INVESTMENT BANKS AS FIDUCIARIES: IMPLICATIONS FOR CONFLICTS OF INTEREST

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[Investment banks play an intermediary role in the financial system that is integral to its efficient operation. A core, and highly visible, aspect of their work is providing financial advisory services to institutional clients on transactions that have strategic importance, such as mergers and acquisitions. As these services are but one aspect of the broad and diverse range of financial services that investment banks typically provide, challenges such as conflicts of interest inevitably arise. Somewhat anomalously, the question of whether these firms owe fiduciary duties to their clients when providing financial advisory services has received little regulatory, judicial or scholarly attention. This article will address that question, consider the parameters of any fiduciary obligation to avoid conflicts of interest that may arise, and discuss the implications for responses to these conflicts.]

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I INTRODUCTION

This article discusses whether, in the context of financial advisory services,[1] the relationship between investment banks and their clients is fiduciary in character, such that it gives rise to the obligation to avoid conflicts of interest. The fiduciary obligation is a demanding standard of propriety in conduct that is unequalled elsewhere in the law.[2] Discharging it may require an investment bank to decline instructions from a prospective client that are likely to give rise to a conflict between the bank's duty to that client and either the bank's self-interest or its duty to another client — or else risk confronting the distinctive remedial consequences of breaching the obligation.

The question is significant for a number of reasons. First, in the absence of a fiduciary relationship and outside any express contractual undertaking, investment banks will, generally speaking, not be obliged to avoid conflicts of interest in providing these financial advisory services. Second, the imposition of fiduciary obligations could have very real practical consequences for investment banks: they may be restrained from acting on a transaction or be exposed to equity's gain-stripping remedies, and the banks' current measures for responding to conflicts of interest — involving the use of Chinese walls — may be ineffective. Third, major investment banks have indicated publicly their belief that they operate unconstrained by fiduciary obligations in these circumstances.[3] Fourth, the regulation of other aspects of an investment bank's operations would appear to be inconsistent with the imposition of fiduciary obligations in this context. In

[1] Financial advisory services are sometimes also referred to as corporate advisory services or corporate finance services. The first expression is adopted in this article and appears to be the more widely used: see, eg, Charles Geisst, *Investment Banking in the Financial System* (1995) 191; The Goldman Sachs Group Inc, *Annual Report on Form 10-K* (2003) 4; Morgan Stanley, *Annual Report on Form 10-K* (2003) 2; cf Samuel Hayes III and Philip Hubbard, *Investment Banking: A Tale of Three Cities* (1990) 129.

[2] *Bristol & West Building Society v Mothew* [1998] Ch 1, 16–19 (Millett LJ).

[3] See, eg, *Mannesman AG v Goldman Sachs International* (Unreported, High Court of Justice of England and Wales, Chancery Division, Lightman J, 18 November 1999) [3], [8].

particular, the regulation provided for recently in Chapter 7 of the *Corporations Act 2001* (Cth)[4] arguably assumes that conduct which would amount to a breach of fiduciary obligations is lawful for investment banks. Fifth, the question has received little judicial, regulatory or scholarly attention.[5]

In view of the current unprecedented levels of investment banking activity in Australia,[6] and recent reconsideration by many investment banks of the logic of financial conglomeration (or, more specifically, whether they should continue to provide financial advisory services in addition to their other diversified products and services),[7] it is timely that the question considered in this article be addressed.

The article is organised as follows. Part II discusses the theoretical orientation adopted to address the question. Part III broadly outlines the nature of investment banks and the range of services they provide, and describes the core investment banking activity of providing financial advisory services. Part IV describes the factual relationship that exists between a firm and its clients in that context. Part V describes the legal reasoning courts have used when recognising a new category of relationship as being fiduciary in nature, and discusses the case law relevant to the allegedly fiduciary character of the relationship in question. Part VI applies this law to that relationship and concludes that a strong case exists for characterising it as fiduciary, while also discussing the content and scope of any duty to avoid conflicts of interest. The implications for how firms respond to conflicts of interest are considered in Part VII and conclusions are drawn in Part VIII.

4 For a description of these regulations, see below Part VII(B).

5 This appears to be primarily because the entry of foreign investment banks into Australia (and the increased levels of investment banking activity that followed) is largely a product of the financial market deregulation of the 1980s, and because any disputes in which the question has arisen have been resolved without public ventilation of the issue. For a discussion of the entry of foreign investment banks, see International Banks and Securities Association of Australia (‘IBSA’), *Investment Banking in Australia* (2002) 4, 24–5 <http://www.ibsa.asn.au/Reports/FinalProfile-NoCover.pdf>. See also discussion of the United States position, below Part VI.

6 See Joyce Moullakis, ‘Bumper Year for M&A Transactions’, *The Australian Financial Review* (Sydney), 2 February 2005, 19 (reporting that the value of announced merger and acquisition transactions in Australia increased by 81 per cent from 2003 to a record level in 2004). See also ‘Boom Times for Mergers and Acquisitions’, *The Sydney Morning Herald* (Sydney), 16 March 2005, 27 (reporting the result of a study by Ernst & Young that predicted merger and acquisition activity would increase further in 2005).

7 In 2005, American Express decided to dispose of its financial advisory division and Citigroup announced its decision to narrow the range of its financial services by selling its life insurance and annuity business. Morgan Stanley, one of the world’s leading investment banks, is also questioning whether it should be providing the broad range of financial services and products that it currently offers. See Jenny Anderson, ‘American Express Plans to Spin Off Wall St Unit’, *Business Day*, *The New York Times* (New York), 2 February 2005, C1 (reporting that the decision of American Express to spin off its financial advisory business ‘reflects a growing trend on Wall Street to unwind the giant financial supermarkets built over the 1990s’); ‘Morgan Stanley under Fire’, *The Economist*, 9–15 April 2005, 60–1 (reporting that firms have begun questioning the logic of financial conglomeration); Ann Davis, ‘Morgan Stanley Plans to Spin Off Discover Card’, *The Wall Street Journal* (New York), 5 April 2005, A1 (reporting that Morgan Stanley confirmed plans to disamalgamate a division of its business).

II Theoretical Basis

The identification of relationships as fiduciary in character is important because the obligations imposed as a consequence of fiduciary characterisation exact from a person or persons a standard of loyalty, as expressed in conduct, that is both uncompromising and rigorous.[8] Honest conduct alone is insufficient to discharge the obligations: it is said that even a person of integrity may abrogate his or her fiduciary obligations without being dishonest.[9] What is required is complete loyalty to the service of another's interests.[10]

The evident concern of fiduciary principle is with the maintenance of loyalty and fidelity,[11] which is achieved by exacting the very high standard of conduct. This concern reflects public policy considerations, not least of which is the need to maintain public confidence in the integrity and utility of a range of relationships perceived to be socially important, in which the (or a) role of one person is, or is seen to be, to serve the interests of another.[12] Fiduciary principle can thus be regarded as an expression of how a society, as represented by the courts, may wish to regulate the conduct of persons in their relations with others.[13]

In broad terms, in the case of a relationship that is not 'established' or 'accepted' as fiduciary,[14] two judicial approaches can be discerned for addressing the question of whether it is fiduciary in character. The first is that courts have endorsed particular features of a relationship as identifying fiduciary character. Although none is determinative, these features 'point towards' the existence of a fiduciary relationship.[15] They include the existence of an undertaking by a person (the fiduciary) to act in the interests of another person;[16] a relation of

[8] *Breen v Williams* (1996) 186 CLR 71, 93 (Dawson and Toohey JJ) ('*Breen*'). See also P D Finn, 'The Fiduciary Principle' in T G Youdan (ed), *Equity, Fiduciaries and Trusts* (1989) 1, 26. Cardozo CJ in *Meinhard v Salmon*, 249 NY 458, 464 (1928) asserted that '[n]ot honesty alone, but the punctilio of an honor the most sensitive, is then the standard of [the fiduciary's] behavior.'

[9] John Glover, *Commercial Equity: Fiduciary Relationships* (1995) 147–8; see also *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151, 237 (Finn J).

[10] Finn, 'The Fiduciary Principle', above n 8, 27.

[11] Ibid 2, 25.

[12] Ibid 3, 26, 27, 42; *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151; Sir Anthony Mason, 'The Place of Equity and Equitable Remedies in the Contemporary Common Law World' (1994) 110 *Law Quarterly Review* 238, 246.

[13] Finn, 'The Fiduciary Principle', above n 8, 3.

[14] 'Accepted' or 'established' fiduciary relationships include those between trustee and beneficiary, agent and principal, solicitor and client, employer and employee, director and company and between partners. See *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41, 96 (Mason J) ('*Hospital Products*'). Additional 'accepted' categories of fiduciaries include receivers in bankruptcy and creditors, liquidators and contributories (see John Glover, *Equity, Restitution and Fraud* (2004) 28–9; Patrick Parkinson, 'Fiduciary Obligations' in Patrick Parkinson (ed), *The Principles of Equity* (2nd ed, 2003) 339, 340–6; R P Meagher, J D Heydon and M J Leeming, *Meagher, Gummow & Lehane's Equity: Doctrines and Remedies* (4th ed, 2002) 158); promoters of a company and its subscribers (*Aequitas Ltd v Sparad No 100 Ltd* (2001) 19 ACLC 1006, 1070 (Austin J) ('*Aequitas*'); John Glover, *Equity, Restitution and Fraud* (2004) 28–9; Patrick Parkinson, 'Fiduciary Obligations' in Patrick Parkinson (ed), *The Principles of Equity* (2nd ed, 2003) 339, 342); and perhaps stockbrokers and their clients (*Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371 ('*Daly*')).

[15] *Breen* (1996) 186 CLR 71, 107 (Gaudron and McHugh JJ).

[16] *Hospital Products* (1984) 156 CLR 41, 96–7 (Mason J); *Bristol & West Building Society v Mothew* [1998] Ch 1, 18 (Millett LJ).

trust and confidence;[17] vulnerability to another's power or vulnerability necessitating reliance;[18] power held by a person (the fiduciary) to affect the interests of the other person in a real or practical sense;[19] and a reasonable expectation that a person (the fiduciary) will act in the interests of another in and for the purposes of a relationship.[20]

The second approach is to reason by analogy from previously decided cases and established categories of fiduciary relationship.[21] This clearly overlaps with the first approach since, in making analogies, courts may and do have regard to similarities in terms of the features identifying fiduciary character.

Although the fiduciary principle is incapable of precise definition,[22] a number of modern commentators have suggested a unifying theory of fiduciary principle to explain the pervasive reach of the obligation.[23] In Australia and other jurisdictions, there is growing support for the notion that 'reasonable expectations — an amalgam of actual expectations and judicial prescription — are a potent factor in the identification of the standard appropriate to a given situation.'[24] Propounded

[17] *Hospital Products* (1984) 156 CLR 41, 69 (Mason J), citing *Tate v Williamson* (1866) LR 2 Ch App 55, 61 (Lord Chelmsford LC); *Coleman v Myers* [1977] 2 NZLR 225, 325 (Woodhouse J).

[18] *Hospital Products* (1984) 156 CLR 41, 142 (Dawson J); *Mabo v Queensland [No 2]* (1992) 175 CLR 1, 200–1 (Toohey J) ('*Mabo*'); *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504, 521 (Finn J) ('*ASC v AS Nominees*').

[19] *Hospital Products* (1984) 156 CLR 41, 96–7 (Mason J). Mason J appears to have cited all three features as common to fiduciary relationships:

> The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position.

For other characteristics, see *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165, 220 (Kirby J) ('*Pilmer*') and Glover, *Equity, Restitution and Fraud*, above n 14, ch 2.

[20] *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151, 181 (Finn J); *ASC v AS Nominees* (1995) 62 FCR 504, 521 (Finn J); *Glandon Pty Ltd v Strata Consolidated Pty Ltd* (1993) 11 ACSR 543; *Doolan v Dare* [2004] FCA 682 (Unreported, Spender J, 27 May 2004) [39]; Finn, 'The Fiduciary Principle', above n 8, 46.

[21] See Glover, *Equity, Restitution and Fraud*, above n 14, 33–8.

[22] The fiduciary relationship has been said to defy definition: *Breen* (1996) 186 CLR 71, 106 (Gaudron and McHugh JJ). Furthermore, the features or indicia giving rise to a fiduciary relationship are nowhere exhaustively defined: *Mabo* (1992) 175 CLR 1, 200 (Toohey J); *Hospital Products* (1984) 156 CLR 41, 68 (Gibbs CJ), 96–7 (Mason J); *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410, 538–9 (Lockhart, von Doussa and Sackville JJ); P D Finn, *Fiduciary Obligations* (1997) 1.

[23] Shepherd concluded that a fiduciary relationship 'exists whenever any person receives a power of any type on condition that he also receive with it a duty to utilise that power in the best interests of another, and the recipient of the power uses that power': J C Shepherd, 'Towards a Unified Concept of Fiduciary Relationships' (1981) 97 *Law Quarterly Review* 51, 75; see also J C Shepherd, *The Law of Fiduciaries* (1981). Frankel asserted that 'all fiduciary relations give rise to the problem of abuse of power, [and] that the purpose of fiduciary law should be to solve this problem': Tamar Frankel, 'Fiduciary Law' (1983) 71 *California Law Review* 795, 807. See also Deborah A DeMott, 'Fiduciary Obligation under Intellectual Siege: Contemporary Challenges to the Duty to Be Loyal' (1992) 30 *Osgoode Hall Law Journal* 471, 472, for a discussion of the significant challenge faced by legal theorists due to the pervasive reach of fiduciary obligation, coupled with the variable content of the obligation.

[24] Finn, 'The Fiduciary Principle', above n 8, 6. See also Paul Finn, 'Contract and the Fiduciary Principle' (1989) 12 *University of New South Wales Law Journal* 76, 84: in respect of judicially-prescribed expectation, Finn explains that it may arise either because on the facts it 'should' or 'because the purpose of the relationship itself is perceived to be such that to allow

by Professor Finn, the 'reasonable expectations' criterion has been regarded as both a unifying theory for the fiduciary principle[25] and a feature identifying when a relationship is fiduciary in nature.[26] According to this criterion, a fiduciary relationship arises where, within the scope of the relationship in question or in respect of a particular matter, a person can be reasonably expected to act in the interests of another in and for the purposes of the relationship.[27] What must be shown 'is that the actual circumstances of a relationship are such that one party is entitled to expect that the other will act in his interests.'[28] Whether regarded as a unifying theory or identifying feature, the 'reasonable expectations' criterion — when taken together with other fiduciary identifying features — assists in the practical application of basic doctrine to varying relationships and facts.[29]

The approach adopted in this article in considering the question of whether the relationship between investment banks and their financial advisory clients is fiduciary in character emphasises the 'reasonable expectations' criterion in addition to considering other judicially-endorsed criteria for identifying fiduciary relationships. Adopting this approach ensures that the identification of a fiduciary relationship takes account of public policy considerations that underpin fiduciary principle, since these will invariably inform an assessment of whether a reasonable expectation exists in the circumstances. This approach has also been accepted in a growing number of contemporary cases, including in contexts that have strong parallels with investment banking.[30] Thus, at a doctrinal level, it carries legitimacy. In addition, this approach is said, '[a]s a matter of practicality, to reduce the uncertainties that arise' from applying the reasonable expectations criterion alone.[31] The final reason for adopting this approach is that it provides a normative basis for assessing whether the extension of fiduciary principles to the relationship in question is justified.

This article also applies analogical reasoning to a core of relevant cases and established fiduciary relationships to consider the fiduciary character of the

disloyalty in it would be to jeopardise its perceived social utility.' Cases referring with approval to the 'reasonable expectations' criterion as a theoretical basis of the fiduciary principle, whether with or without attribution to Finn, include *Pilmer* (2001) 207 CLR 165, 192 (McHugh, Gummow, Hayne and Callinan JJ); *Wik Peoples v Queensland* (1996) 187 CLR 1, 95–6 (Brennan CJ); *United States Surgical Corp v Hospital Products International Pty Ltd* [1983] 2 NSWLR 157, 208 (Moffit P, Hope and Samuels JJA); *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390 ('*CBA v Smith*'); *Glandon Pty Ltd v Strata Consolidated Pty Ltd* (1993) 11 ACSR 543; *Hodgkinson v Simms* [1994] 3 SCR 377; *Merrill Lynch, Pierce, Fenner & Smith Inc v Boeck*, 377 NW 2d 605, 609 (Steinmetz J) (Wis, 1985). See also Mason, above n 12, 246.

25 See, eg, Robert Flannigan, 'The Boundaries of Fiduciary Accountability' (2004) 83 *Canadian Bar Review* 35, 54–61.

26 See above n 20.

27 See *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151, 181 (Finn J); *ASC v AS Nominees* (1995) 62 FCR 504, 521 (Finn J); Finn, 'The Fiduciary Principle', above n 8, 46.

28 Finn, 'The Fiduciary Principle', above n 8, 46.

29 See *Pilmer* (2001) 207 CLR 165, 219 (Kirby J).

30 See above nn 20, 24. Significantly, Finn J also appears to have endorsed the approach of applying the 'reasonable expectations' criterion in conjunction with others: see *ASC v AS Nominees* (1995) 62 FCR 504, 521.

31 *Pilmer* (2001) 207 CLR 165, 220 (Kirby J).

relationship in question. Reasoning in this way gives some confidence that legal developments in regard to the application of the fiduciary principle will maintain the continuity of the law and preserve its coherence.[32]

III Investment Banks

A *Origins and Importance*

Investment banks are a unique breed of institution, one that is incapable of precise definition.[33] In the main, they are corporations that provide a broad range of financial intermediary services, a core part of which involves advising corporations, institutions and governments on commercial transactions of strategic importance.[34] Since the turn of the 20th century, investment banks have been providing such services, which have been integral to the efficient operation of the financial system.[35]

The term 'investment banking' was coined in the United States in the early part of the 20th century and is now widely used in other countries, including Australia.[36] It is a term that is generally descriptive of the specialised intermediary functions or activities such banks perform, rather than a specific designation given by the state or by a professional association. Although referred to as 'banks', historically they have not held banking licences nor been permitted to provide commercial banking services such as taking deposits from or lending money to retail customers. In Australia they have also been referred to as merchant banks or money market corporations, although the American term is now more prevalent.[37]

The influence of investment banks in the financial system and broader community is vast and their importance is increasing.[38] The transactions on which they advise can have significant consequences for business competition and employment, often on an industry-wide or national basis. These transactions can transform the financial and corporate landscape of entire economies and affect many thousands of people as customers or workers. The financial advisory fees they generate are large. In 2004, the fees earned in Australia from advising on just one type of transaction — mergers and acquisitions — were in excess of

32 See *Esanda Finance Corporation Ltd v Peat Marwick Hungerfords* (1997) 188 CLR 241, 298 (Gummow J), referring to Sir Owen Dixon, 'Concerning Judicial Method' (1956) 29 *Australian Law Journal* 468, 472, 475.

33 Vincent P Carosso, *Investment Banking in America: A History* (1970) ix.

34 Geisst, above n 1, 2.

35 Ibid 1.

36 See, eg, 'Investment Banking', *Special Reports*, *The Australian Financial Review* (Sydney), 6 April 2005, 1.

37 Ibid. In the case of some firms, their description as money market corporations is still appropriate since the firms adopt this form of structure: see below n 45.

38 The Australian Securities and Investments Commission ('ASIC') has noted that trends in capital markets over the years have resulted in the increased importance of investment banking: ASIC, *Research Analyst Independence: Surveillance Report* (2003) 7. IBSA, an industry association that represents investment banks in Australia, estimates that Australian investment banks employ approximately 20 000 Australians: IBSA, *Economic and Social Impacts of Investment Banking in Australia* (2004) 3 <http://www.ibsa.asn.au/Reports/FinalEconSocial.pdf>.

US$500 million,[39] with the value of the actual transactions amounting to US$102 billion.[40] On a worldwide basis, the corresponding figures were far greater.[41]

B *Evolution*

Today, the major international investment banks are listed public corporations that provide a broad and diverse range of financial services.[42] Prominent examples are Goldman Sachs, Merrill Lynch and Morgan Stanley.[43] In Australia, the investment banking landscape features these and other international investment banks from the United States and Europe, smaller Australian investment banks, and the wholesale banking arms of major Australian (commercial) banks.[44] The structure adopted by firms to conduct investment banking business varies, depending on the range of services provided and other factors, including taxation and regulation considerations.[45]

Many of these firms now describe themselves as global financial services firms[46] or are referred to as financial services conglomerates.[47] In this article they are referred to as investment banks.

Formerly, these firms were partnerships that provided what are regarded as traditional investment banking activities, which are described in more detail below. While these activities have remained core operations, over the last few decades the firms have expanded their operations to offer a more diverse and fuller range of financial intermediary services. This diversification and expansion was in response to the internationalisation of capital markets and industry deregulation, and was carried out for the purpose of benefiting from synergies thought to arise from providing complementary financial services and products. To raise the capital required to achieve this, the firms discarded their partnership status and incorporated, listing publicly and taking form as the public corporations that today dominate the industry.

39 Michael Evans, 'Investment Bankers Have Reason for Joy', *The Sydney Morning Herald* (Sydney), 13 December 2004, 36.

40 Ibid. This figure is for the value of publicly-announced mergers and acquisitions transactions.

41 For example, the value of mergers and acquisitions activity worldwide in the first half of 2005 was in excess of US$1.4 trillion: 'The Ticker', *The Boston Herald* (Boston), 6 July 2005, C4.

42 Geisst, above n 1, 14, 205; Hayes and Hubbard, above n 1, 2.

43 The incorporated names of these companies according to public documents filed with the US Securities and Exchange Commission ('SEC') are: The Goldman Sachs Group Inc; Merrill Lynch & Co Inc; and Morgan Stanley. All are incorporated in Delaware and have their principal executive offices in New York City. See SEC, *List of Section 13F Securities* (2005) <http://www.sec.gov/divisions/investment/13f/13flist2005q1.pdf>.

44 See ASIC, *Research Analyst Independence*, above n 38, 17–18.

45 See IBSA, *Investment Banking in Australia*, above n 5, 27. Most investment banks are 'authorised deposit-taking institutions' ('ADIs'), pursuant to s 5 of the *Banking Act 1959* (Cth), operating as either locally-incorporated banks or foreign branch banks, in either case supervised by the Australian Prudential Regulation Authority ('APRA'). Other investment banks operate as money market corporations, broadly regulated by ASIC and subject to the provisions of the *Corporations Act 2001* (Cth).

46 See, eg, Morgan Stanley, which describes itself as a 'global financial services firm': Morgan Stanley, above n 1, 1.

47 See, eg, Law Commission, United Kingdom, *Fiduciary Duties and Regulatory Rules*, Consultation Paper No 124 (1992) 12 ('*Fiduciary Duties Consultation Paper*').

C *Range of Operations*

The activities regarded as the core or traditional operations performed by investment banks relate to the issuing, buying and selling of securities and the giving of related financial advice to wholesale clients — or, in industry parlance, securities underwriting and financial advisory services.[48] In their annual reports and on their websites, investment banks hold themselves out as being expert in providing these services.[49] Securities underwriting involves providing assistance to corporate, institutional and governmental clients in public offerings and private placements of debt, equity and other securities. Financial advisory services, sometimes also referred to as corporate advisory services[50] or more generally as part of a firm's corporate finance activities,[51] involve giving advice to clients on strategic transactions or matters such as mergers and acquisitions, divestitures, spin-offs, restructurings, joint ventures, privatisations and leveraged buyouts.

The financial advisory services provided by firms are the major focus of this article and are discussed in more detail in Part IV.

Investment banks currently provide a wide range of additional services. These include securities trading (or brokerage) activities, investment research,[52] dealing,[53] market-making, financing,[54] asset management and customer advisory services, private equity activities, and foreign exchange dealings. In providing these services a firm may either 'deal as an agent or in its own right' (as principal).[55] In many cases, a separate department or business segment (though not necessarily a separate corporate entity within the firm) will provide each of these services. Although services have expanded considerably, securities underwriting and financial advisory work remain the core functions of investment banks.[56]

Investment banks have often been contrasted with commercial banks, which deal with the investing public by taking deposits and making loans. However, many investment banks do not hold banking licences and, except in respect of their brokerage activities, will deal only with corporate, institutional and government clients.

48 Geisst, above n 1, 2.

49 See, eg, The Goldman Sachs Group Inc, above n 1, 5; Merrill Lynch & Co Inc, *Annual Report on Form 10-K* (2003) 4–6; Morgan Stanley, above n 1, 2–3; and the websites for each of these investment banks: The Goldman Sachs Group Inc <http://www.gs.com>; Merrill Lynch & Co Inc <http://www.ml.com>; Morgan Stanley <http:/www.morganstanley.com>.

50 IBSA, *Economic and Social Impacts*, above n 38, 1.

51 IBSA, *Investment Banking in Australia*, above n 5, 7.

52 Investment research involves providing 'fundamental research on companies, industries, economies, currencies, commodities and portfolio and quantitative strategy': The Goldman Sachs Group Inc, above n 1, 12.

53 Dealing involves the firm buying or selling securities for its own account, rather than for a client: Marc Steinberg, *Understanding Securities Law* (1996) 355. See also Law Commission, United Kingdom, *Fiduciary Duties Consultation Paper*, above n 47, 16–17.

54 Forms of finance provided include 'project finance, infrastructure finance, structured finance, syndicated loans, securitisation, corporate lending, leasing [and] trade finance': IBSA, *Economic and Social Impacts*, above n 38, 1.

55 Law Commission, United Kingdom, *Fiduciary Duties Consultation Paper*, above n 47, 18.

56 Geisst, above n 1, 133, 191; Hayes and Hubbard, above n 1, 129.

D *Potential for Conflicts of Interest*

There is significant potential in the investment banking environment for conflicts of interest to occur. Indeed, conflicts are regarded as an inevitable or inescapable feature of the business of investment banking.[57] This is due to the multiple services offered by firms, the different capacities in which they act, and their broad client base.

Positions of conflict with the interests of financial advisory clients can arise in a number of ways.[58] First, an investment bank's self-interest may conflict with that of its financial advisory client. Examples of this would include competing with a client for an investment opportunity (or being part of a syndicate doing the same) and providing financial advisory services to the target company of an unsolicited takeover offer at the same time as the firm's asset management arm independently sells some of its holding of shares in that company.[59]

Second, a firm may be in a position where the interests of one client conflict with those of another. Examples of this include where a firm is providing financial advisory services to separate clients who are considering the same investment opportunity; and where an investment bank is advising the target of an unsolicited takeover offer while also being part of a syndicate raising finance for the bidder.

Third, conflicts may arise among functions or services provided by an investment bank such that there is a systemic incompatibility with the interests being served. A recent industry-wide example of this concerns the securities trading (or brokerage) services of investment banks, which involve banks providing timely, 'independent' and unbiased information about public companies to individual investors. This is done by the provision of 'research reports'. Since the firms also provide — or desire to provide — financial advisory services to these companies, they often are placed in positions where the interests of recipients of the research reports (individual investors) diverge from the interests of the financial advisory clients.[60]

57 See Royston Goode, *Conflicts of Interest in the Changing Financial World* (1986) xv, with respect to the inescapable existence of conflicts of interest in financial services conglomerates; Law Commission, United Kingdom, *Fiduciary Duties Consultation Paper*, above n 47, 1, 12–18, 61–3, regarding the effect of the way in which these firms are organised and the services they provide on the risk of conflicts arising, and regarding the inevitability of conflicts arising. See also Deborah A DeMott, *Fiduciary Obligation, Agency and Partnership: Duties in Ongoing Business Relationships* (1991) 671.

58 I am grateful to Deborah DeMott for suggesting a classification for positions of conflicts of interest that investment banks may face, which has formed the basis of the discussion in the accompanying text.

59 In these circumstances, the share sale may depress the target company's share price, which could hinder its efforts to defend itself from takeover.

60 In the United Kingdom, see, eg, Financial Services Authority, 'Investment Research: Conflicts and Other Issues' (Discussion Paper No 15, 2002) 16–17, 20–1. In these circumstances, firms are alleged to have allowed the interests of financial advisory clients to influence the content of published research reports. In the United States, an investigation initiated by New York Attorney-General Eliot Spitzer found that analysts at Merrill Lynch had consistently skewed their research reports and stock recommendations in an effort to generate investment banking business for the firm. See Office of New York State Attorney-General Eliot Spitzer, 'Merrill Lynch Stock Rating System Found Biased by Undisclosed Conflicts of Interests' (Press Release, 8 April 2002) <http://www.oag.state.ny.us/press/2002/apr/apr08b_02.html>. For a discussion of the settlement between the Attorney-General and Merrill Lynch, including the reforms and disclo-

The response of an investment bank to conflicts of interest such as these will depend on whether it is obliged by fiduciary principles to *avoid* positions of conflict and possibly by regulatory provisions, which are discussed later.[61]

IV THE FACTUAL RELATIONSHIP BETWEEN INVESTMENT BANKS AND FINANCIAL ADVISORY CLIENTS

An incident of the relationship between investment banks and their financial advisory clients is the giving of advice on strategic transactions or matters such as mergers and acquisitions, divestitures, spin-offs, restructurings, joint ventures, privatisations and leveraged buyouts.[62] Of these strategic transactions, mergers and acquisitions comprise a significant proportion.

Clients involved in or considering a strategic transaction will engage an investment bank to provide financial advisory services in respect of that transaction.[63] As with law firms, which are also retained to advise on the same transactions, the engagement will relate to the specific transaction or matter, and will not generally be of a long-term or ongoing nature.[64] Typically, an engagement letter (or retainer agreement), which details the contractual relationship between the parties, will be entered into between the investment bank and its client at the outset of the relationship. The letter sets out the general nature of the services to be provided and the fee structure.

A transaction of this type will often involve a number of clients (usually companies), each separately advised. In part because of the high media profile that these transactions attract, much of which is speculation prior to public announcement, and because amicable commercial dealings can quickly deteriorate, the prevailing attitude to a transaction — among the various advised parties — is one of partisanship, much as in the adversarial litigation context.[65] As a consequence, it has become almost an article of faith that each client or 'side' will have its 'own' advisers, being an investment bank and law firm, each of which will act in the interests of its client.[66]

During the course of the engagement, the relationship between an investment bank and its client involves close and frequent contact. Advice, ideas, information and documents will be exchanged. In the case of client disclosures of

sures agreed to by the firm as a form of self-regulation, see Jill E Fisch and Hillary Sale, 'The Securities Analyst as Agent: Rethinking the Regulation of Analysts' (2003) 88 *Iowa Law Review* 1035, 1071.

61 See below Part VII(B).

62 For a description of these activities see Greenhill & Co Inc, *Form S-1 Registration Statement* (2004) 44–5; The Goldman Sachs Group Inc, above n 1, 5; Merrill Lynch & Co Inc, above n 49, 4–6; Morgan Stanley, above n 1, 2.

63 For large transactions it is usual for a client to engage multiple investment banks. However, this circumstance would not alter the analysis in the accompanying text.

64 See, eg, Greenhill & Co Inc, above n 62, 9, 44.

65 For a discussion of the prevailing attitude of partisanship in the adversarial legal system, see G E Dal Pont, *Lawyers' Professional Responsibility in Australia and New Zealand* (2nd ed, 2001) 73–5.

66 See Barry S Alberts and Samuel Thompson, 'Ethics Issues Faced by Lawyers and Investment Bankers in Mergers and Acquisitions: A Problem Approach and Report of Panel Discussion' (2000) 54 *University of Miami Law Review* 697, 704–5; Laura M Holson, 'It Takes Two to Merge but One Firm to Give Advice', *The New York Times* (New York), 13 June 1998, D1.

non-public information, it will be done in the strictest confidence.[67] In the usual course, the engagement will involve more than the investment bank providing some tangible, identifiable work product, such as a prospectus or letter of advice. Much work will be undocumented and much that is documented will remain confidential.

Financial advisory services involve all or some of the following activities: advising on the merits and wisdom of entering into the proposed transaction; providing valuation analyses for the proposed transaction; evaluating and recommending financial and strategic alternatives; advising as to the timing, structure and pricing of the transaction; analysing and advising on potential financing for the transaction; assisting in implementing the transaction; assisting in preparing an offering document or other materials, as required; and assisting in negotiating and consummating the proposed transaction.[68]

For each client, the investment bank and law firm engaged will work closely together. In fact, in the early stages of the transaction, a 'working group' or team will be assembled — comprising the client and its financial and legal advisers — for the purpose of evaluating and potentially executing the transaction. At critical stages during the transaction, the group will often occupy a single physical working space. Trust and confidence are reposed in both advisers. The advisers will necessarily be involved in almost every facet of the matter. The roles of investment bank and legal adviser will often become inseparable, as at each step issues will arise that require the expertise of both. Furthermore, the advice of one will often depend on advice of the other, resulting in an integration of their roles. Accordingly, information will be disclosed to and among them almost without distinction.

The fee structure of investment banks, negotiated for each transaction, is generally calculated as a percentage of the value of the transaction. Based on this method of remuneration, it is not uncommon for an investment bank to earn tens of millions of dollars in fees for advising on a single transaction.[69] When an engagement is terminated, however, 'whether due to the cancellation of a transaction for market reasons or otherwise', a firm may earn 'limited or no fees and may be [unable to recoup] the costs [it has incurred]'.[70]

Financial advisory services are hence highly lucrative[71] and are a highly visible and high-status aspect of investment banking.[72] These operations are regarded as underscoring a firm's ability to advise top corporate management and are a measure of a firm's connections and influence, which are important to the industry as a whole.[73] They are also a primary basis on which investment

67 Geisst, above n 1, 199.

68 See above n 49.

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

70 Greenhill & Co Inc, above n 62, 9.

71 Geisst, above n 1, 10; Hayes and Hubbard, above n 1, 133.

72 Geisst, above n 1, 200.

73 Ibid.

banks compete and are compared.[74] So important are the fees generated, particularly on mergers and acquisitions transactions, that it has been said that the mergers and acquisitions tail now wags the investment banking dog.[75]

V THE LAW RELEVANT TO IDENTIFYING FIDUCIARY RELATIONSHIPS

This part discusses the fiduciary character of the relationship between an investment bank and its client in the context of financial advisory services, and whether the duty to avoid conflicts of interest arises.

A *Nature and Identification of the Fiduciary Relationship*

As noted above, courts have formulated no single test for determining whether a given relationship is fiduciary in character.[76] At the same time, for relationships not 'established' as fiduciary,[77] courts have endorsed a number of features which if found to exist are indicative of a fiduciary relation. Likewise, many modern courts have regarded a fiduciary relationship as arising where there exists a 'reasonable expectation' that a person will act in the interests of another in and for the purposes of the relationship.[78]

For reasons given in Part II, this article considers fiduciary identifying features, giving emphasis to the 'reasonable expectations' criterion, and applies the general process of reasoning by analogy from established categories of fiduciary relationships or from previously decided cases (or both), having regard to the actual facts of the relationship in question.[79] The established relationships and previous cases are said to '*serve as a kind of analogical core*'.[80] For the purposes of analogical reasoning, in a particular context certain features (often those judicially-endorsed identifying features) will be referred to by courts.[81]

Some analogous relationships — between stockbroking firm and client, commercial bank and customer, corporate adviser and client, and solicitor and client — are considered below. From these a number of relevant features are identified

[74] See, eg, 'Macquarie Clears Field in Bumper Year for Bankers', *Special Reports*, *The Australian Financial Review* (Sydney), 6 April 2005, 3; 'UBS Persuaded to Take a Walk on the Wild Side', *Special Reports*, *The Australian Financial Review* (Sydney), 6 April 2005, 13. See also Geisst, above n 1, 10.

[75] Hayes and Hubbard, above n 1, 131.

[76] See above n 22.

[77] See above n 14.

[78] See above n 20.

[79] See *Hospital Products* (1984) 156 CLR 41, 96 (Mason J); Glover, *Equity, Restitution and Fraud*, above n 14, 33–4; DeMott, *Fiduciary Obligation, Agency and Partnership*, above 57, 2–3.

[80] Glover, *Equity, Restitution and Fraud*, above n 14, 29 (emphasis added). An example of this reasoning is provided by *Breen* (1996) 186 CLR 71, 107 (Gaudron and Toohey JJ). In order to determine whether the relationship of medical practitioner and client did, without more, create fiduciary obligations, the High Court made an analogy from the accepted categories of solicitor and client and trustee and beneficiary: see *Pilmer* (2001) 207 CLR 165, 196 (McHugh, Gummow, Hayne, Callinan JJ).

[81] Glover, *Equity, Restitution and Fraud*, above n 14, 33–4.

and, in Part VI, applied to assess the fiduciary character of the relationship in question. Significantly, no case has considered whether this particular relationship is fiduciary in nature.[82]

B *Limitation of Analysis*

The judicial inquiry into whether a particular relationship is fiduciary or not is fact specific. The analysis in this article involves attributing fiduciary character to a specific category of relationship — that between an investment bank and its financial advisory client in respect of a financial advisory transaction — rather than to a relationship between particular, identified parties. A limitation of this analysis is that the category of relationship cannot be described with the same degree of precision as can a specific relationship.

However, this limitation is reduced if it is accepted — as Part III of this article illustrates — that the relationship between investment banks and their financial advisory clients is well established and stable enough across firms and clients so as to be capable of description with sufficient precision to enable an informed assessment of its fiduciary character. In other words, it is possible to draw analogies from recognised fiduciary relationships to this one, as it has been described as existing in the usual course, to ascertain whether or not the features identified in relevant cases as giving rise to fiduciary obligations exist.

This is not necessarily to say that this category of relationship should be 'established' as fiduciary in character. In individual cases, differences may arise in the relationship between an investment bank and its financial advisory clients. In any event, even if the analysis were restricted to major investment banks, it would have a very broad application by reason of their size and the number of transactions on which they advise.[83]

C *The 'Analogical Core'*

To aid with reasoning by analogy, cases that consider the fiduciary character of relationships between stockbroking firm and client, bank and customer, corporate adviser and client, and solicitor and client are discussed below.

1 *Stockbroking Firm and Client*

A stockbroking firm that provides investment advice to its client has been held to owe fiduciary duties to that client. In *Daly*, a potential investor sought advice from a firm of stockbrokers about share investment opportunities. An employee of the firm advised the investor to deposit his funds with the stockbroking firm until an opportune time arose to buy shares. The investor did so, unaware that the

[82] In the United States, *Re Daisy Systems Corp*, 97 F 3d 1171 (9^{th} Cir, 1996) considered the issue in a similar context, although due to the very different conception of fiduciary obligations in that jurisdiction, the case is of minimal precedential value in Australia. As to the extent to which the Australian understanding of fiduciary obligations differs from the North American, see *Breen* (1996) 186 CLR 71, 127 (Gummow J); Parkinson, 'Fiduciary Obligations', above n 14, 391–2; Richard C Nolan, 'The Legal Control of Directors' Conflicts of Interest in the United Kingdom: Non-Executive Directors Following the Higgs Report' (2005) 6 *Theoretical Inquiries in Law* 413, 420 fn 29.

[83] See above nn 39–41 and accompanying text.

firm was in a precarious financial position. Just months later, the firm became insolvent and the investor's funds were lost. He sought compensation from the fidelity fund of the stock exchange, alleging that a fiduciary relationship existed between himself and the stockbroking firm.

The High Court declined to award compensation from the fidelity fund for reasons relating to the terms of the statute setting up the fund.[84] However, in his reasoning, Brennan J regarded a primary issue as being whether, in advising the client on the investment of his money, the stockbroking firm was in the position of a fiduciary.[85] In addressing this issue, his Honour noted that in respect of another function commonly performed by stockbrokers, the buying and selling of shares, a fiduciary relationship had been held to arise between the firm and client.[86] However, the question of whether fiduciary duties exist had to be determined according to the particular function being performed by the broker here — providing investment advice. Brennan J stated the relevant law in the following terms:

> Whenever a stockbroker or other person who holds himself out as having expertise in advising on investments is approached for advice on investments and undertakes to give it, in giving that advice the adviser stands in a fiduciary relationship to the person whom he advises.[87]

Since these features were present, the relationship between the stockbroking firm and client was fiduciary in nature.

In consequence, the fiduciary obligations said by Brennan J to arise were as follows:

> The adviser cannot assume a position where his self-interest might conflict with the honest and impartial giving of advice … His duty is to furnish the client with all the relevant knowledge which the adviser possesses, concealing nothing that might reasonably be regarded as relevant to the making of the investment decision including the identity of the buyer or seller of the investment when that identity is relevant, to give the best advice which the adviser could give if he did not have but a third party did have a financial interest in the investment to be offered, to reveal fully the adviser's financial interest, and to obtain for the client the best terms which the client would obtain from a third party if the adviser were to exercise due diligence on behalf of his client in such a transaction.[88]

Brennan J found that the stockbroking firm, by failing through its representative to tell its client 'fully and truthfully what they knew about their financial

[84] In *Daly* (1986) 160 CLR 371, in order for the investor to recover it was not enough that the investor establish a fiduciary relationship with the stockbroking firm. The terms of the statute establishing the Exchange's fidelity fund required, among other things, that the funds invested be received by the broking firm 'as trustee'. Since the funds had not been received on this basis, the investor failed to recover from the fidelity fund: at 376 (Gibbs CJ).

[85] Ibid 384.

[86] Ibid.

[87] Ibid 385.

[88] Ibid.

position and to warn him … that it was unwise to lend the money',[89] failed to discharge its fiduciary obligations.

Gibbs CJ also found that the stockbroking firm breached the fiduciary obligations it owed to its client.[90] Like Brennan J, Gibbs CJ found it material that the firm had held itself out as an adviser on matters of investment and had undertaken to advise the client who, in turn, had relied on the advice given to him.[91]

The content of the adviser's fiduciary duties, according to Brennan J in the extract above, is broad. Included are positive duties, such as to provide the best advice that could be given in the absence of an interest in the investment. Subsequently, however, the High Court in *Breen* and *Pilmer* characterised fiduciary obligations as proscriptive in nature, rather than prescriptive as Brennan J stated in *Daly*, and accordingly the content of these duties must be narrowed.[92] This is discussed further below.[93]

2 *Bank and Customer*

The relationship between a (commercial) bank[94] and customer has also been held to be fiduciary in nature where the bank advised its customer on the wisdom of a proposed transaction in circumstances that created in the customer an expectation that the bank would act in the customer's interests. In Australia, this line of reasoning has developed from *Daly*.

(a) CBA v Smith

In *CBA v Smith*, the branch manager of a bank advised longstanding customers on their purchase of a hotel business in a small country town. The customers had limited experience in business matters and were accustomed to seeking advice from the branch manager about such matters. The branch manager introduced the customers to the vendor and then acted as a financial adviser to the customers in the matter. This involved him advising the customers that the proposed investment was a good one from a number of points of view, including price, and that it was preferable to other investments they were considering. The hotel business performed poorly and the customers sought relief against the bank on a number of grounds, including for breach of fiduciary duties owed to them.

The Full Federal Court found that a fiduciary relationship arose even though the bank had a 'manifest personal interest' in the transaction by acting as financier for it. The basis of the existence of the fiduciary relationship was the expectation that the bank created in the customers. The Court explained as follows:

89 Ibid 385–6.
90 Ibid 377.
91 Ibid.
92 For a discussion of the reasons for this, see *Aequitas* (2001) 19 ACLC 1006; below Part V(C)(3). Critical analysis of obiter statements that fiduciary duties are only proscriptive is provided in Matthew Conaglen, 'Fiduciary Liability and Contribution to Loss' (2001) 60 *Cambridge Law Journal* 480, 481–2 and Deborah A DeMott, 'Fiduciary Obligation in the High Court of Australia' in Peter Cane (ed), *Centenary Essays for the High Court of Australia* (2004) 277.
93 See below nn 163–5.
94 For a discussion of the distinction between commercial and investment banks, see above Part III.

> A bank may be expected to act in its own interests in ensuring the security of its position as lender to its customer, but it may have created in the customer the expectation that nevertheless it will advise in the customer's interests as to the wisdom of a proposed investment. This may be the case where the customer may fairly take it that to a significant extent his interest is consistent with that of the bank in financing the customer for a prudent business venture. In such a way the bank may become a fiduciary and occupy the position of what Brennan J has called 'an investment adviser' …[95]

The requisite expectation had been created in the customers and fiduciary obligations arose on the part of the bank.

The Court also considered it significant to the existence of the fiduciary relationship that the parties could not be properly described as acting in a commercial transaction at arm's length and each with the assistance of fully independent professional advice.[96]

Although citing *Daly* as authority, the Federal Court did not refer to the features of holding out and undertaking that the High Court expressly referred to as giving rise to the fiduciary relationship.[97] Furthermore, the 'expectation' criterion that the Federal Court clearly found material in fact has no apparent basis in *Daly*. Instead, it would appear to be a reference to the 'reasonable expectations' criterion propounded by Professor Finn.[98]

One further point of comparison relates to the content of the resulting fiduciary obligations. In *Daly*, Brennan J identified a number of obligations, both proscriptive and prescriptive. Although the Federal Court found that the bank occupied 'the position of what Brennan J has called an "investment adviser"',[99] it is very doubtful that the Court considered that this imposed the same duties on the bank. Rather, the Federal Court found that the relationship obliged the bank to avoid placing itself in positions of conflict between duty and personal interests and to eschew conflicting engagements without the fully-informed consent of its customers.[100] The Court does not suggest any positive duties arose from the relationship.

In this case, the vendor was also a customer of the bank and although the purchasing customers had been informed of this, their fully informed consent had not been obtained.[101] Accordingly, by advising the clients as it did, the bank breached its fiduciary obligations.

(b) Commonwealth Bank of Australia v Finding

In *Commonwealth Bank of Australia v Finding*,[102] the Queensland Court of Appeal found that no fiduciary relationship arose between the bank and its

95 *CBA v Smith* (1991) 42 FCR 390, 391 (Davies, Sheppard and Gummow JJ) (citations omitted).
96 Ibid.
97 *Daly* (1986) 160 CLR 371, 385 (Brennan J).
98 See above n 20 and accompanying text.
99 *CBA v Smith* (1991) 42 FCR 390, 391 (Davies, Sheppard and Gummow JJ).
100 Ibid 392.
101 Ibid. The Court agreed with the trial judge that the bank's branch manager ought never to have provided the financial advice to the purchasing customers and, instead, should have explained to them the need to obtain independent advice.
102 [2001] 1 Qd R 168 ('*CBA v Finding*').

customer because, unlike in *CBA v Smith*, which the Court distinguished, the bank had not assumed the role of financial adviser and the customer had not placed complete faith in the bank as adviser.[103]

In *CBA v Finding*, a longstanding customer of the bank purchased a hotel business from the bank, which sold the hotel as mortgagee exercising its power of sale and also provided finance for the purchase. The bank failed to disclose the poor state of the business or that it had been valued at substantially less than the contract price.

The customer brought proceedings claiming, among other things, that the bank had breached the fiduciary obligations it owed the customer. However the Court rejected this claim, primarily because the bank had not acted as a financial adviser to the customer on the transaction; in fact, the bank had expressly disavowed that role.[104] Furthermore, the customer had not relied on any advice from the bank: it had already decided to buy the business before approaching the bank. Neither the longstanding relationship between the bank and customer nor the dual roles the bank performed (as vendor and financier) provided a sufficient basis on which to found a fiduciary relationship.[105]

(c) Other Cases

In England, the giving of financial advice by a bank to its customer has been found to give rise to a fiduciary relationship. In *Woods v Martins Bank Ltd*,[106] relying on the advice of his bank manager, the plaintiff made several investments in a company that was also a customer of the bank. The bank had failed to disclose its conflict or that it had no basis for recommending the investments, which turned out to be imprudent. A fiduciary relationship arose between the bank and the plaintiff, which imposed on the bank an obligation to advise him with reasonable care and skill and, in turn, required it to fully disclose its conflict.[107] Although the court did characterise the relationship as fiduciary, it did not expressly state its reasons for this characterisation and the case was not considered relevant in either *CBA v Smith* or *CBA v Finding*. Furthermore, while the English position on fiduciary principles is clearly now heavily influenced by, and tending towards, the Australian approach,[108] the conception of the fiduciary duty of care and skill lacks support in contemporary Australian cases.

In Canada, the Court of Appeal of Ontario in *Standard Investments Ltd v Canadian Imperial Bank of Commerce*[109] characterised the relationship between a bank and its customer as fiduciary where the bank was providing advice and financial support on the proposed acquisition of control of a trust company. In breach of obligation, the bank had taken a stake in the target that thwarted its customer's intentions. The fiduciary characterisation arose because

103 Ibid 172 (Davies and Pincus JJA, and Derrington J).
104 Ibid.
105 Ibid 173.
106 [1959] 1 QB 55.
107 Ibid 72–3 (Salmon J).
108 See *Bristol & West Building Society v Mothew* [1998] Ch 1; *Hilton v Barker Booth & Eastwood (a firm)* [2005] 1 All ER 651, 660 (Lord Walker).
109 (1985) 22 DLR (4th) 410.

the customer had relied on the 'advice, assistance and guidance' of the bank, of which the bank was aware, and disclosed confidential information to the bank.[110] Little legal principle for the identification of fiduciary relations is discussed in the case, and in the circumstances the bank's relationship with its customer appears to have been materially different from (and far more distant than) that between an investment bank and its financial advisory client.[111]

3 *Corporate Adviser and Client*

More recently, the giving of investment advice was found to give rise to fiduciary obligations between a company that described itself as a 'corporate adviser' or 'merchant bank' and its client. Although giving itself this label, the adviser cannot be regarded as an investment bank in the sense adopted in this article.[112] In *Aequitas* joint venturers, acting through an agent, undertook to provide 'corporate and financial advice' to their client, Aequitas Ltd, a company that proposed to raise capital from outside investors. Services that were contracted for included advice relating to the structure of the client, the raising of equity (including by private placement to selected investors or by public offering) and investments to be made, such as the purchase of shares in another company or other assets.[113]

In a very detailed judgment, Austin J found that the corporate adviser was in a fiduciary relationship with its client, which arose 'because the financial adviser, having held itself out as an adviser on matters of investment, [undertook] a particular financial advisory role for the client'[114] (echoing the formulation in *Daly*). The advice provided on the transaction in question was '"financial advice" of the kind that Brennan J had in mind [and] extended to corporate advice as well'.[115] Although not explaining the difference between 'financial advice' and 'corporate advice', it is evident from the judgment that, in composite, they encompass those activities that were contracted for by the parties. In any case, the difference does not matter for purposes of the existence of a fiduciary relationship since

> there can be no material difference … between an arrangement for the provision of financial advice and an arrangement for the provision of corporate advice, since in both cases the adviser undertakes to act in the interests of the client and not solely in the adviser's own interests, and the client is in a position of vulnerability.[116]

[110] Ibid 435–6 (Goodman JA).

[111] It appears from the case that dealings between bank and customer were relatively infrequent and that a primary feature of the assistance sought from the bank was a 'business introduction'. Cf above Part IV. The case has also been criticised for mischaracterising the relationship: see Finn, 'The Fiduciary Principle', above n 8, 48.

[112] For a factual description of investment banks, see above Part III.

[113] (2001) 19 ACLC 1006, 1026–7 (Austin J).

[114] Ibid 1063.

[115] Ibid.

[116] Ibid, citing *Hospital Products* (1984) 156 CLR 41, 96–7 (Mason J) as authority.

It is evident from his Honour's reasons that Austin J equated 'financial advice' with 'investment advice', which was the expression in fact used by Brennan J.[117]

In conclusion, Austin J stated that: 'Having held the joint venture out as having expertise in corporate advising, and having undertaken through their agent … to provide corporate advice to Aequitas, the joint venturers stood in a fiduciary relationship to Aequitas.'[118]

Of further significance is Austin J's discussion of the content of the consequent fiduciary obligations. His Honour explained that in cases subsequent to *Daly*, the High Court has confined fiduciary obligations to a number of specific proscriptive duties — namely, in the absence of fully informed consent, to avoid both conflicts of interest and profits arising out of fiduciary office.[119]

4 *Solicitor and Client*

The solicitor–client relationship differs from those previously considered because solicitors generally will not be expected to provide financial advice nor be obliged to do so.[120] Further, their advisory function has a distinctive quality: as officers of the court, at least in contentious matters, solicitors are instrumental in maintaining the public perception of integrity of the legal profession and the administration of justice,[121] a role not performed by investment banks. However, like the relationship between investment banks and financial advisory clients, the relationship has a contractual basis provided by a retainer or engagement agreement. Solicitors clearly perform a broader function, also being engaged to advise clients on financial advisory transactions. As described in Part IV, clients will ordinarily engage both a law firm and investment bank to form an integrated working group, and the advisers will be involved with the client on almost every facet of the transaction. The group will work closely together, often in the same physical working environment for extended periods. Information will be exchanged to and among them almost without distinction. While the nature of advice that each adviser provides differs, a close analogy between the relationships does exist in this context.

D *Synthesis of Case Law*

It is evident from these cases that commercial relations between parties may be fiduciary in nature where, generally speaking, an incident of the relationship is the giving of investment or financial advice. In particular, the relationships of stockbroking firm and client and analogous relationships, such as bank and customer and corporate adviser and client, may be fiduciary in character where the firm or other adviser holds itself out as an expert in investment or financial matters and undertakes to provide advice of that nature to the client or cus-

117 *Daly* (1986) 160 CLR 371, 385.

118 *Aequitas* (2001) 19 ACLC 1006, 1063.

119 Ibid 1064.

120 *Krambousanos v Jedda Investments Pty Ltd* (1996) 64 FCR 348; aff'd (1997) 72 FCR 138; see also Dal Pont, *Lawyers' Professional Responsibility in Australia and New Zealand*, above n 65, 90–6.

121 See *Blackwell v Barroile Pty Ltd* (1994) 51 FCR 347; see also Dal Pont, *Lawyers' Professional Responsibility in Australia and New Zealand*, above n 65, 204.

tomer.[122] Another feature identifying a fiduciary relationship, although apparently not considered by the Full Federal Court in *CBA v Smith* to be a separate basis, is where the adviser 'creates an expectation' in the customer or client that it will advise in the customer's interests.

The latter feature, although formulated differently, is a clear reference to the 'reasonable expectations' criterion, according to which a fiduciary relationship arises where, in respect of a particular matter, a person can be reasonably expected to act in the interests of another in and for the purposes of the relationship.[123] It is unclear whether, by omitting the qualification of reasonableness, the Federal Court was providing a different criterion; however, considering the growing acceptance of the criterion in Australia and other jurisdictions, it is doubtful that the court intended that to be the case.

It is also apparent from the cases that the nature of the advice provided bears on the fiduciary question.[124] Investment or financial advice (these expressions are used synonymously in the cases) must be provided in order for the fiduciary relationship to be established in this context. The giving of what Austin J in *Aequitas* referred to as 'corporate advice' will also invoke fiduciary obligations, this being regarded as not materially different in terms of fiduciary obligation from financial advice.[125]

In none of the cases did the courts explain the meaning of the expressions 'investment', 'financial' or 'corporate' advice. However, they clearly capture advice of broad scope. In *Daly*, the 'investment advice' related to how or where to invest available funds for financial return. In *CBA v Smith*, the advice related to weighing up competing investment opportunities and the wisdom of investing in a particular transaction, which involved assessing the contract price and the funding options. In *Aequitas*, the advice broadly related to investment opportunities (which included buying shares of another company) and raising funds for or financing those opportunities. Specifically, the advice related to the structure of the client, the merits and wisdom and structure of a securities issue to raise funds, and the relative merits and wisdom of a number of investment opportunities for those funds. The advice that in these cases founded the existence of the fiduciary relationship can be broadly described as advice on the merits and other aspects of raising funds (either privately or publicly, by either debt or equity instruments) and of investing or spending those funds. In other words, the advice may be described as relating to the merits of entering into a particular investment

122 *Daly* (1986) 160 CLR 371, 385 (Brennan J); *Aequitas* (2001) 19 ACLC 1006, 1063 (Austin J).

123 See above n 27 and accompanying text.

124 In *Pilmer* (2001) 207 CLR 165, 197, McHugh, Gummow, Hayne and Callinan JJ referred with approval to the comments of the trial judge in that case suggesting that when determining whether the adviser (a firm of accountants) owed fiduciary obligations to its client, it was relevant whether the adviser had advised on the transaction in question, which was a takeover by one company of another: see *Duke Group (in liq) v Pilmer* (1997) 27 ACSR 1, 376–7 (Mullighan J). The High Court majority agreed with the approach of the trial judge, who, having found that there was 'no evidence to suggest that the [adviser] gave any advice, or made any representation to, [its client] about the efficacy or wisdom of the takeover' or that there was any evidence suggesting 'that the [adviser] advised, or even suggested to [its client], that the takeover … be undertaken', concluded that the adviser had not acted in the capacity required to give rise to fiduciary obligations.

125 *Aequitas* (2001) 19 ACLC 1006, 1063 (Austin J).

and its alternatives, to financing and timing considerations and to documenting and implementing the investment transaction.

It is apparent from the cases generally, and *CBA v Finding* in particular, that reliance by the client or customer on the adviser is required for a fiduciary relationship to arise. It is also apparent that an anterior relationship need not exist between the parties in order for that relationship to exist.

The relationship between the parties must be vertical in nature, not horizontal, in which one party places trust or confidence in the party providing the advice.[126] But the client need not be financially unsophisticated: in none of the Australian decisions was this factor considered essential by the court; and, indeed, in *Aequitas*, the client was in all likelihood as financially sophisticated as the adviser.[127]

The cases demonstrate that the scope of the consequent fiduciary obligations is confined to the giving of advice of the requisite type. In *Daly*, the question was framed as whether, *in advising its client*, the stockbroking firm was in the position of a fiduciary.[128] Professor Glover has interpreted the law in this area as imposing fiduciary obligations 'to the extent of [the] advice'.[129] It is apparent that the fiduciary obligations relate to the giving of advice, or, more specifically, to the undertaking to give advice, and will apply in respect of those advisory services for which the parties have contracted. As regards other activities between the parties in respect of which the adviser has a self-interest (such as financing by a bank), fiduciary obligations may not be owed, as discussed above.[130]

The existence of a commercial self-interest on the part of the adviser in the transaction is no barrier to the fiduciary relationship arising. According to the Federal Court in *CBA v Smith*, the relationship may be fiduciary even where the adviser has a manifest personal interest in the transaction, provided that the customer 'may fairly take it that to a significant extent his interest is consistent with that of the [adviser]'.[131] Complete alignment of interests is not required; this did not exist in *CBA v Smith*. This does leave the adviser free to act in its self-interest in respect of some matter of the relationship, such as, in the case of a bank acting as financier on a transaction, ensuring the security of its position as lender.[132] Presumably, the requisite consistency of interests prevents a conflict arising in respect of that matter or dimension of the relationship, or, alternatively,

126 John Glover describes vertical fiduciary relationships as involving one-way duties and in which fiduciaries are subjugated to fiduciary obligations: Glover, *Equity, Restitution and Fraud*, above n 14, 27.

127 In *Aequitas* (2001) 19 ACLC 1006, 1063 (Austin J), the adviser and client had similar levels of sophistication since at least two directors or senior officers were common to both entities. In any case, it is extremely difficult for a court to assess the financial sophistication of a client. Even companies whose management have wide experience of financial advisory transactions would be unsophisticated in comparison to, for example, an investment bank itself when in the position of a client.

128 (1986) 160 CLR 371, 384 (Brennan J).

129 Glover, *Equity, Restitution and Fraud*, above n 14, 96.

130 See above Part V(C).

131 *CBA v Smith* (1991) 42 FCR 390, 391 (Davies, Sheppard and Gummow JJ).

132 Ibid.

it might be that by confining the scope of fiduciary obligations to the giving of advice, actions by the adviser in respect of that matter or dimension will not be subject to equitable intervention (for reasons discussed in the following section).

E *Contractual Techniques to Modify or Displace Fiduciary Obligations*

One feature of fiduciary law bearing on the question discussed in this article is that parties may displace fiduciary obligations by contract; or, if such obligations arise, modify their parameters (that is, their content and scope). There are a number of contractual techniques for achieving this.

First, contractual arrangements are themselves relevant to the existence, scope and content of a fiduciary relationship. Where a relationship is not by virtue of its status fiduciary in character, contractual arrangements between the parties may provide the basis for the court finding that a fiduciary relationship exists[133] or does not exist.[134] Where the relationship is fiduciary, the contract defines the content and scope of the fiduciary obligations that arise.

The scope of a fiduciary obligation refers to the defined area of conduct in respect of which the fiduciary obligation operates. Within that scope the fiduciary comes under the obligation; in respect of other areas of conduct, the person is exempt from the obligation and retains his or her economic liberty.[135] In *Hospital Products*, 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.'[136] For example, in the context under consideration, fiduciary obligations are owed by advisers to the extent of the giving of financial or investment advice, but not in respect of other areas, such as providing finance.

The content of fiduciary obligations must also conform to the contract underlying a relationship. It follows that 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'.[137] In language similar to that of Mason J in *Hospital Products*, Lord Browne-Wilkinson in *Henderson v Merritt Syndicates Ltd* asserted that 'the extent and nature of the fiduciary duties owed in any particular case fall to be

[133] See, eg, *Noranda Australia Ltd v Lachlan Resources NL* (1988) 14 NSWLR 1.

[134] See, eg, *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410, 539 (Lockhart, von Doussa and Sackville JJ).

[135] *Noranda Australia Ltd v Lachlan Resources NL* (1988) 14 NSWLR 1, 15 (Bryson J). In *Birtchnell v Equity Trustees Executors & Agency Co Ltd* (1929) 42 CLR 384, 408, Dixon J (speaking in the context of partnerships) referred to fiduciary obligations as extending over particular subject matter. Similarly, in *Boardman v Phipps* [1967] 2 AC 46, 127, Lord Upjohn explained that '[o]nce it is established that there is … [a fiduciary] relationship, that relationship must be examined to see what duties are thereby imposed upon the agent, to see what is the scope and ambit of the duties charged upon him.' As to the contractibility of fiduciary obligations, see Nolan, above n 82, 420–1.

[136] (1984) 156 CLR 41, 97. His Honour further explained that the fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction.

[137] *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410, 539 (Lockhart, von Doussa and Sackville JJ), citing *Kelly v C A & L Bell Commodities Corporation Pty Ltd* (1989) 18 NSWLR 248, 258 (Mahoney JA).

determined by reference to any underlying contractual relationship between the parties.'[138] For example, an agent's contract of retainer might provide that the agent remains free to act for other parties in the same interest, or that the agent will deal, on occasions, as a principal.[139]

The use of the expression 'scope' in many cases often subsumes what here has been described as the content of the obligation (and there is, admittedly, overlap). The Privy Council decision of *Kelly v Cooper*[140] provides a useful example, and also illustrates that contractual arrangements — express and implied — between the parties to the fiduciary relationship will set the parameters of the fiduciary obligations that arise.[141] The case involved an alleged breach of fiduciary duty by real estate agents who represented both the plaintiff in selling his property and the vendor of a property adjoining the plaintiff's. The estate agents failed to disclose that the same purchaser had offered to buy both properties, a fact the plaintiff alleged would have had favourable price implications for his property. The plaintiff claimed, among other things, that by representing the vendor of the adjacent property the estate agents were in a position of conflict: the agents' direct financial interest in selling that property conflicted with their duty to the plaintiff. Although these circumstances did give rise to a conflict of interest, according to the Board,[142] no breach of fiduciary obligation arose.

Lord Browne-Wilkinson, delivering the Board's judgment, reasoned that 'the plaintiff was well aware that the [estate agents] would be acting also for other vendors of comparable properties and in so doing would receive confidential information from those other vendors.'[143] The contract of agency between the parties 'envisaged' that a position of conflict may occur, and, in turn, the contract defined the scope of fiduciary obligations that arose.[144] Accordingly, no breach of fiduciary obligation to avoid positions of conflict arose. The Privy Council concluded that:

> in the present case, the scope of the fiduciary duties owed by the [real estate agents] to the plaintiff (and in particular the alleged duty not to put themselves in a position where their duty and their interest conflicted) are to be defined by the terms of the contract of agency.[145]

138 [1995] 2 AC 145, 206.

139 Glover, *Equity, Restitution and Fraud*, above n 14, 273.

140 [1993] AC 205.

141 For an example of an Australian decision in which it appears that the expression 'scope' of fiduciary obligation subsumes its 'content' (or that the two terms are used interchangeably), see *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410, 535 (Lockhart, von Doussa and Sackville JJ), citing J R F Lehane, 'Fiduciaries in a Commercial Context' in P D Finn (ed), *Essays in Equity* (1985) 95–6.

142 The Board referred to these circumstances, describing them as a conflict of interest: *Kelly v Cooper* [1993] AC 205, 215 (Lord Browne-Wilkinson).

143 Ibid.

144 Ibid.

145 Ibid.

The Board's reference to the 'scope' of fiduciary obligations appears to be one relating to the content of the obligation, as that expression is used in this article; that obligation prohibited positions of conflict except for conflicts envisaged by contract.

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 fiduciary obligations does not prohibit the conduct or because the conduct occurred outside the scope of the fiduciary obligations.[146]

There are, however, limits on the ability of parties to negotiate to exclude fiduciary obligations or confine their parameters, something not recognised by the Privy Council in *Kelly v Cooper*. The response of fiduciary law depends on the relationship under consideration. Professor Maxton observes that there is a spectrum of possibilities: at one end, where status-based fiduciary relationships are located, 'policy seems to demand that certain fiduciary norms may not be the subject of contractual negotiation'; towards the other end, where the relationships involve parties

> striking a commercial bargain which has fiduciary consequences, there seems to be less need for the protective function of fiduciary law [and] equity recognises that it is the contract which should govern the basic rights and liabilities of the parties.[147]

In the context under consideration, involving investment banks and their financial advisory clients (a relationship that is not, by virtue of its status, fiduciary), the cases discussed above suggest no limits to the ability of parties to contract around any fiduciary obligations.

The second contractual technique parties may use to modify or displace fiduciary obligations is to agree on a generalised advance disclosure provision. This would effectively give the fiduciary the informed consent of the client to act in what would otherwise be a breach of those fiduciary obligations. This technique would be effective provided that the contract clearly delimited the scope of fiduciary obligations owed to the client and displaced the obligation to make full disclosure of all material facts.[148]

Third, the contract between parties may provide for an ad hoc disclosure mechanism different from that implied by law. That the parties could adopt such a technique would be implicit from their ability to modify or vary fiduciary obligations by contract.

146 As to impugned behaviour falling outside the scope of fiduciary obligations, see J K Maxton 'Contract and Fiduciary Obligations' (1997) 11 *Journal of Contract Law* 222, 229, and Robert Flannigan, 'Fiduciary Obligation in the Supreme Court' (1990) 54 *Saskatchewan Law Review* 45, 68.

147 Maxton, above n 146, 229. It is unclear, however, where on this spectrum the relationship between investment banks and their financial advisory clients falls. It is likely to be towards the latter end, since it would be a fact-based fiduciary relationship; although, again, there is uncertainty as to whether it follows from this that courts would respect parties' efforts to contract around any fiduciary obligations.

148 Law Commission, United Kingdom, *Fiduciary Duties and Regulatory Rules*, Report No 236 (1995) 23 ('*Fiduciary Duties Report*').

Finally, it has been suggested that, subject to limits, the retainer between parties to a fiduciary relationship might include an exclusion clause whereby the client agrees not to rely on conflict of interest assertions in proceedings against the firm for breach of fiduciary duty.[149]

F *Continued Relevance of the Fiduciary Question*

There are a number of ways in which parties might relieve themselves of fiduciary obligations, leading to different doctrinal results, as explained above. However, at a theoretical level, the amenability of fiduciary obligations to modification or displacement by contract raises a single policy issue.

The question here — the existence of a fiduciary relationship — remains significant because, in any transaction, parties may choose not to contract around fiduciary obligations. Indeed, in none of the cases considered above did the parties contractually modify or displace fiduciary obligations. Furthermore, where parties merely intend by contract to modify — rather than displace — fiduciary obligations, the question of whether their relationship is fiduciary remains a critical one. In any case, it is valuable for commercial parties to know whether fiduciary obligations would arise in the absence of contractual variation or displacement in order to know their 'default' position and the utility to be gained from negotiating the issue at all.

VI IS THE RELATIONSHIP BETWEEN INVESTMENT BANKS AND FINANCIAL ADVISORY CLIENTS FIDUCIARY IN NATURE?

Based on the law discussed in Part V, this part considers whether, in the context of financial advisory services, the relationship between investment banks and their clients is fiduciary in character, such that it gives rise to the obligation to avoid conflicts of interest.

A *Existence of Fiduciary Relationship*

The relationship under consideration is that between the investment bank (or relevant entity in a group of companies)[150] and its financial advisory client. It follows that if the relationship is fiduciary in character, any resulting fiduciary obligations will be owed by the firm (or relevant entity), being an incorporated entity, rather than by individual bankers or other employees.[151]

The approach to considering this question, as developed in Part II, is to reason analogically from previous cases and established relationships, drawing upon judicially-endorsed features identifying fiduciary character and giving emphasis to the 'reasonable expectations' criterion.

[149] The limits of such an exclusion clause would be that fiduciaries cannot exempt themselves from responsibility for actual fraud, nor for any other breach of duty which involves their having dishonest intention: see Glover, *Equity, Restitution and Fraud*, above n 14, 185–6, 272–4.

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

[151] For a discussion of the possible accessorial liability of these individuals, see below Part VI(C).

1 *Previous Cases and Established Relationships*

At a broad level, this relationship is analogous to the relationship between stockbroking firm and client. It is vertical in the sense that any fiduciary duties will be owed in one direction only — to the client.[152] Also, since stockbroking services are now commonly provided by investment banks, the parties to both relationships may well be identical.

The feature of giving investment or financial advice is also present in the relationship under consideration. In the Australian cases considered above in which fiduciary obligations arose,[153] the advice provided by the advisers related to the wisdom or merits of entering into the investment and of alternative opportunities, to financing and timing considerations, and to the documentation and implementation of the investment — broadly speaking, to the very advice provided to financial advisory clients by investment banks. In *Aequitas*, for example, Austin J found that advising a company on the purchase of shares of another company and on financing techniques (such as a public offering of shares) did amount to financial advice for purposes of giving rise to fiduciary obligations.[154]

Arguably, some extension is required to equate the relationship under consideration with those in the cases referred to above: the investment banking relationship usually involves greater complexity and a large, commercially-sophisticated corporate client. However, all that appears to be required is vulnerability in the sense of reliance on the adviser for financial experience; investment banks will possess this by virtue of their experience of advising, on a regular basis, about strategic matters that any individual client will encounter far less frequently.

The feature referred to in *Daly* and *Aequitas*, namely that the adviser holds itself out as expert in financial matters and undertakes to advise in the client's interests, will almost invariably exist in the relationship between investment banks and their financial advisory clients.[155] Similarly, the scope of any resulting fiduciary obligation will extend to the giving of advice. Like the solicitor–client relationship, the investment banking relationship is one of trust and confidence. A strong analogy exists between the counselling role of a solicitor on a financial advisory transaction and that of an investment bank, providing a firm basis for arguing that investment banks, like solicitors and their firms, should be obliged to show undivided loyalty towards their clients.

2 *Reasonable Expectations and Policy Justification*

It must also be considered whether, in the context of providing financial advisory services, an investment bank can be reasonably expected to act in the interests of its client in and for the purposes of the financial advisory

[152] See above n 127.
[153] See above Part V.
[154] (2001) 19 ACLC 1006, 1063.
[155] For a discussion of this relationship, see above Part IV.

engagement. The inquiry is made from the perspective of the client. Both the actual circumstances of the relationship and public policy reasons will inform this assessment.[156]

The strategically significant transactions for which the financial advisory services of investment banks are required will almost invariably influence a client's value, as measured by its share price (assuming it is a publicly listed company, which is usually the case) and, as a consequence, its capacity to borrow or raise capital. These transactions, particularly mergers and acquisitions, often pit a client against an adversary (or at least a party with divergent interests) and, as previously discussed, a notion of partisanship prevails among the advised parties. An investment bank or law firm almost never represents opposing parties on a transaction.[157]

At a lower level of abstraction, as explained in Part IV, investment banks and law firms will be fully integrated into their client's working group for the transaction. Advisers will be, as part of the group, involved in almost every facet of the transaction. The trust implicit in the role is such that being engaged is seen both as underscoring an investment bank's ability to advise top management and as a measure of its connections and influence, which are regarded as important to the industry as a whole.[158] To contend in these circumstances that an investment bank may legitimately pursue self or third party interest within the scope of the transaction is implausible; the financial advisory client can — indeed, in the circumstances, must — reasonably expect that the investment bank will provide faithful service in and for the purpose of the transaction.

Furthermore, due to the visibility and widespread social repercussions of these transactions, the relationship in question has public dimensions. The intermediary function performed by investment banks is, after all, integral to the efficient operation of the financial system.[159] Permitting investment banks to have interests conflicting with their clients' would damage community confidence in the integrity and utility of the relationship. Indeed, such conduct may erode public confidence in the securities and investment markets more generally.

Other public policy reasons also support the reasonableness or legitimacy of an expectation of loyalty and thereby justify the imposition of fiduciary obligations on investment banks in these circumstances. First, clients assured of fiduciary protection would be encouraged to disclose confidential information openly and candidly to investment banks, which in almost all cases would be necessary for their effective representation. Second, requiring conflict avoidance would militate against the temptations for an investment bank to act disloyally, which are created by a firm's fee structure, which rewards it in proportion to the value of a completed transaction (and sometimes not at all if the transaction is terminated). A final public policy justification is that, in this relationship, clients may

156 See Finn, 'Contract and the Fiduciary Principle', above n 24, 92.
157 See Alberts and Thompson, above n 66, 704–5; Holson, above n 66, D1.
158 Geisst, above n 1, 200.
159 Ibid 1.

be regarded as being relatively vulnerable, as they are unlikely to have the specialist skills and judgement that investment banks possess as a result of regular transactional experience.

3 *Other Considerations*

As explained in Part III, investment banks may also provide finance or equity for a transaction on which they are advising, thus giving them a commercial self-interest in the transaction. The Court in *CBA v Smith* is explicit that this feature of a relationship will be no bar to the existence of fiduciary obligations provided that the client's interest is, to a significant extent, consistent with that of the firm providing the finance or equity for the transaction. This may be explained by regarding this dimension of the relationship as being outside the scope of fiduciary obligations. In the case of providing finance by an investment bank, there will be a consistency of interests between the firm and its client (for the same reasons as in *CBA v Smith*). In the case of the provision of equity by a firm, the interests of the firm and client will be even more closely aligned, since the firm would effectively be a co-investor in the transaction. The consequence is that in neither case will this feature prevent a fiduciary relationship from arising.

Finally, it should be noted that there appears to be nothing about the nature of investment banking that would require courts to presume that clients consented to firms acting in what would otherwise amount to a conflict of interest. Lord Millett in *Bolkiah v KPMG*[160] has explained that in the case of large accounting firms that provide auditing services to clients, courts do presume that the clients consent to the firms acting for competing clients (in what would otherwise amount to a breach of duty). This is because: there are very few firms that are capable of providing these services to major public companies; the auditing function is statutorily required; and clients publicly disclose the identity of their auditors. In contrast, major investment banks that provide financial advisory services are far more numerous; the financial advisory role is not statutorily required; and many of the transactions on which they are engaged are not publicly disclosed (for example, if they are not completed). There is also nothing to suggest that financial advisory clients (in contrast to clients of real estate agents) 'envisage' that positions of conflict may occur. Accordingly, there is no reason to vary the duty to avoid conflicts in the investment banking context by reason of the nature of the industry.

B *Content of Fiduciary Obligations*

To characterise the relationship between an investment bank and its financial advisory client as being fiduciary in nature does not fully describe it: the content and scope also remain to be defined, as do aspects of it that are governed by statute, common law principles, or other (non-fiduciary) equitable principles.[161] As explained in Part V(E) above, in circumstances such as the one under consideration here, where a contract underlies the relationship:

[160] [1999] 2 AC 222, 235 ('*Bolkiah*').
[161] Meagher, Heydon and Leeming, above n 14, 161–2.

> 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. Thus, in the case of an agent employed under a contract, the scope of his fiduciary duties is determined by the terms of the underlying contract. Although an agent is, in the absence of contractual provision, in breach of his fiduciary duties if he acts for another who is in competition with his principal, if the contract under which he is acting authorises him so to do, the normal fiduciary duties are modified accordingly … The existence of a contract does not exclude the co-existence of concurrent fiduciary duties (indeed, the contract may well be their source); but the contract can and does modify the extent and nature of the general duty that would otherwise arise.[162]

In a sense, therefore, the analysis is whether, in the absence of contractual modification, equity will impose on an investment bank the duty to avoid positions of conflict with the interests of its financial advisory client. It would follow from the above analysis of cases such as *Aequitas* and *CBA v Smith* (in which fiduciary relationships arose in circumstances where financial, investment, or corporate advice was given, or where an expectation was created that such advice would be provided) that the duty to avoid conflicts would be owed by the fiduciary within the scope of the relationship.

Fiduciary obligations are proscriptive in nature — prohibiting conduct of the fiduciary rather than compelling it — for the purpose of exacting from the fiduciary, in this case the investment bank, a standard of undivided loyalty.[163] Twin obligations ordinarily arise: without fully informed consent, the fiduciary must avoid conflicts of interest and not obtain any unauthorised profit from the fiduciary relationship.[164] Abrogation of either obligation exposes the fiduciary to equity's gain-stripping remedies, which are considered further below. The main focus of this article is on the former obligation, although it does necessarily discuss much of the latter.[165]

The obligation to avoid positions of conflict prohibits a fiduciary from putting himself or herself in a position where his or her duty conflicts with self-interest or a duty, legal or equitable, owed to a third party. The rigorous application of the doctrine extends to prohibiting the fiduciary from occupying positions in which there is a 'real or substantial possibility of a conflict'[166] and in the principle that the honesty of the fiduciary does not provide a complete defence to a fiduciary charged with abrogating his or her duty.[167]

162 *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 206 (Lord Browne-Wilkinson).

163 See *Maguire v Makaronis* (1997) 188 CLR 449; *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 1, 46–7 (Spigelman CJ, Sheller and Stein JJA).

164 *Breen* (1996) 186 CLR 71, 113 (Gaudron and McHugh JJ), 137–8 (Gummow J).

165 This is because a person who makes an unauthorised profit from his or her fiduciary position has usually, but not always, placed self-interest ahead of the interest of the person to whom the duty is owed and thereby also breached the duty to avoid conflicts: see *Boardman v Phipps* [1967] 2 AC 46, 123 (Lord Upjohn). See also R P Austin, 'Fiduciary Accountability for Business Opportunities' in P D Finn (ed), *Equity and Commercial Relationships* (1987) 141, 146; G E Dal Pont 'Conflicts of Interest: The Interplay between Fiduciary and Confidentiality Law' [2002] *Australian Mining and Petroleum Law Association Yearbook* 583, 584–5.

166 *Hospital Products* (1984) 156 CLR 41, 103 (Mason J).

167 See T G Youdan, 'The Fiduciary Principle: The Applicability of Proprietary Remedies' in T G Youdan (ed), *Equity, Fiduciaries and Trusts* (1989) 93, 94.

Whether an actual conflict, or a real or substantial possibility of one, exists can be a difficult question for courts to answer.[168] In the context of investment banks, there are a number of areas where an investment bank could abrogate this obligation.

The classification of conflicts of interest adopted for the solicitor–client relationship provides a useful starting point for considering possible investment banking conflicts. First, a conflict may arise where, in providing financial advisory services, an investment bank is swayed by self-interest. For example, an investment bank uses information derived in the course, or resulting from the position, of being fiduciary for its own trading position.

Second, a 'concurrent conflict' may arise where an investment bank represents two or more clients on a single transaction. This might arise, for example, where a firm is providing financial advisory services to a bidder for a target while providing underwriting services to another company bidding for the same target, a situation that has occurred in the United States.[169]

'Successive conflicts' may also arise where an investment bank acts against a former client. This would in fact activate a bank's duty to protect confidential information, rather than its fiduciary obligation to avoid conflicts. This is because, according to the House of Lords in *Bolkiah*, fiduciary obligations end once the relationship giving rise to them has ended.[170] Further detailed examples indicating the potential for conflicts were provided in Part III.

C *Remedial Consequences of Breach and Accessorial Liability*

Of particular significance is the distinctive remedial regime that a breach of a fiduciary obligation attracts. Where this occurs, the fiduciary 'must account for any profits and make good any losses arising from the breach.'[171] While remedial consequences will vary according to the circumstances of the case, available remedies include an account of profits;[172] a finding that benefits are held on constructive trust for the party to whom the duty was owed;[173] an award of damages or equitable compensation;[174] or the grant of an injunction to restrain the breach.[175]

In the case of breach of fiduciary obligation by an investment bank, the scope of liability may also include individual bankers and other employees of the firm.

168 See *Pilmer* (2001) 207 CLR 165, 199 (McHugh, Gummow, Hayne and Callinan JJ).

169 Nicholas Wolfson, Twentieth Century Fund, *Conflicts of Interest: Investment Banking Report to the Twentieth Century Fund Steering Committee on Conflicts of Interest in the Securities Market* (1976) 75–8.

170 [1999] 2 AC 222, 235 (Lord Millett). This is the position, at least in England, in the case of the solicitor–client relationship. This may be the position in Australia too: as McHugh, Gummow, Hayne and Callinan JJ explained in *Pilmer* (2001) 207 CLR 165, 200–1, the 'fact that dealings are completed will ordinarily demonstrate that any interest or duty associated with those dealings is at an end'.

171 *Breen* (1996) 186 CLR 71, 113 (Gaudron and McHugh JJ).

172 *Warman International Ltd v Dwyer* (1995) 182 CLR 544.

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

174 See, eg, *Mordecai v Mordecai* (1988) 12 NSWLR 58, 64 (Hope JA); *CBA v Smith* (1991) 42 FCR 390, 394–6 (Davies, Sheppard and Gummow JJ).

175 See, eg, *Marks & Spencer Group plc v Freshfields Bruckhaus Deringer* [2004] 3 All ER 773.

These individuals may be exposed to liability, and so be subject to the equitable remedies that are available against the fiduciary, where they induce or assist in the breach of obligation by the fiduciary.[176] This accessorial liability of the individual may arise even though he or she owed no fiduciary obligation to the client, and even where the fiduciary is an incorporated entity.[177] Admittedly, judicial views have diverged on whether dishonest assistance or knowing assistance by the individual is required.[178] It is tolerably clear, however, that the active and knowing participation by an individual banker or other employee in the breach by the investment bank of its fiduciary obligation would expose him or her to accessorial liability.[179]

D *Summary*

Investment banks hold themselves out as expert in providing financial advisory services and undertake to provide those services. Furthermore, advice that constitutes financial advisory services — that which relates to the merits and wisdom of entering into an investment and of alternative opportunities, to financing and timing considerations, and to the documentation and implementation of the investment — is the very type of work which is the basis of the existence of a fiduciary relationship in Australian case law commencing with the decision in *Daly*. Also, in view of the circumstances of the relationship, a reasonable expectation exists that an investment bank will act in its client's interests for the purposes of the transaction, and there are compelling public policy reasons that support this. Accordingly, a strong case may be made that, in the context of financial advisory services, the relationship between an investment bank and its client is fiduciary in nature.[180] It may also be said, based on the normative proposition that a fiduciary relationship should exist where the reasonable expectations criterion is satisfied, that fiduciary obligations in this context *should* be owed.

It follows from this conclusion that investment banks are obliged to avoid positions where, in providing financial advisory services, their interests or duties conflict with the interests of their financial advisory clients. The remedial

176 See *Barnes v Addy* (1874) 9 Ch App 244, 251 (Lord Selborne LC); *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373; *ASC v AS Nominees* (1995) 62 FCR 504, 531 (Finn J); *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378; G E Dal Pont and D R C Chalmers, *Equity and Trusts in Australia and New Zealand* (2000) 971–3.

177 *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, 392 (Lord Nicholls).

178 The more recent view appears to be that dishonesty, objectively determined, is required. See *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, 389 (Lord Nicholls); *The Hancock Family Memorial Foundation Ltd v Porteous* (1999) 32 ACSR 124, 141–2 (Anderson J); Dal Pont and Chalmers, above n 176, 971. See also, for support of the requirement of 'knowing assistance', *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, 396 (Gibbs J); Glover, *Equity, Restitution and Fraud*, above n 14, 460–4. As to the uncertainty that exists on the appropriate touchstone of liability, see *ASC v AS Nominees* (1995) 62 FCR 504, 521, 523 (Finn J).

179 See *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, 397 (Gibbs J). Furthermore, these individuals may be similarly liable where they participate in a breach of the duty of confidence. See Meagher, Heydon and Leeming, above n 14, 1117, 1131.

180 Note, however, the limitations of analysis discussed above Part V(B), and contractual techniques to modify or displace fiduciary obligations discussed above Part V(E).

consequences of a breach of this obligation have been discussed. Part VII considers the consequences of the obligation for the way in which investment banks respond to conflicts of interest.

VII Consequences of the Obligation to Avoid Conflicts

A *Practical Consequences*

1 *Difficulties with Discharging the Obligation*

The imposition on investment banks of the fiduciary obligation to avoid conflicts of interest is likely to raise practical difficulties, especially since the organisational nature of these firms increases the potential for conflicts to occur, and may make them inevitable.[181] Several examples of the conflicts that can arise were provided in Part III(D) above.

In responding to conflicts such as these, there can be no assurance that the existence in investment banks of structural measures such as Chinese walls[182] alone would — as a matter of legal principle — prevent the breach of a duty to avoid conflicts of interest;[183] certainly in the context of law firms they would not.[184] This is despite the prevalence of their use.[185] Moreover, from a practical perspective, the use of Chinese walls may in fact decrease a firm's ability to properly respond to conflicts because they have the functional effect that the firm is unaware of the existence of the conflict at all.[186] In reality, however, Chinese walls are often porous, and are thus an appealing but ineffective answer to the problem of conflicts of interest.[187]

At the same time, the highly visible and lucrative nature of financial advisory services creates powerful financial incentives for firms to accept

[181] See above n 57.

[182] Chinese walls are internal policies and procedures that restrict information flows within a firm to ensure that information that is confidential to one department or segment of operations is not improperly communicated to another within the same firm. For a description of Chinese walls, see Law Commission, United Kingdom, *Fiduciary Duties Consultation Paper*, above n 47, 138.

[183] See Law Commission, United Kingdom, *Fiduciary Duties Report*, above n 148, 49. See also Andrew Mitchell, 'Whose Side Are You on Anyway? Former Client Conflict of Interest' (1998) 26 *Australian Business Law Review* 418, 431–3. However, the law is uncertain, and Chinese walls may be effective in some transactions where, on the basis of the decision of Lord Browne-Wilkinson in *Kelly v Cooper* [1993] AC 205, 215, 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': see Law Commission, United Kingdom, *Fiduciary Duties Report*, above n 148, 26.

[184] The purpose of using Chinese walls in law firms is to prevent what would otherwise be a breach of the duty to protect confidential information: see below nn 195–7 and accompanying text.

[185] Law Commission, United Kingdom, *Fiduciary Duties Consultation Paper*, above n 47, 138.

[186] See Goode, above n 57, xix–xx. He indicates that by adopting information barrier measures, it can be more difficult for a firm to identify conflicts of interest; in particular, the speed and volume of business that can now be accommodated by modern technology may make it difficult to identify any particular transaction as linked to another.

[187] Fisch and Sale, above n 60, 1095.

instructions — even in the face of possible conflicts. These incentives can be expected to exacerbate the practical difficulties that firms face in responding to conflicts.

The current state of the law offers no apparent resolution, except perhaps by allowing the parties to use the contractual techniques described in Part V(E) above to modify or exclude fiduciary obligations. However, this requires parties to negotiate or bargain around otherwise applicable obligations, raising questions about both the efficiency of bargaining in these circumstances and, more broadly, the appropriateness of investment banks providing the broad and diverse range of services they currently provide.

2 *Overlap with the Duty to Protect Confidential Information*

One consideration that may diminish the practical significance of whether the relationship under consideration is fiduciary is that in many cases an alternative to an action for breach of fiduciary duty will be an action for breach of the duty to protect confidential information.[188] The duty to protect confidential information prohibits persons who receive information of a confidential nature in what the law regards as circumstances of confidence from making unauthorised use of that information.[189] The relationship between an investment bank and its financial advisory client is a situation where this duty arises.[190] According to Professor Parkinson, the underlying rationale for both duties is the same — namely, to intervene in cases of breaches of trust and confidence.[191]

There are significant differences between the doctrines. To make out a case in equity for protection of confidential information, there must be 'actual or threatened misuse of that information';[192] conversely, as Austin J explained in *Oceanic Life Ltd v HIH Casualty & General Life Insurance Ltd*, fiduciary principles may apply where there is no misuse of confidential information.[193] Further, a misuse of confidential information may occur where the parties do not stand in a fiduciary relationship, provided that the information is communicated in such circumstances as to import an obligation of confidence.

Another difference between the doctrines relates to the effect on each of Chinese walls. In respect of actions for breach of the duty to avoid conflicts, the use of Chinese walls by investment banks will not always protect a fiduciary against such actions.[194] In the case of confidential information, however, the use of

[188] See Glover, *Equity, Restitution and Fraud*, above n 14, 221–2, 308–23.

[189] Ibid 315.

[190] That the relationship between an investment bank and its financial advisory client in the course of a transaction gives rise to a duty for the investment bank to protect confidential information is implicit in the decision of *Mannesman AG v Goldman Sachs International* (Unreported, High Court of Justice of England and Wales, Chancery Division, Lightman J, 18 November 1999).

[191] Patrick Parkinson, 'The Conscience of Equity' in Patrick Parkinson (ed), *The Principles of Equity* (2nd ed, 2003) 29, 37; Parkinson, 'Fiduciary Obligations', above n 14, 351.

[192] *Corrs Pavey Whiting & Byrne v Collector of Customs* (1987) 14 FCR 434, 443 (Gummow J).

[193] (1999) 10 ANZ Ins Cas ¶61-438, 74 977.

[194] The view of the United Kingdom Law Commission is that, as a matter of law, Chinese walls do not afford the type of protection that is needed for a firm to carry on its functions with the degree of assurance that the wall is intended to provide: Law Commission, United Kingdom, *Fiduciary Duties Report*, above n 148, 13.

Chinese walls and other measures such as undertakings can be effective to prevent what would otherwise be a breach of confidence. Recent cases (in the context of law firms and their close analogues) indicate that courts are now more prepared to accept the potential effectiveness of these measures.[195] The wall will be effective where it eliminates any real risk of disclosure of confidential information beyond its parameters.[196] This apparent difference in the effectiveness of Chinese walls under the doctrines takes on greater importance in the context of investment banks where their use is widespread.[197]

Professor Glover points to other differences between the two doctrines. Less stringent remedies were traditionally available against defaulting recipients of confidential information than against defaulting fiduciaries.[198] Also, fiduciary law requirements are increasingly imported into tests for whether a confidence should be protected and the two obligations are often conflated,[199] highlighting the importance of determining whether a particular relationship is fiduciary in character.

3 *Termination of the Obligation to Avoid Conflicts*

By analogy with the fiduciary relationship between a solicitor and his or her client, the fiduciary relationship between an investment bank and its financial advisory client would end when the retainer or engagement is terminated.[200] The fiduciary obligation to avoid conflicts of interest would also end at this point, subject to the possible continuation of a 'duty of loyalty', the content of which is

[195] See, eg, *PhotoCure ASA v Queen's University at Kingston* (2002) 56 IPR 86, 99 (Goldberg J); *Bureau Interprofessionnel des Vins de Bourgogne v Red Earth Nominees Pty Ltd* [2002] FCA 588 (Unreported, Ryan J, 9 May 2002). See also Dal Pont, *Lawyers' Professional Responsibility in Australia and New Zealand*, above n 65, 223–5; P G Willis, 'Chinese Walls: Myth, Metaphor and Reality — Living with Fiduciary Duties in Resource Relations' [2002] *Australian Mining and Petroleum Law Association Yearbook*, 558, 579–81.

[196] 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, 235, 237 (Lord Millett). Information barriers will be effective provided the court is satisfied on the basis of clear and convincing evidence that all effective measures have been taken to ensure that no disclosure of the confidential information will occur: at 237–8. This analysis has been embraced in Australia: see, eg, *Newman v Phillips Fox* (1999) 21 WAR 309, 315 (Steytler J); *Bureau Interprofessionnel des Vins de Bourgogne v Red Earth Nominees Pty Ltd* [2002] FCA 588 (Unreported, Ryan J, 9 May 2002).

[197] A survey by the United Kingdom Law Commission indicated that Chinese walls are very widely used in organisations offering financial services: Law Commission, United Kingdom, *Fiduciary Duties Consultation Paper*, above n 47, 138.

[198] Glover, *Equity, Restitution and Fraud*, above n 14, 308–9.

[199] Ibid. One additional difference between the duties is that the duty to protect confidential information extends in time beyond the consensual termination of the fiduciary relationship, whereas fiduciary obligations end at that point, subject to the possible continuation of a duty of loyalty.

[200] *Bolkiah* [1999] 2 AC 222, 235 (Lord Millett).

still being developed by Australian courts.[201] It follows from this that the question of whether the obligation to avoid conflicts arises in the question under consideration has greatest application to existing (rather than former) clients of investment banks. In the case of former clients, the more appropriate basis for any court intervention will be to protect confidential information disclosed during the course of the engagement.[202]

B *Regulatory Consequences*

Existing regulation broadly applicable to the financial services industry requires that investment banks 'manage' conflicts arising in their business.[203] ASIC, which administers these regulations, regards them as coexisting with any general law obligations, including fiduciary obligations.[204] However, if the firms do owe fiduciary obligations in respect of their financial advisory services, as this article asserts, there is a mismatch or inconsistency between the regulations that require investment banks to manage conflicts and general law obligations that would require conflict avoidance in the provision of financial advisory services. There is no apparent way to reconcile this inconsistency outside of contractual variation of fiduciary obligations, and neither the regulations nor ASIC provide guidance on the issue.[205] This raises the question of whether the regulations adequately protect those to whom the general law would grant

201 The law in Australia appears to have diverged from that in England by asserting that a duty of loyalty, which may be fiduciary in nature, survives the termination of the retainer: see *Spincode Pty Ltd v Look Software Pty Ltd* (2001) 4 VR 501; *Wagdy Hanna & Associates Pty Ltd v National Library of Australia* [2004] ACTSC 75 (Unreported, Higgins CJ, 1 September 2004) [31]–[42]; *McVeigh v Linen House Pty Ltd* [1999] 3 VR 394; *Wan v McDonald* (1992) 33 FCR 491, 512–13 (Burchett J); cf *Belan v Casey* [2002] NSWSC 58 (Unreported, Young CJ in Eq, 4 February 2002) [21]. 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 Ltd v Tomkies* (1936) 54 CLR 583, 592 (Latham CJ); Glover, *Equity, Restitution and Fraud*, above n 14, 323.

202 In the case of solicitors — and by analogy with the relationship between investment banks and their financial advisory clients — the duty to protect any confidential information obtained during the course of an engagement continues after the retainer or engagement has ended: *Bolkiah* [1999] 2 AC 222, 235 (Lord Millett). See also *Mannesman AG v Goldman Sachs International* (Unreported, High Court of Justice of England and Wales, Chancery Division, Lightman J, 18 November 1999), where it was implicit in the court's reasoning that an investment bank owed a duty to protect confidential information to its former financial advisory client.

203 *Corporations Act 2001* (Cth) s 912A(1)(aa). See pt 7(6) of the Act generally for the licensing regime.

204 See ASIC, *Licensing: Managing Conflicts of Interest* (Policy Statement 181, 2004) 2, 8. This approach is open because there is no statutory provision indicating that the requirement to 'manage' conflicts is in any way intended to affect the operation of the general law.

205 ASIC indicates that fiduciary obligations 'should be taken into account when formulating conflicts [of interest] arrangements' required by regulations, but does not indicate or suggest how this might be achieved: ibid 8; see also ASIC, *Managing Conflicts of Interest: An ASIC Guide for Research Report Providers* (2004) 4. There appears to be nothing in ASIC's policy statements to suggest that the fiduciary obligation might trump the more lenient regulatory obligation: ibid 11. Furthermore, it is acknowledged that some conflicts cannot be managed by a combination of internal controls and disclosures, and where that occurs, 'the licensee must avoid the conflict or refrain from providing the affected financial service': ibid 16. See also Law Commission, United Kingdom, *Fiduciary Duties Report*, above n 148, 85–6, for a discussion of the effectiveness of contractual techniques to solve problems that arise from any mismatch between fiduciary rules, regulatory rules and market structure.

protection afforded by the fiduciary relationship. It is clear, in any event, that regulatory guidance is required as to how these inconsistent requirements might be reconciled.

1 *Regulation of Conflicts of Interest*

The *Corporations Act 2001* (Cth) requires persons who carry on a financial services business to hold a licence covering the provision of those financial services.[206] The licence, which is obtained from ASIC, imposes various obligations on licensees, including the obligation to 'manage' conflicts of interest.[207] 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.[208] 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.[209] The requirement to 'manage' conflicts will indirectly affect financial advisory services where the provision of those services is implicated in a conflict with other services provided by the firm that are subject to the licensing regime.

The licence obligation to manage conflicts of interest, provided for in s 912A(1)(aa) of the *Corporations Act 2001* (Cth), requires that licensees '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 the licensee, or a representative of the licensee, as part of their financial services business.'[210]

[206] *Corporations Act 2001* (Cth) s 911A(1). See generally pt 7(6) of the Act for the licensing regime, which was introduced by the *Financial Services Reform Act 2001* (Cth).

[207] *Corporations Act 2001* (Cth) s 912A(1)(aa) requires a licensee to have adequate arrangements to manage conflicts of interest. The conflicts management obligation has been in effect since 1 January 2005.

[208] *Corporations Act 2001* (Cth) s 911A(1) requires that a person who carries on a financial services business must hold a licence covering the provision of financial services. Pursuant to s 761A, a 'financial services business' means a business of providing 'financial services', which in turn means (a) providing financial product advice; (b) dealing in a financial product; (c) making a market for a financial product; (d) operating a registered scheme; (e) providing a custodial or depository service; or (f) engaging in conduct of a kind prescribed by regulations (ss 761A, 766A(1)). Based on the statutory meanings of each of these activities and the obligations imposed in respect of them by the licences, it appears highly unlikely to the author that the licensing regime was intended to apply to the *financial advisory* services of investment banks. No ASIC policy guidance is provided on this issue, however. Further, no exemption would appear to apply; in particular, s 911A(2)(g) does not apply since APRA does not regulate the financial advisory operations of the firms. It is clear, however, that the services identified in s 766A(1) will also generally be provided by investment banks, each of which will therefore be required to hold a licence '*covering the provision of [those] financial services*': s 911A(1) (emphasis added).

[209] The obligations of licensees apply only in respect of the 'financial services covered by the licence' and so the investment bank would not be subject to those obligations in respect of its *financial advisory services* operations. This contrasts with what appears to have been the position before the commencement of the *Financial Services Reform Act 2001* (Cth), which reformed the licensing provisions: see John O'Sullivan and Tony Damian, 'Regulation of Securities and Intermediaries in Australia' in Gordon Walker, Brent Fisse and Ian Ramsay (eds), *Securities Regulation in Australia and New Zealand* (2nd ed, 1998) 449, 460.

[210] *Corporations Act 2001* (Cth) s 912A(1)(aa). See also ASIC, *Licensing*, above n 204, 7.

Conflict management is an elusive concept. In its policy guidance, which gives an indication to the marketplace of how it will interpret the law that it has responsibility for administering (without having the force of law), ASIC makes it clear that the conflict management requirement may not require the licence-holder to avoid conflicts.[211] According to ASIC, arrangements to manage conflicts will be 'measures, processes or procedures' that control, avoid or disclose conflicts,[212] and will depend on the nature, scale and complexity of the licensee's business.[213] ASIC asserts that any conflict may be handled in a number of different ways (with avoidance being but one option) and that many conflicts of interest may be managed by a combination of internal controls and disclosures.[214]

ASIC has provided more detailed guidance in respect of one aspect of an investment bank's operations: the provision of research reports (associated with the brokerage operations of a firm).[215] However, it is clear from this policy that conflict *avoidance*, as a general approach, is not required.[216]

These regulations, and ASIC's interpretation of them, clearly contemplate that Chinese walls or other information barriers will provide a primary means by which investment banks will manage conflicts. It is also evident that the requirement to manage conflicts is unlikely in many circumstances to be tantamount to the fiduciary obligation to avoid conflicts, which obligation is unlikely to be discharged by the use of Chinese walls.[217] There is also nothing to suggest that parties might adopt contractual techniques to modify or displace the regulatory obligation.[218]

2 *Mismatch between Regulatory Requirements and Fiduciary Obligations*

The mismatch or inconsistency between the regulatory requirements and the fiduciary obligation to avoid conflicts arises because the regulatory regime operates in addition to the fiduciary obligation; it does not displace it. A direct conflict between these requirements will occur when the regulatory requirement may be discharged by measures, such as adopting Chinese walls, which would not also discharge the fiduciary obligation. It follows that complying merely with the regulatory requirements may well leave an investment bank in breach of the fiduciary obligation. More significantly, it might reasonably be concluded that the conduct of an investment bank that discharges its regulatory require-

[211] ASIC, *Licensing*, above n 204, 8.

[212] Ibid.

[213] Ibid 5.

[214] Ibid 5, 8, 11.

[215] ASIC, *Managing Conflicts of Interest*, above n 205. The policy sets out how the requirement to manage conflicts imposed by s 912A(1)(aa) of the *Corporations Act 2001* (Cth) might be satisfied.

[216] ASIC notes that '[s]ome conflicts of interest should be avoided entirely. Other conflicts, however can be addressed by adequate controls and appropriate disclosure': ASIC, *Licensing*, above n 204, 10.

[217] See above n 183 and accompanying text.

[218] The regulatory obligation arises where a conflict of interest arises: see above n 207 and accompanying text. There appears to be no provision for parties by contract to relieve themselves of, or modify, this obligation.

ments, even if not meeting its fiduciary obligation, is immune from sanction. With regard to the fiduciary relationship under consideration, for example, an investment bank might be in a position of conflict with its financial advisory client, but have in place measures, such as information barriers, to manage that position. In this case, the regulatory requirements might be thought to assume the legitimacy of conduct (without actually sanctioning it) that would arguably otherwise be a breach of fiduciary obligation.[219] These problems are at the core of the structure of the financial markets and underscore the significance of the question being considered in this article.

C *Industry and Institutional Consequences*

The imposition of a fiduciary obligation to avoid conflicts in providing financial advisory services poses a serious challenge to investment banks. One option for firms is to spin off the financial advisory department to minimise the risk of conflicts occurring, as some firms have done recently or are reported to be considering.[220] Disamalgamation in this way may mean that firms lose economies of scope and other benefits of diversification and, as Easterbrook and Fischel note, prices of services may increase without any improvement in the quality of advice.[221] Many questions, including the fiduciary issue, will be relevant to an assessment of this option. Another option would be for firms not to offer these services, although their highly profitable nature provides incentives against firms adopting this course.

One plausible option open to firms is to contract around any fiduciary obligations that arise. However, this is costly and there is uncertainty as to the effectiveness of these measures in the investment banking context.[222] Even where these contractual techniques are legally effective, questions arise about the appropriateness of the organisational nature of firms whose operation depends on avoiding the obligations that the law would otherwise impose. Since an underlying motivation of the imposition of fiduciary obligations is to maintain public confidence in socially important relationships like that of investment, the routine circumvention of such obligations raises public policy concerns. This, however, is not to deny that the fiduciary obligations would otherwise be imposed.

Further complicating this analysis is the statutory regulation of conflicts of interest that applies to these firms and its relationship with fiduciary principles.

VIII CONCLUSION

Financial advisory services are a core part of the work of investment banks, which in turn are integral to the efficient operation of any modern financial system. Based on the analysis in this article, it is strongly arguable that, in

[219] These problems are identified in the same terms by the Law Commission, United Kingdom, *Fiduciary Duties Consultation Paper*, above n 47, 7.

[220] See above n 7.

[221] Frank Easterbrook and Daniel Fischel, 'Contract and Fiduciary Duty' (1993) 36 *Journal of Law and Economics* 425, 428.

[222] See above n 194.

providing these services, investment banks are — and indeed should be — in a fiduciary relationship with their clients that will oblige them to avoid conflicts of interest. This has significant consequences for investment banks since their very organisational nature makes conflicts likely, if not inevitable, and the measures they adopt in response to conflicts do not, as a matter of legal principle, discharge the fiduciary obligation. At the same time, the lucrative and highly visible nature of financial advisory services creates powerful incentives for firms to undertake this work.

This conclusion also has significant implications for the regulation of investment banks and for their very organisational nature. This article does not consider the merits of disamalgamation of the modern investment bank. However, at a time when many investment banks are reconsidering the logic of financial conglomeration, the fiduciary question and its implications for the way in which firms respond to conflicts of interest cannot be ignored.