disclose to each client any knowledge relevant to his affairs that may be possessed by any of his partners or staff. Nor do I think it right to enlarge the law to that extent ... The solicitors in the present case comprised 107 partners at the last count. It seems to be impracticable and even absurd to say that they are under a duty to reveal to each client, and use for this benefit, any knowledge possessed by any one of their partners or staff. I would not hold that to be the law.⁵¹

This approach has been adopted in a number of recent decisions⁵² and has been described as "the preferable approach".⁵³ It is also consistent with the view of Lord Millett in *Bolkiah* that, in the context of protecting confidential information, there was no reason to impute or attribute the knowledge of one partner to his fellow partner.⁵⁴ At the same time, the approach cannot be regarded as settled since it suggests that solicitor cases qualify the general rule for partnerships that notice to one partner of any matter relating to the affairs of the partnership will normally be imputed to the other partners.⁵⁵ It might be that the qualification relates only to large law firms or that, as the United

⁴⁹ This conflict between the duty of confidence to the former client and the apparent duty of disclosure to an existing client "cannot be avoided by asserting, as a proposition of law, that the duty to the [existing] client is qualified by performance of the duty to the former client": *Oceanic Life Ltd v HIH Casualty & General Insurance Ltd* [1999] NSWSC 292 at [58] (Austin J). However, it is open to the existing client to provide informed consent to non-disclosure: *Newman v Phillips Fox* (1999) 21 WAR 309 at 316; *Mallesons Stephen Jaques v KPMG Peat Marwick* (1990) 4 WAR 357 at 370; [1991] ANZ ConvR 200.

⁵⁰ See, eg, *National Mutual Holdings Pty Ltd v Sentry Corp* (1989) 22 FCR 209 at 230 (Gummow J), *Mallesons Stephen Jaques v KPMG Peat Marwick* (1990) 4 WAR 357 at 370; [1991] ANZ ConvR 200 (Ipp J), *Wagdy Hanna* (2004) 185 FLR 367; [2004] ACTSC 75 at [24]-[25] (Higgins CJ); *Farrow Mortgage Services Pty Ltd (in liq) v Mendall Properties Pty Ltd* [1995] 1 VR 1 at 5.

⁵¹ The court had been referred to *Moody v Cox* [1971] 2 Ch 71 for the principle that "if a solicitor or firm of solicitors has acquired relevant knowledge concerning a former client during the course of acting for him, he or it must not accept instructions to act against him". Staughton LJ's statement above makes it clear that he did not detect in *Moody* any authority for that principle.

⁵² See, eg, *Unioil International Pty Ltd v Deloitte Touche Tohmatsu* (1997) 17 WAR 98 at 110-111.

⁵³ *Newman v Phillips Fox* (1999) 21 WAR 309 at 317-318 (Steytler J).

⁵⁴ *Bolkiah* [1999] 2 AC 222 at 235.

⁵⁵ UK Law Commission, n 33 at [2.3.10]. As to the general rule for partnerships, see Banks RC l'A, *Lindley and Banks on Partnership* (17th ed, Sweet & Maxwell, 1995) pp 307-309. This approach also contrasts with the position of companies where,

Kingdom Law Commission suggested in another context,⁵⁶ the use of Chinese walls prevents attribution of knowledge of one partner to others.

In the present case, there is a credible basis for not imputing to the Sydney solicitors any confidential information about Amarillo. Furthermore, as Barbara McDonald contended during the panel discussion, Stone & Simpson may limit its retainer with Sidewood in order to limit any duty of disclosure owed to Sidewood.⁵⁷ For these reasons, Stone & Simpson should not decline to act for Sidewood by reason of some irresolvable conflict with the duty owed to Amarillo to protect confidential information.

6. Professional regulations

The final issue is whether professional regulations will change Stone & Simpson's decision to accept or not Sidewood's instructions. Legislation in each state established a regime for control of the legal profession, including supervision of professional conduct.⁵⁸ Where the question is one of professional conduct, such legislation may operate to qualify what otherwise would be the scope of the fiduciary obligations of solicitors.⁵⁹ On the current facts, however, since the retainer between Amarillo and Stone & Simpson has ended, so too have any fiduciary obligations, except perhaps a continuing duty of loyalty. So far as the regulations go, none in either New South Wales or Victoria, the relevant jurisdictions, would change Stone & Simpson's proposed response.⁶⁰

7. Conclusion

Stone & Simpson would be on solid ground were it to accept Sidewood's instructions. There is real doubt about whether the firm holds relevant confidential information arising from the earlier representation of Amarillo and, even if it does, by instituting Chinese walls and other measures discussed above, it may remove any real risk of disclosure and thereby discharge its duty of confidence.

C. Legal adviser conflicts: Attendance at "beauty parade"

Fraser & Galloway has potentially received confidential information at a "beauty parade" to represent one party to a transaction and, later, after failing to secure that instruction, is engaged to represent the other party to the proposed transaction. In determining its response, Fraser & Galloway must consider first, whether its solicitors are obliged to protect the confidentiality of any information disclosed to it at the beauty parade, and second, whether any duty is owed to its current client, Amarillo, to disclose any information obtained at the beauty parade.

as a matter of principle, any matter known by one part of a company is attributed to all other parts of the firm, whether or not it has in place Chinese walls or other information barriers: UK Law Commission, *Fiduciary Duties and Regulatory Rules*, Report No 236 (1995) [7.15].

⁵⁶ See UK Law Commission, n 33 at [2.3.10].

⁵⁷ Barbara McDonald indicated that this would limit any contractual or tortious duty of disclosure owed to Sidewood and may also amount to advance informed consent in the case of any fiduciary duty of disclosure.

⁵⁸ *Maguire v Makaronis* (1997) 188 CLR 449 at 456; 71 ALJR 781; 144 ALR 729. See also Law Council of Australia, *Model Rules of Professional Conduct and Practice* (2002); New South Wales Law Society, *Revised Professional Conduct and Practice Rules* (1995); Law Institute of Victoria, *Members' Handbook* (1993), "Professional Ethics"; Law Society of South Australia, *Professional Conduct Rules* (2000); Law Society of Western Australia, *Professional Conduct Rules*; Law Society of the Australian Capital Territory, *Professional Conduct Rules* (1998).

⁵⁹ *Maguire v Makaronis* (1997) 188 CLR 449 at 456; 71 ALJR 781; 144 ALR 729. However, as the High Court in *Maguire v Makaronis* explained at 456-466, "it by no means follows that the legislation, upon its proper construction, limits the well-entrenched equitable jurisdiction, in matters of private law, to remedy, at the instance of the client, abuses of what equity regards as the fiduciary duties of solicitors". See also *Farrington v Rowe McBride & Partners* [1985] 1 NZLR 83 at 91-92.

⁶⁰ See, however, Law Council of Australia, *Model Rules of Professional Conduct and Practice* (2002), rule 4, which provides that a "practitioner must not accept an engagement to act for another person in any matter against, or in opposition to, the interest of a person ('the former client') ... if the former client might reasonably conclude that there is a real possibility that information will be used to the former client's detriment". See also New South Wales Law Society, *Revised Professional Conduct and Practice Rules* (1995), rule 3, which is in substantially the same terms. This requirement is arguably broader than the duty, as articulated in *Bolkiah*, of a solicitor to a former client to protect confidential information.

1. Practical responses

Ideally, Fraser & Galloway would have made clear to Sidewood that it was attending the beauty parade on the basis that, if unsuccessful, it would not thereby be prohibited from acting for another party on the transaction. However, Rowan Russell observed during the panel discussion that in Australia that practice is not always adopted, even though it is one encouraged by many firms. Faced with the commercial imperative, some solicitors can be reluctant to make this basis of their participation explicit at the time a beauty parade is conducted. At the same time, it is unusual for the client conducting the parade to specify that any information disclosed is confidential and must be kept so.

2. Fiduciary duty to avoid conflicts of interest

It is unlikely that solicitors at Fraser & Galloway will owe fiduciary obligations to Sidewood. Even if a fiduciary relationship did arise between the parties at the beauty parade, that relationship has now ended and no fiduciary obligation will survive.⁶¹ Accordingly, representing Amarillo after participation at the beauty parade could not be restrained for breach of the fiduciary obligation to avoid positions of conflict.

3. Duty to protect confidential information

Any duty owed to Sidewood to protect confidential information will continue beyond the consensual termination of the retainer.⁶² But for the duty to arise, the information must have “the necessary quality of confidentiality (and is not, for example, common or public knowledge)” and have been “received by the [firm] in such circumstances as to import an obligation of confidence”.⁶³

The mere fact that information is communicated to a lawyer by his or her client does not give it a confidential quality.⁶⁴ In these circumstances, then, assuming that Sidewood can identify with specificity the information alleged to be confidential, that information will lose its protection if it has been publicly disclosed. It is unclear what information was disclosed to Fraser & Galloway at the beauty parade; however, presumably much of it will have been publicly disclosed at the time that Sidewood announced its proposed takeover. Information such as Sidewood’s intention to make a substantial acquisition, the identity of the target, the offer terms and other matters that may have been disclosed at the beauty parade will be publicly known. However, other details that may have been disclosed, such as the strategy to be employed by Sidewood, may remain confidential.

To restrain Fraser & Galloway from acting, Sidewood would also need to establish that the alleged confidential information was disclosed to or received by the firm in circumstances that imported an obligation of confidence. Such an obligation can be inferred where the confidants, in this case Fraser & Galloway at the beauty parade, know (or ought to have known) of restrictions placed on the use of information.⁶⁵ The obligation will also arise where the information disclosed is obviously confidential in nature.⁶⁶ In *Fractionated Cane Technology Ltd v Ruiz-Avila* [1988] 1 Qd R 51 at 66-67; (1987) 8 IPR 502, McPherson J explained that “objective circumstances” are required to import an obligation of confidence. Objective circumstances may exist where the parties have agreed to respect confidentiality, but that alone will be insufficient if the agreement is unenforceable. Other circumstances would include some indication that the information was “received” (and not just disclosed) in confidence; in other words, the party to whom the disclosure is made must have had the opportunity of rejecting the attempted disclosure.⁶⁷ In *Fractionated Cane Technology*, the alleged confidential information was not disclosed in circumstances that would have given the other party an opportunity of rejecting the attempted disclosure. There were also no other objective circumstances

⁶¹ *Bolkiah* [1999] 2 AC 222 at 235. This statement is subject to the possible continuation of a fiduciary duty of loyalty, considered below. See also n 12, above.

⁶² *Bolkiah* [1999] 2 AC 222 at 235.

⁶³ *Corrs Pavey Whiting & Byrne v Collective Customs* (1987) 14 FCR 434 at 443; 74 ALR 428.

⁶⁴ See *Australian Commercial Research and Development Ltd v Hampson* [1991] 1 Qd R 508 at 518 and *D & J Constructions Pty Ltd v Head* (1987) 9 NSWLR 118 at 120.

⁶⁵ Glover, n 12 at [6.28].

⁶⁶ Glover, n 12 at [6.28].

⁶⁷ [1988] 1 Qd R 51; (1987) 8 IPR 502.

that attracted the intervention of equity (at 67). However, according to Professor Glover, the confidentiality of information will be inferred if the information was obviously confidential,⁶⁸ presumably even where such objective circumstances are absent.

In the present case, it is unknown whether Sidewood expressly reserved confidence in terms that would clearly have imposed on the participants an obligation of confidence. Clearly, greater facts would be required of the alleged confidential information and the circumstances in which it was disclosed. However, it may well be obvious in the circumstances that the information disclosed was confidential in nature. The type of transaction proposed – a hostile takeover – will often depend on the element of surprise and, because the information is non-public and price-sensitive at the time when legal advisers are engaged, it will be intended to retain its confidential character until its public disclosure. By giving the preliminary advice in these circumstances, it is likely that Fraser & Galloway received the information in confidence.

Accordingly, Fraser & Galloway's response should be informed by the following considerations:

1. The firm may attempt to obtain the informed consent of Sidewood to act on the transaction. However, Sidewood may, for purely strategic reasons, refuse. But these would not foreclose the possibility of Fraser & Galloway acting for Amarillo.
2. If the firm is in possession of information relevant to Amarillo's defence, it is arguable that it may be obliged to disclose that information to Amarillo. However, for reasons explained above, this argument is not strong, particularly since Fraser & Galloway is a large firm.⁶⁹ To avoid it arising, however, it would be advisable for the firm to restrict the scope of its retainer with Amarillo in order to limit any such duty of disclosure. Rowan Russell commented that this approach is often adopted, although it raises the issue of whether the consent provided by the existing client is informed.
3. Fraser & Galloway should have in place Chinese walls or other information barriers that eliminate any real risk that the alleged confidential information obtained from the beauty parade will come into the possession of those – lawyers and non-lawyers – who will act for Amarillo.⁷⁰ The firm should establish "clear and convincing evidence" that all effective measures have been taken to ensure that no disclosure will occur.⁷¹ The measures recommended in these circumstances will mirror those for Stone & Simpson, and adopting them should allow the firm to act, even without the informed consent of Sidewood.

4. Policy matters

Finally, David Friedlander raised the issue of whether Sidewood might make strategic use of a beauty parade precisely as a way to disqualify the very strongest firms whom they would not want to see appearing on the other side; that is, whether they may, in effect, "conflict out" a number of law firms by disclosing confidential information in circumstances importing a duty of confidence. These concerns have been expressed in other jurisdictions.⁷² Judicial sanction of this practice would certainly encourage its use and may have the effect of a client "cornering the market" in legal services. The question is, whether in these circumstances a court would restrain a firm such as Fraser & Galloway by reason of its participation at the beauty parade.

There is no direct authority on this point. A number of arguments may be advanced, however, for restricting the ability of Sidewood to restrain Fraser & Galloway. First, it could be argued that in these circumstances Sidewood would not be coming to court with "clean hands" and that this claim is relevant to a court's willingness to grant an injunction.⁷³ The allegation is a serious one and it would

⁶⁸ Glover, n 12 at [6.28]

⁶⁹ For a discussion of circumstances in which fiduciary obligations can be modified by contract, see n 41.

⁷⁰ See *Bolkiah* [1999] 2 AC 222 at 237.

⁷¹ *Bolkiah* [1999] 2 AC 222 at 237-238.

⁷² See Shapiro, n 3, p 285.

⁷³ See *Fractionated Cane Technology Ltd v Ruiz-Avila* [1988] 1 Qd R 51 at 60, for comments of McPherson J on the relevance of this maxim in circumstances where the plaintiff is seeking an injunction for alleged breach of the duty of confidence. He comments that "Such conduct confronts more than one of equity's most cherished maxims. It may not be fatal to the plaintiffs' claim; but it can hardly be counted a promising start." Similarly, in *Australian Commercial Research and Development Ltd v*

involve a conclusion that Sidewood and its legal advisers were involved in practices that should not be condoned.⁷⁴

Second, with the disclosing of the information at the beauty parade to a number of law firms for the purpose of “contaminating” them, the information that might otherwise be confidential loses that character. In *Australian Commercial Research and Development Ltd v Hampson* [1991] 1 Qd R 508 the plaintiff briefed 14 senior counsel in Queensland for the alleged purpose of “cornering the market”. One of the briefed counsel, who had provided an opinion to the plaintiff, proposed to represent the defendant in proceedings, which the plaintiff sought to restrain. In the case, no argument was made, and the court did not find, that because it was disseminated so widely the information thereby lost its confidential status. Certainly, it would be difficult to argue that the information became public or common knowledge by virtue of its disclosure to a number of firms.

Third, the disclosure of information by Sidewood, ostensibly for the purpose of assessing Fraser & Galloway’s expertise, was in fact for the purpose of disqualifying it from acting against Sidewood, and thus does not import an obligation of confidence on Fraser & Galloway.

These arguments would be difficult to sustain since they depend on Fraser & Galloway establishing that Sidewood’s motive in inviting it to the beauty parade was to disqualify it from acting against the company. At the same time, there must be some limit to a court’s willingness to prevent a number of firms being “contaminated” in these circumstances; sanctioning such behaviour would provide incentives for clients to engage in it. The question may ultimately come down to whether the serious allegation is established. A similar argument was made in *Australian Commercial Research and Development Ltd v Hampson* [1991] 1 Qd R 508 at 522 although the judge did not find it necessary to answer the question. The case illustrates the real difficulties involved in establishing such a serious claim.

5. Conclusion

It is difficult to respond definitively without knowing more facts. It is highly likely that confidential information was disclosed and that this was obvious to Fraser & Galloway; it is unclear, however, whether that information would have retained its confidential nature at the time the transaction became publicly known. In the absence of Sidewood giving informed consent, Fraser & Galloway should have in place Chinese walls to ensure that no real risk of disclosure exists.

D. Legal adviser conflicts: Information received from potential client

1. Legal issues

Fred Fullagar confronts a difficult dilemma: he is in possession of confidential information about an existing client by virtue of a request for legal representation by a party with interests adverse to that client. Twin legal issues arise for Fraser & Galloway’s consideration: first, whether it may act for Tulkinghorn on a transaction clearly inimical to the interests of its existing client, Amarillo; and second, irrespective of the answer to the first question, whether it is obliged to disclose to Amarillo the information it received from Tulkinghorn.

2. Acting against existing client

The relationship between Fraser & Galloway solicitors and Amarillo is fiduciary in nature. It follows that, during the course of that retainer, Fraser & Galloway would be obliged to avoid positions of conflict with the interests of Amarillo. The obligation to avoid positions of conflict, also referred to as a “duty of undivided loyalty”,⁷⁵ has been described as manifested in the “duty and duty” rule and a

Hampson [1991] 1 Qd R 508 at 520, Mackenzie J discusses the argument that the conduct of the plaintiff, in that case also seeking an injunction to protect allegedly confidential information from disclosure, was relevant to whether the equitable remedy should be granted. Mackenzie did not decide this issue.

⁷⁴ See *Australian Commercial Research and Development Ltd v Hampson* [1991] 1 Qd R 508 at 520.

⁷⁵ See *Maguire v Makaronis* (1997) 188 CLR 449; 71 ALJR 781; 144 ALR 729 and *Beach Petroleum v Kennedy* (1999) 48 NSWLR 1 at 46-47; 33 ACSR 1.

“duty and self-interest” rule.⁷⁶ It prohibits the fiduciary from putting himself or herself in a position where his or her duty conflicts with another duty owed or with self-interest. Breach of the obligation would expose the fiduciaries, that is, the solicitors at Fraser & Galloway, and, as a consequence, the firm, to equity’s “gain-stripping” remedies.

At first blush, the matters in question – the takeover (representing Amarillo) and the litigation (for Tulkinghorn) – are unrelated. In these circumstances, the firm may argue that no conflict arises. This is because the solicitor cases state the conflict avoidance obligation as applying to prevent a firm acting against a client on the same matter or closely related matters.⁷⁷ While this is true, there cannot be said to be an absolute rule to this effect.⁷⁸ Furthermore, a strong argument exists that the matters here are in fact related: the information disclosed by Tulkinghorn would be relevant to Amarillo’s defence of Sidewood’s attempted takeover; certainly, a claim of that size, assuming it has some merit, may affect Amarillo’s market value and therefore its view on the price offered by Sidewood for its shares. There can be little doubt that it would be damaging to the firm’s reputation to be seen to be both representing and opposing one of its clients. In order to discharge its fiduciary duty to Amarillo, Fraser & Galloway should refuse to represent Tulkinghorn on the breach of contract claim or to advise it any further.⁷⁹

3. Duty of disclosure to existing client

The information disclosed by Tulkinghorn – its intention to bring a \$50 million breach of contract claim – would be relevant to Amarillo’s defence of Sidewood’s attempted takeover, as explained above. Doing so, however, may amount to a breach of a duty of confidence owed to Tulkinghorn.

As discussed above, it appears to be the case that information in the possession of a lawyer at a large law firm will not necessarily be imputed to other lawyers within the firm. The preferred view appears to be that, in the case of large law firms, it is “impracticable ... to say that [solicitors] are under a duty to reveal to each client, and use for this benefit, any knowledge possessed by any one of their partners or staff”.⁸⁰ As a large national law firm with multiple partners, Dunhill would have grounds for not disclosing that to its existing client Amarillo, provided that those solicitors representing Amarillo are not privy to it. The existence of Chinese walls would strengthen its position.

Furthermore, were Fraser & Galloway to disclose that information to Amarillo that would arguably constitute a breach of confidence owed to Tulkinghorn. Whether the circumstances impute a duty of confidence to Tulkinghorn is a difficult question. The panel did not reach a firm view on this. One approach to the problem would be for Fred Fullagar to have gathered information from Tulkinghorn in a limited fashion initially in order to determine the existence of a conflict and avoid being conflicted out by unwanted disclosures.⁸¹ Furthermore, as Lee Aitken explained, it is clear that client legal privilege attaches as soon as Tulkinghorn discloses the information, even if Fraser & Galloway declines the instruction. This would provide a further basis prohibiting Fred Fullagar from disclosing the information to Amarillo or to the Sydney solicitors representing it.

4. Effectiveness of Chinese walls

Where the issue is whether the duty to avoid conflicts has been discharged, as it is here, the use of Chinese walls or other information barriers will not, as a matter of legal principle, always protect a

⁷⁶ See *Beach Petroleum v Kennedy* (1999) 48 NSWLR 1 at 46-47; 33 ACSR 1.

⁷⁷ See, eg, *Wan v McDonald* (1991) 33 FCR 491 at 513; 105 ALR 473; [1992] ANZ ConvR 385 and *Spincode* [2001] 4 VR 501 at [53], *Australian Liquor Marketers Pty Ltd v Tasman Liquor Traders Pty Ltd* [2002] VSC 324 at [15]-[19] (Habersberger J).

⁷⁸ *Macquarie Bank Ltd v Myer* [1994] 1 VR 350 at 359 (JD Phillips J).

⁷⁹ Of course, Fraser & Galloway could accept Tulkinghorn’s instruction with the informed consent of Amarillo. However this is unlikely to be forthcoming.

⁸⁰ *Re a firm of Solicitors* [1992] QB 959 at 973. These remarks were adopted by Ipp J in *Unioil International Pty Ltd v Deloitte Touche Tohmatsu* (1997) 17 WAR 98 at 110-111 and the approach described as “the preferable [one]” by Steytler J in *Newman v Phillips Fox* (1999) 21 WAR 309 at 317.

⁸¹ This approach is one advocated by practitioners. See Shapiro, n 3, p 282.

fiduciary breaching the duty.⁸² 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.⁸³ However, information barriers may prevent what would otherwise be breach of the duty to protect confidential information.⁸⁴ It follows that Chinese walls may prevent a breach of any duty of confidence owed to Tulkinghorn, but would not, as a matter of principle, protect Fraser & Galloway against claims that it breached its fiduciary duty were it to agree to represent Tulkinghorn in the litigation.

5. Other considerations

One possibility for Fraser & Galloway, which was canvassed by the panel, was that the firm could have limited the retainer with Amarillo to exclude its duty to reveal any information coming into its possession that might be relevant to the representation. Although this practice of obtaining advance consent is adopted in some jurisdictions,⁸⁵ its effectiveness does not appear to have been tested in Australia. Taking this course would also be imprudent in view of the factors discussed above, particularly the risk of reputational damage.

The commercial imperative to accept this instruction will be strong. A matter of this size is likely to be lucrative, and the firm's method of remunerating its partners will also complicate matters. If the partners were remunerated on the basis of the fees they generated, rather than the "lockstep" method of compensation (under which partners are paid on the basis of their seniority at the firm), Fred Fullagar may have an even greater financial incentive to accept Tulkinghorn's instruction.⁸⁶ This would be exacerbated by the consideration that, if the takeover succeeds and Amarillo is subsumed into Sidewood, that client's ongoing commercial importance to Fraser & Galloway would be reduced, thus increasing Tulkinghorn's relative attractiveness. However, to act for Tulkinghorn would clearly be damaging to public confidence in the legal profession and the administration of justice. The reputational risk to the firm itself would also be significant. In view of this, the obvious ethical issues raised and the legal considerations discussed above, the firm should refuse to accept the instruction.

E. Investment bank conflicts: Opposing former client

Manhattan Burnham is confronted with the challenge of advising a company that proposes to takeover the bank's former client. In deciding how to respond to the Amarillo executive's communication, Manhattan Burnham must consider the following issues: first, whether any basis exists for Amarillo to seek to restrain it for having previously represented Amarillo in its 2001 merger; second, whether the firm should institute Chinese walls or other measures in order to act for Sidewood; and third, whether and how any statutory provisions bear on its response.

1. Duty to protect confidential information

Although it is strongly arguable that Manhattan Burnham was in a fiduciary relationship with Amarillo in respect of its provision of financial advisory services in 2001,⁸⁷ the fiduciary obligations

⁸² See UK Law Commission, n 33 at [7.15]. See also Mitchell A, "Whose Side Are You on Anyway? Former Client Conflict of Interest" (1998) 26 *American Business Law Review* 418 at 429. However, the law is uncertain, and 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 would 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: UK Law Commission, n 33 at [3.34].

⁸³ UK Law Commission, n 33 at [2.16].

⁸⁴ A court will intervene to protect confidential information unless it is satisfied that there is no real risk of disclosure of that information (*Bolkiah* [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 (*Bolkiah* at 237-238, altering the test in very similar terms enunciated in *MacDonald Estate v Martin* (1990) 77 DLR (4th) 249 at 269).

⁸⁵ See Shapiro, n 3, p 393.

⁸⁶ The incentives created by compensating partners on their individual fee generation are discussed in Shapiro, n 3, p 273.

⁸⁷ See Tuch A, "Investment Banks as Fiduciaries: Implications for Conflicts of Interest" (2005) 29 MULR 478.

arising from that relationship would have ended once the relationship was consensually terminated,⁸⁸ possibly subject to any continuing duty of loyalty owed to Amarillo. In contrast, the duty of Manhattan Burnham to protect confidential information disclosed in the course of the 2001 transaction will continue beyond the termination of the retainer. That a duty to protect confidential information will arise in these circumstances, namely, where an investment bank provides financial advisory services to a client, was implicit in the recent English decision of *Mannesmann v Goldman Sachs* 1999 WL 1613186.⁸⁹ Accordingly, the relevant jurisdictional basis for Amarillo to restrain Manhattan Burnham is the preservation of confidential information.

On the basis of the decision in *Mannesmann*, the test from *Bolkiah* is applicable to determine whether the duty to protect confidential information is breached. It follows that Manhattan Burnham is in possession of confidential information that is, or may be, relevant to Sidewood's proposed takeover, an injunction will be granted unless Manhattan Burnham satisfies the court that there is no real risk of disclosure of the information to those individuals at the investment bank now acting for Sidewood.⁹⁰ Chinese walls and other information barriers may be employed for this purpose.

One difficulty for Amarillo may be in establishing the relevance of specifically identified confidential information. Courts have not articulated a test for determining whether information is "relevant" for purposes of the *Bolkiah* formulation. However, information received by Manhattan Burnham in the course of the earlier representation would likely be relevant if it bears on the value of Amarillo to Sidewood or if it could give Sidewood some strategic advantage in the transaction. Information that reflects poorly on the management of Amarillo would fall into the latter category since a stated motivation of the takeover is to improve the efficiency of Amarillo's management.

2. Effectiveness of Chinese walls

Chinese walls will be effective in the sense that their use will allow Manhattan Burnham to discharge its duty of confidence to Amarillo where they eliminate any real risk of disclosure of confidential information to bankers and other staff acting for Sidewood.⁹¹ Based on these principles, and particularly on the court's approach in *Gugiatti* and *Red Earth Nominees* (admittedly cases involving law firms rather than investment banks), Manhattan Burnham should adopt (or have adopted as part of its organisational structure) measures, similar to those described above,⁹² to quarantine any documents and personnel from the 2001 Amarillo transaction; obtain an undertaking from personnel involved in the 2001 transaction not to disclose any confidential information to anyone at the firm about the earlier matter; and limit Manhattan Burnham's retainer with Sidewood so that the firm is not obliged to disclose any confidential information in its possession that was obtained in the course of formerly representing Amarillo.⁹³

There appear to be no cases in which the effectiveness of Chinese walls in investment banks has been in issue. At the same time, their use in these firms is widespread.⁹⁴ While the corporate personality of investment banks or institutional characteristics might justify an application of legal principles that differs from the solicitor cases, there appears to be no reason why the principles themselves would differ. Accordingly, a court would be likely to test the effectiveness of the measures in this context by asking whether there is "clear and convincing evidence" that all effective

⁸⁸ By analogy with the fiduciary relationship between a solicitor and his or her client (*Bolkiah* [1999] 2 AC 222 at 234-235), the fiduciary relationship between an investment bank and its financial advisory client (Amarillo in the case study) would end when the retainer or engagement is terminated.

⁸⁹ In *Mannesmann v Goldman Sachs*, Goldman Sachs, the investment bank, had formerly provided financial advisory services to Mannesmann AG; after that transaction had ended, the firm was retained to represent another client on a transaction adverse to the interests of Mannesmann. Although it declined to grant the injunction requested, the court did apply the test from *Bolkiah* for whether the duty to protect confidential information had been breached, an implicit indication in the circumstances that the duty arose.

⁹⁰ *Bolkiah* [1999] 2 AC 222 at 237.

⁹¹ For a discussion of the effectiveness of Chinese walls and other information barriers, see Part 4.A under the heading "Duty to protect confidential information – Effectiveness of Chinese walls and other information barriers".

⁹² See the text surrounding n 41.

⁹³ For a discussion of circumstances in which fiduciary obligations can be modified by contract, see n 41.

⁹⁴ UK Law Commission, n 33 at [4.5].

measures have been taken to ensure that no disclosure will occur.⁹⁵ If Manhattan Burnham can establish this, it will not be restrained from acting for Sidewood.

Furthermore, unlike solicitors, investment bankers are not officers of the court involved in the administration of the justice system and courts, therefore, would have no inherent jurisdiction to restrain investment bankers on this additional basis.

3. Regulatory regime

The regulatory regime applicable to Manhattan Burnham would oblige it to have in place Chinese walls in any case.⁹⁶ Although that regime is stated to apply in respect of “conflicts of interest”, the circumstances in which it applies will clearly encompass situations where a firm is in possession of confidential information in circumstances where no fiduciary obligations exist.⁹⁷ Pursuant to that regime, Manhattan Burnham would be required to adopt “measures, processes and procedures” that control, avoid or disclose conflicts, such as through the use of internal controls.⁹⁸ The regime imposes no other specific obligations on Manhattan Burnham in these circumstances. To comply, however, one would expect the firm to have Chinese walls as an established part of the organisational structure of the firm, rather than created “ad hoc”. This would certainly improve the chances of a court finding such information barriers to be effective.⁹⁹

4. Duty of bank to disclose “all knowledge and skill” to client

One remaining issue is whether Manhattan Burnham, like a law firm, might be obliged to apply for the benefit of its client “all knowledge and skill”; if so, this would oblige it to provide the confidential information about Amarillo to Sidewood. There is no authority imposing this duty on an investment bank. Indeed, one way to avoid the issue would be for Manhattan Burnham and Sidewood to contractually agree that the firm is not obliged to disclose to the client any confidential information obtained in the course of another transaction. It is also strongly arguable that, whatever the express terms of the retainer, it was implied that Manhattan Burnham would not be obliged to disclose confidences owed to other clients. In *Kelly v Cooper* [1993] AC 205 at 214, Lord Browne-Wilkinson, delivering the opinion of the Privy Council, asserted that stockbrokers “cannot be contractually bound to disclose to their private clients inside information disclosed to the brokers in confidence by a company for which they also act”, it being understood that the broker would also act for other clients. The position of the investment bank providing financial advisory services is analogous, it would seem. It is also possible that such a term would be implied in the contract of retainer. Certainly this issue should not prevent Manhattan Burnham from acting for Sidewood on the proposed transaction.

5. Immediate practical responses

If the measures suggested above have been taken, the firm may respond to the Amarillo executive by asserting that it has complied with its obligations, namely, to ensure that there is no real risk that any confidential information of Amarillo’s in the firm’s possession will be disclosed to those now representing Sidewood. In this regard, it is certainly critical that different personnel are representing Sidewood. Disclosing the particular measures adopted may help to allay the concerns of Amarillo.

More generally, in what circumstances would it be advisable to challenge an investment bank’s decision to act on a takeover for alleged conflicts of interest? Legal and non-legal considerations are relevant here. Legal analysis of the merits of an action against an investment bank will include

⁹⁵ *Bolkiah* [1999] 2 AC 222 at 237-238. The legal position is complicated by the rules of imputation of information. Since Manhattan Burnham is incorporated, any knowledge or information within one part of it is imputed to all parts of the company: UK Law Commission (1995), n 55 at [7.15]. It is unclear how this principle may be reconciled with the use of Chinese walls as an effective mechanism to protect confidential information. In any case, use of these measures in Australia can be relied upon to preserve confidential information.

⁹⁶ See *Corporations Act 2001* (Cth), s 911A(1) and Pt 7.6 of that Act generally for the licensing regime.

⁹⁷ See *Corporations Act 2001* (Cth), s 911A(1) and Pt 7.6 of that Act generally for the licensing regime. For the view of the Australian Securities and Investments Commission (ASIC), which administers the regulations, see Australian Securities and Investments Commission, Policy Statement 181 *Licensing: Managing Conflicts of Interest* [PS 181] (issued 30 August 2004).

⁹⁸ Australian Securities and Investments Commission, n 97 at [PS 181.10], [PS 181.11], [PS 181.20], [PS 181.27]. For further discussion of this policy, see Part 4.E below.

⁹⁹ See *Bolkiah* [1999] 2 AC 222 at 239.

considering the nature of the confidential information, the risk of disclosure and the response of the impugned bank (such as whether it has in place Chinese walls and other measures). In addition, strategic considerations, such as the advantage to be gained (and perhaps the disadvantage, including embarrassment, to be caused) by successfully bringing the action, will weigh heavily. In Australia, it is likely that any such challenge would be brought before the Takeovers Panel, which is the main forum for resolving disputes about a takeover bid in these circumstances.¹⁰⁰

Any temporary suspension of an investment bank's representation would finally determine its involvement in the transaction. This is because even a very limited period of sterilisation of the investment bank is likely to put it out of action for good for the purposes of a fast moving takeover bid.¹⁰¹

The risks associated with seeking to restrain an investment bank for tactical or strategic reasons are well illustrated in *Mannesmann v Goldman Sachs* 1999 WL 1613186. Having previously represented Mannesmann AG, a major German-domiciled global telecommunications company, the investment bank Goldman Sachs acted on behalf of English company Vodafone Airtouch plc, another major telecommunications group, which proposed to acquire Mannesmann. The basis for the application was that in two previous matters affecting Mannesmann, Goldman Sachs had acquired confidential information belonging to Mannesmann relevant to the proposed takeover which gave rise to a real risk that the investment bank (if it continued to act for Vodafone) would make use of the information to the prejudice of Mannesmann.

Based on affidavit evidence from the Chief Executive Officer of a wholly-owned subsidiary of Mannesmann, Lightman J accepted an undertaking from the bank that it would cease to act until both parties were heard on Thursday of the same week. At that hearing the Mannesmann executive made a "wholesale departure" from his initial evidence, which the judge described as having been "totally false" (at [9], [10]). Mannesmann failed to identify any confidential information acquired by Goldman Sachs in respect of which Mannesmann was entitled to protection. Furthermore, information that might have constituted confidential information was disclosed publicly to the court – rather than, say, being included in confidential exhibits – and, accordingly, it was "no longer private, but common knowledge" (at [10]). The judge was scathing of the application, stating that it "should never have been made", and said that the "conduct of [Mannesmann] calls for severe criticism" (at [13]). Lightman J dismissed the application with costs and concluded as follows (at [14]):

All these considerations raise serious questions as to the good faith of the claim in the first place and whether it was indeed (as suggested by [Goldman Sachs]) merely a spoiling exercise designed to rule out of play Vodafone's first choice of advisers in the hostilities to come and pre-empt a bid by Vodafone. It is to be noted that the other two leading [investment banks] are already retained by [Mannesmann]. It is to be hoped that there will be no repetition of this unseemly exercise in other cases.

As important as strategic and tactical considerations are in contested takeovers, it is clearly imprudent for one party to seek to restrain another party's adviser from acting on the basis only of these considerations or even as an expression of moral indignation. Regard must be had first and foremost to the well-settled legal principles for the protection of confidential information and to a factual assessment of the effectiveness of information barriers in place.

¹⁰⁰ *Corporations Act 2001* (Cth), s 659AA. It would appear that the objective of this legislation is to exclude court proceedings of most kinds which may impact on the progress of a takeover bid: Austin RP and Ramsay IM, *Ford's Principles of Corporations Law* (12th ed, LexisNexis Butterworths, 2005) at [23.620]. The Takeovers Panel is intended to "take the place of courts as the principal forum for resolving takeover disputes under the corporations legislation, with the exception of civil claims after a takeover has occurred and criminal prosecutions": Commonwealth, Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998, House of Representatives, 30 November 1998 at [7.16]. At issue here will be whether the proposed proceedings are "in relation to a takeover bid" for purposes of s 659B. Amarillo is likely to prefer a judicial forum for its complaint and may argue that the proceedings properly relate to the former transaction (during which it disclosed the confidential information) rather than the current takeover bid.

¹⁰¹ *Mannesmann v Goldman Sachs* 1999 WL 1613186.

F. Investment bank conflicts: Research analyst independence

Research reports are typically intended to provide timely, “independent” and unbiased information about public companies to retail investors. The information contained in Shearson Lambert’s report, however, has the potential to prove very embarrassing to Shearson Lambert. This is because it is critical of a client of the firm’s financial advisory division and adds weight to criticism levelled at that client by its current adversary, Sidewood.¹⁰² A conflict thus exists between the interests of research report recipients and the firm’s financial advisory client.¹⁰³

Australia’s financial services licensing regime, to which financial services conglomerates such as Shearson Lambert are subject, requires persons who carry on a financial services business to hold a licence covering the provision of certain financial services.¹⁰⁴ The licence, which is obtained from ASIC, imposes various obligations on licensees, including the obligation to “manage” conflicts of interest.¹⁰⁵ That license obligation requires Shearson Lambert to have adequate arrangements for the management of conflicts of interest that may arise, wholly or partially, in relation to the provision of financial services by it (or by its representative), as part of its financial services business.¹⁰⁶

In November 2004 ASIC released its policy guidance on how research report providers might satisfy the conflict management obligation.¹⁰⁷ To comply, a research report provider must have adequate arrangements to manage conflicts of interest; what is adequate depends on the facts and circumstances.¹⁰⁸ Policy guidance is explicit that conflict *avoidance*, as a general approach, is not required: some conflicts must be avoided and others can be addressed by adequate controls and “appropriate disclosure”.¹⁰⁹ In the present circumstances, the policy guidance requires Shearson Lambert to do the following:

- ... take reasonable steps to ensure that conflicts of interest:
 - (a) do not compromise the integrity of the advice [it gives] in ... research reports;
 - (b) do not result result in the licensee breaching its duties including (but not limited to) the duty to act efficiently, honestly and fairly; and
 - (c) are adequately disclosed.
- ... have [in place] mechanisms to:
 - (a) identify conflicts of interest;
 - (b) assess and evaluate those conflicts; and

¹⁰² A stated motivation for the takeover is to replace the current management of Amarillo. In these circumstances, it would be embarrassing for Amarillo’s financial adviser, responsible in part for defending its position, to publicly express a view that will be seen to support Amarillo’s adversary.

¹⁰³ In fact, it is arguable that there is a systemic incompatibility between the interests being served by the securities trading (or brokerage) services of investment banks, part of whose role is to provide research reports, and the interests of financial advisory clients of the firm. See Press Release, Office of New York State Attorney General Eliot Spitzer, “Merrill Lynch Stock Rating System Found Biased by Undisclosed Conflicts of Interests” (8 April 2002), available at http://www.oag.state.ny.us/press/2002/apr/apr08b_02.html (viewed 27 October 2005) and Financial Services Authority, *Investment Research: Conflicts and Other Issues* (Discussion Essay 15, July 2002) pp 15-16. See also Tuch, n 87.

¹⁰⁴ *Corporations Act 2001* (Cth), s 911A(1). See Pt 7.6 of the Act generally for the licensing regime, which was introduced by the *Financial Services Reform Act 2001* (Cth). Although a wide-ranging licensing regime, it does not appear that the provision of financial advisory services by an investment bank needs to be licensed. In any case, since an investment bank must hold a licence in respect of a number of its other services, which do fall within the scope of the licensing regime, the question of whether the licence also covers the bank’s provision of financial advisory services is not important for present purposes. See Tuch, n 87.

¹⁰⁵ *Corporations Act 2001* (Cth), s 912A(1)(aa) requires a licensee to have adequate arrangements to manage conflicts of interest.

¹⁰⁶ *Corporations Act 2001* (Cth) s 912A(1)(aa). See also ASIC, n 97 at [PS 181.17].

¹⁰⁷ Australian Securities and Investments Commission, *Managing Conflicts of Interest: An ASIC Guide for Research Report Providers* (released 3 November 2004; information release 04-53).

¹⁰⁸ ASIC, n 107.

¹⁰⁹ ASIC notes that “some conflicts of interest should be avoided entirely. Other conflicts, however can be addressed by adequate controls and appropriate disclosure”: ASIC, n 107 at [2.1].

(c) decide upon and implement an appropriate response to those conflicts.¹¹⁰

Furthermore, Shearson Lambert must have in place a documented communication policy, compliance with which it monitors, that ensures “research reports or information about their contents are not communicated outside the research report provider before the report is provided to clients in the normal course of business”.¹¹¹ Information barriers, such as Chinese walls, may be used provided that they “actually prevent information passing between research staff (and their managers) and other staff”.¹¹² ASIC also expects that research staff will be structurally and physically separate from (and not supervised by) any staff who are performing an investment banking or corporate advisory function.¹¹³

In these circumstances, assuming of course that the research report in question is one in the traditional sense, as it appears to be, it is apparent that Arthur Macquarie, the head of the investment banking division at Shearson Lambert, should not have come into possession of the research report or information about its contents; that he did, indicates a breach by the firm of its licence obligation. According to the legislation, this may result in ASIC suspending or cancelling the firm’s licence¹¹⁴ or making a banning order, which will prohibit the firm from providing any (or specified) financial services in specified circumstances or capacities.¹¹⁵ ASIC may also apply for a court order cancelling a licence or for a permanent banning order.¹¹⁶

It is also apparent that Mr Macquarie must not in any way attempt to influence the research report or prevent it from being published; to do so would clearly infringe the bank’s licence obligations. Furthermore, as a conference participant explained, ASIC would not consider that Shearson Lambert had in place adequate arrangements, as required by the licensing regime. The participant also suggested that Swiss Warburg disclose in its engagement letter with Amarillo that it is in the business of producing “independent” research reports in the oil and gas industry and that Shearson Lambert’s representation would not include influencing the content of these reports.

G. Conflict at professional services firm: Independent expert’s report

The central issue for Haskins Lybrand to consider in determining whether it can provide the requested independent expert’s report for use by the target of a proposed takeover relates to its “initial independence”, in the sense of it being free of any association with, or any influence that may be applied by, Amarillo or its directors at the time of the proposed appointment.¹¹⁷ There are two aspects to this issue: first, whether Haskins Lybrand complies with legal provisions and regulatory guidance relating to expert “independence”; and second, whether it complies with its own internal independence guidelines, which are likely to be stricter.

1. Legal provisions and regulatory guidance

Relevant legal obligations and regulatory guidance are provided, respectively, by the *Corporations Law 2001* (Cth) and in ASIC practice notes and policy statements. As outlined below, legal provisions are narrow in scope and the regulatory guidance permissive in application.

(a) Legal provisions

The *Corporations Act* requires experts who provide reports in connection with certain takeover transactions to be “independent” in a sense; specifically, it requires only that the expert “be someone other than an associate of the bidder or target”.¹¹⁸ While some doubt exists, this requirement would

¹¹⁰ ASIC, n 107 at [2.2], [2.3].

¹¹¹ ASIC, 107 at [2.10].

¹¹² ASIC, 107 at [2.11].

¹¹³ ASIC, 107 at [2.12].

¹¹⁴ *Corporations Act 2001* (Cth), ss 915B–915J.

¹¹⁵ *Corporations Act 2001* (Cth), ss 920A–920F.

¹¹⁶ *Corporations Act 2001* (Cth), s 921A.

¹¹⁷ McDonald L et al, *Experts’ Reports in Corporate Transactions* (Federation Press, 2003) p 189 define the question of “initial independence” in these terms and contrast it with “continuing independence”, which entails remaining independent and objective in outlook throughout the course of preparing the report.

¹¹⁸ Section 648A(2).

appear to apply only where the expert's report is mandated by Ch 6 of the *Corporations Act*.¹¹⁹ Under Ch 6, an expert's report is mandated where (a) the bidder's voting power in the target is 30% or more at the time the bidder's statement is sent to the target; or (b) a director of the bidder is a director of the target.¹²⁰ In any case, the requirement is not an onerous obligation.

The requirement that the expert "be someone other than an associate of the bidder or target" is certainly narrower in scope (and thus less restrictive for a firm) than a requirement of "independence". Whether an expert is an associate is a question of fact, to be determined by reference to the relevant statutory provisions.¹²¹ Those provisions – ss 10 to 17 of the Act – are not directed to the expert report context, but are of broader application. They provide little concrete guidance,¹²² except that a person will not be an associate merely because he or she "gives advice to another, or acts on the other's belief, in the proper performance of the functions attaching to a professional capacity".¹²³ In the case study, assuming that the requested valuation report is mandated – a conclusion that is unclear from the facts – there is nothing to suggest that Haskins Lybrand is an "associate" of either Amarillo or Sidewood. Accordingly, the firm would not be prohibited by law from providing the report, whatever the nature or extent of its past association with Amarillo.¹²⁴

(b) Regulatory guidance

In its practice notes and policy statements, which give an indication to the marketplace of how ASIC will interpret the law that it has responsibility for administering (without having the force of law), ASIC provides guidance on the question of Haskins Lybrand's initial independence. Even where an expert is not prohibited by law from providing a report, as appears to be the circumstance in the case study, it is "highly desirable", says ASIC, "that the report here be provided by an independent expert".¹²⁵ In the context of takeovers in particular, ASIC advises that an expert should be independent of the bidder and the target.¹²⁶ It explains that the expert should ensure not only that it is independent, but that it is seen to be independent.¹²⁷ An alternative formulation offered by ASIC, but presumably with the same meaning, is that the expert should be "unbiased".¹²⁸

ASIC offers limited guidance for determining whether experts are independent or unbiased¹²⁹ and, in any case, in the relative small Australian economy where there are a limited number of players, the notion of "independence" is a highly diluted one.¹³⁰ The existence of a current or previous

¹¹⁹ The use of the term "[t]he expert" in s 428A(2) would appear to be a reference to the expert referred to in s 648A(1) where the term is used in the context only of mandated expert's reports. McDonald et al, n 117, p 190, explain that "[a]lthough the matter is not free from doubt, it would appear that experts' reports that are used as part of, but not mandated by, the takeover rules need not be independent". However, the authors also say that s 648A(2) is not, on its face, expressly limited to mandatory expert's reports. While that is true, in the context of s 648A(1) it is difficult to read the provision as contemplating experts' reports not mandated by the takeover rules. That the requirement applies only to mandated expert's report appears to be the view of the Takeovers Panel, in at least one case. Specifically, in *Re Email Ltd* [2000] ATP 5; (2000) 18 ACLC 708. See McDonald et al, n 117, p 190.

¹²⁰ *Corporations Act 2001* (Cth), s 640.

¹²¹ Australian Securities and Investments Commission, Policy Statement 75 *Independent Expert Reports To Shareholders* [PS 75] (updated 3 March 1997) at [75.14].

¹²² "[A] body will be considered an associate where, for example, it has entered into an agreement with its client for the purpose of controlling or influencing the conduct of the expert's affairs": *Corporations Act 2001* (Cth), s 12(2)(b).

¹²³ *Corporations Act 2001* (Cth), s 16(1)(a).

¹²⁴ Nothing in the *Corporations Act* indicates that the nature or extent of past association between an expert and client is relevant to a determination of whether the expert is an "associate". However, in the present case, Haskins Lybrand may be required to disclose certain aspects of any past association with its client in its report. See n 136 below.

¹²⁵ Australian Securities and Investments Commission, Practice Note 43 *Valuation Reports And Profit Forecast* [PN 43] (updated 4 August 1997) at [PN 43.10]. This is because Haskins Lybrand's report is one that involves the "exercise of judgement and opinion".

¹²⁶ ASIC, n 125 at [PN 43.12].

¹²⁷ Australian Securities and Investments Commission, Practice Note 42 *Independence Of Experts' Reports* [PN 42] (issued 8 December 1993) at [PN 42.8].

¹²⁸ ASIC, n 127 at [PN 42.16].

¹²⁹ ASIC, n 127 at [PN 42.9].

¹³⁰ Austin RP, "Commentary on Hill" in Rickett CEF and Grantham RB (eds), *Corporate Personality in the 20th Century* (Hart, 1998) p 212, providing a commentary on the chapter by Hill J: "Changes in the Role of the Shareholder", p 175.

relationship between the expert and client (or another interested party) will not necessarily prevent the expert preparing the report; that will depend on the nature and extent of the relationship.¹³¹ ASIC says that “[t]he closer the relationship between the expert and the interested party, the greater the onus on the expert to demonstrate the absence of bias”.¹³² Furthermore, an expert should “seriously consider declining to accept an engagement as an expert” where it (or a related person) “acts as a ... financial consultant, tax adviser or accountant etc to the client or any other interested party (other than providing professional services strictly for compliance purposes rather than strategic or operational decisions or planning)”.¹³³ At the same time, an expert is not precluded from providing a report “merely because, during the preceding two years, [it] ... acted as an auditor of the target corporation, the client or any other interested party”.¹³⁴

ASIC’s guidance clearly indicates that “independence” or lack of bias is a question of fact in any particular case.¹³⁵ A number of factors will be relevant with none determinative. It is clear that a professional services firm such as Haskins Lybrand, which provides a broad range of services, will not be barred from providing an expert’s report simply because it has provided other services for the client. But the appearance of independence is important, in ASIC’s view, and that will clearly enlarge the range of circumstances when an expert should refuse to act beyond those circumstances prohibited by law. In the present case, on the basis of both legislation and regulatory (ASIC) guidance, neither the prior representation of Kravis Pickens nor the prior (and perhaps current) provision to Amarillo of public auditing services would preclude Haskins Lybrand from providing the requested report.

However, if Haskins Lybrand accepts the instruction, it will be obliged to disclose in its expert’s report details of its current and previous relationships with Amarillo and Sidewood.¹³⁶

2. Internal independence rules

Amid recent and ongoing concerns about auditor independence arising from high profile corporate collapses, particularly Worldcom and Enron in the United States, major professional services firms such as Haskins Lybrand have instituted strict internal policies or rules for determining the firm’s response to positions of potential conflict. Michael Coleman explained this development and said that the internal policy or rules are likely to prevent the firm from providing the report even where the law would allow it. In particular, they would require the firm to obtain confirmation from Kravis Pickens that the company has no interest in the proposed transaction and will not be going forward with it and, further, to obtain the company’s consent to act for another client (being Amarillo) on the proposed transaction. In any case, Michael Coleman explained, it is unlikely that the firm would act because of

¹³¹ ASIC, n 127 at [PN 42.16].

¹³² ASIC, n 127 at [PN 42.16].

¹³³ ASIC, n 127 at [PN 42.18 (c)].

¹³⁴ ASIC, n 127 at [PN 42.19 (a)].

¹³⁵ See, eg, ASIC, n 127 at [PN 42.19].

¹³⁶ *Corporations Act 2001* (Cth), s 648A(3) would require Haskins Lybrand to disclose in its expert’s report details of the following:

“(a) any relationship between [itself, the expert] and

(i) [Sidewood] or an associate of [Sidewood]; or

(ii) [Amarillo] or an associate of [Amarillo];

including any circumstances in which the expert gives them advice, or acts on their behalf, in the proper performance of the functions attaching to the expert’s professional capacity or business relationship with them; and

(b) any financial or other interest of the expert that could reasonably be regarded as being capable of affecting the expert’s ability to vice an unbiased opinion in relation to the matter being reported on; and

(c) any fee, payment or other benefit (whether direct or indirect) that the expert has received or will or may receive in connection with making the report.”

ASIC appears to interpret this as requiring the expert to disclose in its report the nature and extent of any current or previous relationship between it and the client: ASIC, n 127 at [PN 42.17]. Justice Austin and Professor Ramsay in *Ford’s Principles of Corporations Law* comment that the wording in para (a) does not seem to encompass professional or business relationships between an associate of the expert (for example, a firm of auditors, where the expert is the firm’s wholly owed subsidiary) and the bidder (or target) or its associates: Austin and Ramsay, n 100 at [23.510].

its current association with Amarillo (providing public auditing services through its Bermuda branch), since that would diminish or compromise the independence of any report it produced.

The answer therefore is that while the law in Australia would not prohibit Haskins Lybrand from providing the report requested, the firm's internal guidelines are likely to cause it to decline the engagement.

H. Company director conflicts: Multiple directorships

No general rule of law prohibits multiple directorships, even of competing companies.¹³⁷ In such a situation, courts have taken a pragmatic approach by acknowledging that the director owes conflicting fiduciary duties.¹³⁸ But that is not to deny that a director may breach fiduciary obligations by continuing to exercise powers in the face of a conflict. The High Court in *R v Byrnes* (1996) 183 CLR 501 at 517; 69 ALJR 710; 130 ALR 539 explained as follows:

A director of a company who is also a director of another company may owe conflicting fiduciary duties. Being a fiduciary, the director of the first company must not exercise his or her powers for the benefit or gain of the second company without clearly disclosing the second company's interests to the first company and obtaining the first company's consent. Nor, of course, can the director exercise those powers for the director's own benefit or gain without clearly disclosing his or her interest and obtaining the company's consent. A fiduciary must not exercise an authority or power for the personal benefit or gain of the fiduciary or a third party (by 'third party', we mean a party whose interests are not coincident with the interests of the fiduciary's beneficiary) to whom a fiduciary duty is owed without the beneficiary's consent.¹³⁹

This guidance appears to require a common director to determine, in any case, which of the two companies he or she is exercising a power or authority in respect of, since if it is a power exercised in respect of one company it may not be exercised for the benefit of the other or for self-benefit (without consent). This would not seem to impose on the common director any obligation or restriction additional to those owed by other directors. The director may, consistently with the discharge of fiduciary obligations as outlined in the extract above, exercise a power or authority granted by one company contrary to the interests of the other on whose board he or she also sits. It is artificial to partition the exercise of a power or authority in the way apparently suggested by the High Court. There must be some limit to circumstances when a director may owe conflicting fiduciary obligations, even though none is articulated above.

In the case study, the director who sits on the board of both Sidewood and Amarillo – bidder and target in the proposed takeover – is in a position where the duty he owes each company conflicts. There is more than “real and substantial possibility” of conflict; actual conflict exists because, in respect of the proposed transaction (which is likely to dominate discussion at each company's board meetings), each company's interests are opposed and, in fact, the companies are adversaries. It is very difficult to see how the director, while still a member of both boards, could participate in decision-making by either company about the proposed transaction.

The question arises, however, whether the director can avoid breaching his or her fiduciary obligation (assuming that informed consent is not forthcoming) by simply refraining from participating in debate and voting on the takeover or whether he or she must resign from one or both directorships. Rowan Russell indicated that, in practice, the director would have disclosed his or her competing directorship, so that when the issue involving Amarillo arose for discussion at Sidewood, for instance, the director would have been prevented from participating or knowing of it. Without knowledge of the proposed bid for Amarillo, it is difficult to see how the director could be in breach

¹³⁷ Austin and Ramsay, n 100 at [9.410].

¹³⁸ See *R v Byrnes* (1996) 183 CLR 501 at 517; 69 ALJR 710; 130 ALR 539; *Ford v Andrews* (1916) 21 CLR 317 at 322.

¹³⁹ Citations omitted. Presumably the reference to board approval for a director acting in what would otherwise amount to a breach of a fiduciary duty contemplates that the constitution of the company permits this. Ordinarily, ratification or approval for a breach of fiduciary duty must be provided by the company in general meeting. But the High Court notes at 517 that “the articles of a company may permit – they frequently do permit – a director who is interested in a proposed transaction to take the benefit of the transaction if he discloses his interest to the other members of the board and takes no party in the decision of the board on the transaction”.

of any duty to Amarillo by not disclosing the bidder's intentions. However, once the bid was announced, the conflict is clearly unresolvable and it may be appropriate for the director to resign from both boards. There would seem to be no reason why, if the director resigned from the board of one company, he or she should not also resign from the other. Of course, even after resigning (as before), the director "is constrained by the law with respect to confidential information, which is at least as onerous in the director's case as in the case of an employee".¹⁴⁰ Resigning from both boards may be the most prudent approach for the director, particularly considering the appearance of impropriety of resigning from one company only or of simply refraining from decision-making; good corporate governance would probably also favour this approach since it minimises as much as possible any risk of the director acting otherwise than in the interests of the relevant company.

I. Company director conflicts: Legal adviser as director of client

Two issues arise here, where a company director is partner of a law firm that is representing another company with adverse interests: first, whether the law firm, Stone & Simpson, can act for Sidewood and second, whether, if the partner in question continues as a director of Amarillo, he or she is obliged to disclose details of the proposed takeover.

1. Stone & Simpson's retainer with Sidewood

The relationships between solicitor and client and director and company are, by virtue of their status, fiduciary in character. Of course, that does not mean that every aspect or dimension of each relationship is fiduciary in nature.¹⁴¹ Similarly, while the identification of a fiduciary relationship is said to only begin the analysis (in that the precise parameters of the obligations imposed must still be determined), the obligation to avoid conflicts is ordinarily incidental to these classes of relationship.¹⁴² Both a solicitor and director will be obliged to avoid positions of conflict of interest, without the informed consent of the client or company, respectively.

In the present case, the partner in question clearly owes fiduciary obligations to Amarillo in his capacity as a non-executive director of it. It is also clear that the Stone & Simpson solicitors acting for Sidewood on the proposed transaction are in a fiduciary relationship with that client and owe it fiduciary obligations; in respect of the firm Stone & Simpson itself, it is said to be in no better position in terms of fiduciary obligation than those of its solicitors in fact acting for Sidewood (meaning that it is similarly constrained).¹⁴³ It follows, it is submitted, that other solicitors at the firm – those not acting for Sidewood on the transaction (including the partner/director in question) – are similarly in no better position in terms of fiduciary obligation. The partner/director thus owes conflicting fiduciary duties to each of Amarillo and Sidewood; however, like the position of the company director, this does not necessarily mean that any fiduciary breach has occurred.

While it may be argued that the Stone & Simpson partner is acting as a solicitor in his personal capacity, which dimension is not fiduciary in nature for purposes of the directorship, that would probably be to compartmentalise his roles in a way inimical to the high standards required of a fiduciary position. The problem is difficult to analyse and tackle. As for any duty owed to Sidewood as client, it is arguable that a fiduciary breach could be avoided by Stone & Simpson obtaining its informed consent in advance (that is, by disclosing at the outset that one of its partners is a director of the target and by Sidewood permitting the firm to continue to act) or by providing in the engagement letter that the scope of the fiduciary relationship does not extend to that partner's interest as director of the target.

¹⁴⁰ Austin and Ramsay, n 100 at [9.410].

¹⁴¹ In the case of the solicitor–client relationship, the Court of Appeal in *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 1; 33 ACSR 1, stated that "[n]ot every aspect of a solicitor client relationship is fiduciary" and that "[c]onduct which may fall within the fiduciary component of the relationship of solicitor and client in one case, may not fall within the fiduciary component in another": at 45 [188].

¹⁴² However, to accept that parties owe fiduciary obligations to each other does not necessarily mean that all obligations ordinarily incidental to recognised classes of fiduciary relationships will apply. See *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410 at 539; 139 ALR 193, citing *Kelly v C & A Bell Commodities Corporation Pty Ltd* (1989) 18 NSWLR 248 at 258.

¹⁴³ *Bolkiah* [1999] 2 AC 222 at 234-235.

2. Directorship

The partner/director's problem is magnified in respect of his position on the board of Amarillo. The informed consent of Amarillo to Stone & Simpson acting for Sidewood could not be obtained since that would involve disclosing the existence of the proposed takeover offer, which would amount to a breach of fiduciary duty to Sidewood and a breach of the duty to protect confidential information. (Informed consent might be obtained after the takeover has been announced, though, and there is some question as to whether the director might obtain generalised advance consent from Amarillo for his firm acting for an adversary on the type of transaction proposed).¹⁴⁴ From a practical perspective, it would seem that the partner/director should resign from Amarillo since it is difficult to see how he or she might discharge fiduciary obligations as director while being a partner of a firm representing an adversary. As to whether the partner/director has a duty to disclose to Amarillo information about the takeover, that depends on whether any information within the knowledge of any partner at Stone & Simpson is imputed to the partner/director in question (assuming, of course, he or she has no actual knowledge). For reasons explained above,¹⁴⁵ there is no conclusive answer, although the weight of authority is with there being no imputation of knowledge to a partner of a large firm such as Stone & Simpson.

One issue discussed during the conference proceedings was whether Australian firms should, like many major international law firms, prohibit their partners from serving as non-executive directors of public companies. Anthony Alexander, former senior equity partner of Denton Wilde Sapte, the international law firm, explained that his former firm almost invariably forbade any partner from acting as a director of a public company. In response, Lee Aitken suggested that Australia's relatively small population might require that firms here adopt a more liberal approach since a strict approach would deprive companies of a considerable pool of talented potential directors.

4. CONCLUSION

Many of the questions raised by this case study require advisers, particularly legal advisers, to make difficult judgments surrounding pure legal advice. The challenge is magnified because no bright line rules exist and some areas of law require complex factual assessments to be made. In particular, no rigid rules prescribe when knowledge of individual solicitors at large law firms is imputed to others and uncertainty exists as to the extent to which fiduciary duties may be attenuated by contract. Also, the numerous recent disputes over whether Chinese walls remove any "real risk" of disclosure are evidence of the difficult factual assessment required. Finally, the law offers no real guidance on how a director of competing companies may discharge fiduciary obligations owed to each company and this issue, like others, demonstrate the tension and distance between legal principle and commercial reality. At the same time, Justice Austin indicated in his Commentary that courts are responding to these challenges by taking a practical and commercially realistic approach to the balancing of the social policies involved.¹⁴⁶

The case study also shows the importance of non-legal considerations that will inform the responses of companies and their deal advisers. Financial reward creates powerful incentives for parties to navigate their way through the thicket of obligations that might more easily be avoided by refusing to act. Questions of tactics and strategy must be considered in this adversarial setting, as in the case of a former client seeking to restrain an investment bank from representing an adversary. The public interest will be relevant to ensuring that clients can choose their own legal representatives, particularly in the relatively small Australian market.¹⁴⁷ At the same time, there is a strong public interest in upholding the high standards of fiduciary office.

It is inevitable that responses to the challenges of avoiding conflicts of interest and protecting confidences will be informed by legal, tactical, ethical and other considerations. The task is difficult because of the complex amalgam of relevant legal principles and uncertainty about the application of a number of them. In time, Justice Austin forecast during the conference, the law will recognise and

¹⁴⁴ For a discussion of circumstances in which fiduciary obligations can be modified by contract, see n 41.

¹⁴⁵ See Part 3.A above.

¹⁴⁶ Austin, n 130.

¹⁴⁷ See Aitken L, "Chinese Walls, Fiduciary Duties and Intra-Firm Conflicts" (2000) 19 Aust Bar Rev 116 at 134.

accredit prudent conflicts of interest management regimes in large firms. In the meantime, however, deal advisers and their clients must continue to respond to difficult issues with strict adherence to existing legal principles, informed by other relevant considerations. Inevitably, the commercial imperative will impel some advisers to accept instructions where prudence would counsel otherwise. In the final analysis, however compelling these other considerations, the general legal requirements, at least for lawyers, are strict. Conflicts must be avoided. Confidential information must be protected. Anything less will warrant judicial intervention. Appeals to commercial reality or practical necessity will count for little, particularly in the current era where public scrutiny of corporate and professional propriety is intrusive and reputations fragile.

Schedule 1: Cast of characters for hypothetical case study

Clients

Party	Role
Sidewood Petroleum Ltd	Bidder
Amarillo Petroleum Ltd	Target
Tulkinghorn Industries Ltd	Potential litigant adverse to Amarillo
Kravis Pickens Ltd	Potential competing bidder

Deal advisers

Adviser	Role
Stone & Simpson (including partners Stella Smart (Sydney) and Gerry Smooth (Melbourne))	Bidder law firm
Fraser & Galloway (including partner Fred Fullagar (Melbourne))	Target law firm
Manhattan Burnham	Bidder investment bank
Shearson Lambert (including Arthur Macquarie, Head of investment banking)	Target investment bank
Haskins Lybrand	Professional services firm requested to provide independent expert's report.

Schedule 2: List of participants at conference

Participant	Role
Justice R P Austin Supreme Court of New South Wales	Commentator
David Friedlander Mallesons Stephen Jaques	Hypothetical moderator
Lee Aitken Faculty of Law, University Sydney	Panel member
Michael Coleman KPMG	Panel member
Elizabeth Johnstone Blake Dawson Waldron	Panel member
Damian Lovell Freehills	Panel member
Barbara McDonald Faculty of Law, University of Sydney	Panel member
Rowan Russell Mallesons Stephen Jaques	Panel member
Andrew Tuch Faculty of Law, University of Sydney	Panel member