

## Directors and Officers Fiduciary and Best Interest Duties - Navigating a Legal Minefield

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*Recommended citation(APA):*  
Millhouse, D. (2021). *Directors and Officers Fiduciary and Best Interest Duties - Navigating a Legal Minefield*. Legalwise 14th Annual In-house Counsel Conference, Brisbane, Australia.

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## Directors & Officers Fiduciary & Best Interest Duties

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Navigating a  
Legal Minefield

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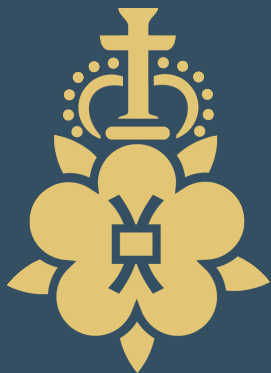
## Is Best Interest a Fiduciary Duty?

Much is made in the media  
and in political circles of the  
adjective “fiduciary” and the  
aphorism “best interest”.



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## Common Heritage But Different Meanings – Fiduciaries

- A creature of the general law imposed by equity & public policy
- Not a choice, but...
- its application usurped by intrusion of statutory best interest duties...and contract
- Fiduciary duty is prohibitive, negative duties...
- but is it? – different & evolving interpretations including positive duties in some cases
- Conflicts require 'Informed Consent'...
- But actions to obtain may be positive and fiduciary but not unanimous opinion
- Other positive actions may be fiduciary
- Fiduciaries are status based but fiduciary status depends on role as well
- A person subject to fiduciary obligations is a fiduciary, whether or not status defined
- Exercised concurrently with best interest & other duties
- Enlivens remedies in equity

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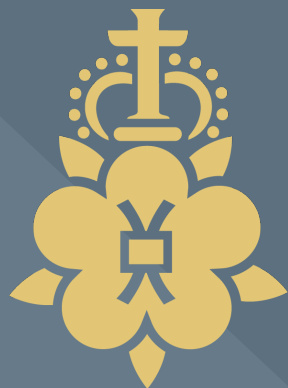
## Common Heritage But Different Meanings – Best Interest

- General law meaning is to act positively in objective interest of beneficiary – essentially fiduciary...
- ...but now best interest duties are largely creatures of statute with...
- bespoke multi-layered ever-changing statutory interventions
- Best interest duties rely on prioritisation of interests, not prohibition
- Best interest, best financial interest, best long-term financial interest, interest and benefit are not the same but are often used interchangeably
- One person's best interest may not be the same as another person's
- Best interest interpretations vary with context
- Intrusion of statute continues (Your Super, Your Future 2021)
- Application often but not always duty of a fiduciary
- Uncertain application in investment strategy formulation & due diligence



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# Fiduciary Expectation Destroyed

## Limited Fiduciary Duties

- Narrowly interpreted

## Assumptions of Fiduciary Relationship Unrealised

## Investors Approve Their Own Destruction

- Compliant statutory disclosures
  - Security holder approvals
- Non-disclosure of economic intent
  - Loss of Capital
  - Death Spirals
  - Fraud

## Lack of Economic Loyalty

- Ignorance & ignoring of fiduciary duty
- Legal rights v economic interest



## Creeping Corruption/Creative Compliance

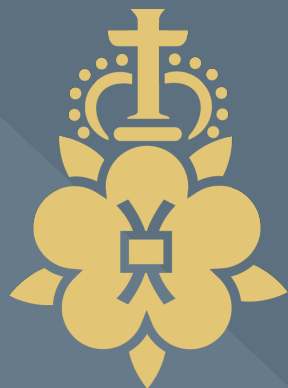
- Statutorily Compliant
- Flawed business models
- Best interest confusion

## Related Party Transactions

- Tunnelling
- 'Informed' consent
- Chinese Walls
- Intrusion of statute

## Conflicts Of Interest & Objectives

## Prioritisation v Prohibition



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# Systemic & Cyclical Failure in Australian Financial Products & Services

Table 3.25 Legal matters raised in the judgments	Variable	Recurrence % of sample	Correlation
Top decile			
Related party transactions CA s 191	1	22.16%	
Misleading & deceptive/unconscionable conduct CA s 1041H, AA s 12DA, ACCA s 52	2	20.70%	93.42%
Top quartile			
Dishonesty	1	15.98%	
Related parties/conflicts of interest CA s 191	2	15.23%	95.31%
Systemic causes - first variable correlation			
Dishonesty	1	15.98%	
Related parties/conflicts of interest CA s 191	2	15.23%	95.31%
Directors/trustee duties CA ss180-184, SISA s 62	3	15.23%	95.31%
Disclosure	4	14.86%	92.97%
Systemic causes - second variable correlation			
Related parties/conflicts of interest CA s 191	2	15.23%	
Directors/trustee duties CA ss180–184, SISA s 62	3	15.23%	100.00%



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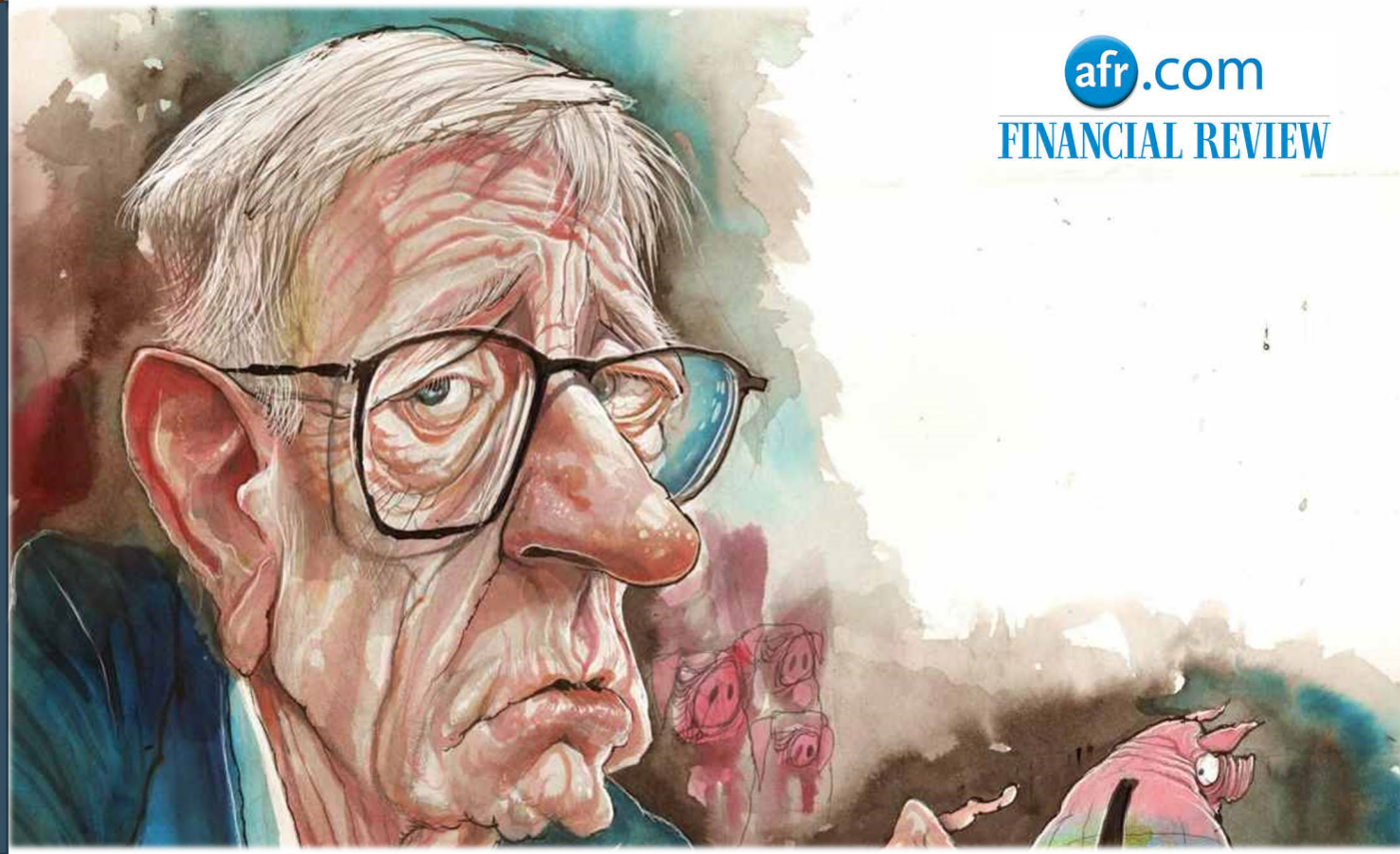
## Kenneth Hayne Must Traverse a Legal Quagmire

Chanticleer is Australia's pre- eminent business column

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‘A stunning finding ...  
ought to be brought to  
the attention of  
Hayne’

(Tony Boyd AFR Jan 16 2019)

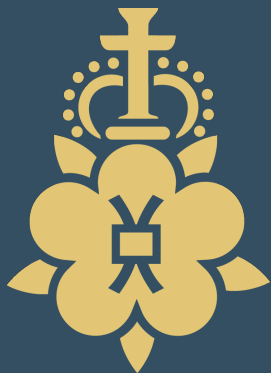






## Statutory Interventions

- Have damaged the Wallis tenets of Disclosure, Advice, & Literacy
- Provided for prioritisation of interests over prohibitions
- Led to a disclosure regime requiring huge incomprehensible documents – data is not knowledge
- Promotes 'box-ticking' compliance over proper outcomes
- Created a large costly compliance industry
- Reduced fiduciary law to 'legal Polyfilla' (eg unregistered MIS)



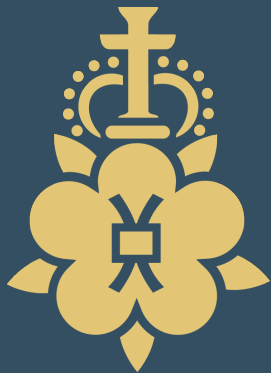
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## Statutory Contexts

- *Corporations Act 2001* ss 180,181 (Good faith – objective), s 180(2)(d) (rational belief – subjective), ss 601FC,FD (MIS), ss 961A,B (advice), ss 766E (custody), Ch 8B (MIS priority, Depositary as fiduciary), s 910A (adviser standard), s 964 (custody), s 921U (advice), s 994 (DDO)
- *Superannuation Industry (Supervision) Act 1993* – (Choice, MySuper Default, SMSF) – ss 52(2),(6),(8) (trustee and director of trustee personal liability), s 29VN (beneficiary MySuper), s 10 (custody)
- *Fair Work (Registered Organisations) Act 2009* s 382 (now amended) – belief – subjective
- *National Consumer Protection & Credit Act 2009* s 158 (mortgage broker best interest)
- Evolving interpretations of ‘retail’ investor – FASEA & Design and Distribution Obligations
- Eleven different contextual interpretations + six FASEA interpretations + 2021 Your Super, Your Future ‘Best Financial Interest’



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## Legal Objections to Best Interest in Statutes

- 'Mad, Bad, and Dangerous to know'



- 
- Superlative 'best' has no objective legal meaning
  - Is not the same as best outcome
  - Can be interpreted literally



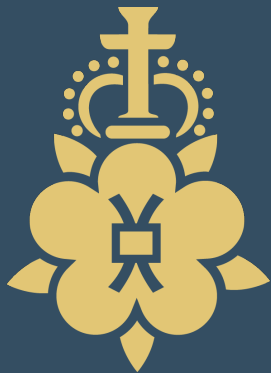
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- Is a trustee indemnity in best interest?
  - Is the charging of fees in best interest?
  - Best interest, interest, benefit, financial interest...used interchangeably



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## Jurisdictional Contexts

- Different jurisdictions use the same terminology but apply it differently
- Usually more onerous
- Australian directors of companies operating internationally or Australian directors of overseas companies in Australia *take note*
- United States & Canada – proscriptive and prescriptive (positive) fiduciary and separate best interest duties – States and Provinces can apply law differently – ambiguous – some (US) require ‘absolute punctilio of honour’ but no uniform fiduciary standard – Canada Client Relationship Model combines all duties – strict liability – no ‘Safe Harbour’ in financial advice – ‘teachable moments’
- United Kingdom Companies Act 2006 – Director’s duties defined as fiduciary & codified – use language of and rely for remedies in the general law – s 172 ‘promote the success of the company’ – very broad drafting – pro-& prescriptive – corporate opportunities liabilities
- Germany, EU & civil law countries – Fiduciary duty a creature of contract – duties vest in the duty of skill and care – but are fiduciary like – *Untreue* doctrine – proscriptive and prescriptive – *culpa in contrahendo* doctrine – clients must understand what they are doing – cannot be contracted away – German civil law written into EU statutes – subjective & objective tests – spirit & letter of the law compliance
- Singapore – strict proscriptive tradition relying on disclosure to avoid breach in the first place – strict liability– mainly statute and contract based, can refer to UK & Australian law – cultural overlays



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## International Trends in Fiduciary Law

Australian fiduciary law is an international outlier – scholarly calls for reform

- United Nations Fiduciary Duty in the 21st century – includes CSG policies in director fiduciary duty
- Global Fiduciary Standard – highly prescriptive – positive duties



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## Fiduciary Duty Case Law

- *Wingecarribee Shire Council v Lehman Brothers Australia* [2012] (existed)
- *ABN Amro Bank NV v Bathurst Regional Council* [2014] (existed)



- 
- *Westpac v Bell Group* [2012] (positive duties may exist)
  - *ASIC v Citigroup Global Markets Limited* [2007] (contractually excluded)
  - *Hospital Products v United States Surgical Corp* [1984] (difference between US and Australian fiduciary law)



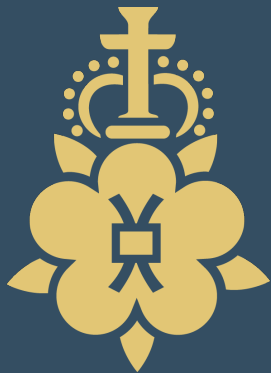
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- *Babcock & Brown Global DIF 111 Global Investment Fund LP v Babcock & Brown International Pty Ltd* [2017] (difference between US & Australian fiduciary law – defines 'promoter' as a fiduciary – positive duties)
  - *Rouse v IOOF* [1999] (undivided loyalty)



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## Best Interest Duty Case Law

- *APRA v Kelaher* [2019] 'IOOF' (best outcome, risks, action not process, *res ipsa loquitur* denied)
- *ASIC v Mitchell* [2020] 'Tennis Australia' (interests of the company, possible conflicts of interest, s 180)
- *ASIC v Australian Property Custodians Holdings Limited* [2013] 'Prime Trust' (uncertain boundaries)
- *Lewski v ASIC* [2017] 'Prime Trust' (Tunnelling – lawful expropriation)
- *ASIC v NSG Services, Golden Financial Group* [2017] (CA s 961)
- *Pioneer Concrete Services* [1986] (interests v best interests)

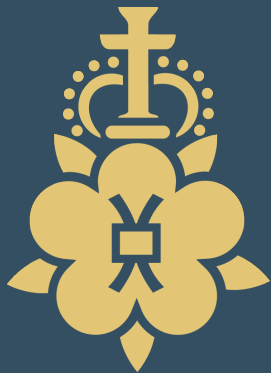


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## Best Interest & Fiduciary Duties In Financial Advice

- FASEA (now abolished) but standards remain CA s 921U – unlimited personal liability (tenor & quantum) – *Caveat Venditor*
- Six additional best interest duties – broad effects long term, conflicts, likely circumstances, appropriateness, comprehension & competence, value for money – FASEA fiduciary-like – does not use adjective or noun
- *Corporations Act* s 961A,B – Safe Harbour defence
- Statutes usurp & subsume general law fiduciary obligation... except in pre-contract advice and/or in advisory contract
- Broadening of adviser to 'Relevant Provider' – (stockbroker, accountant, mortgage broker, sales reps, financial advisers, wealth managers)
- Broadening of interpretation of 'retail' investor – comprehension standards
- Supplemented by *Design & Distribution Obligations & Product Intervention Powers Act* (2020) – adds additional best interest liability CA pt 7.A s 994, 1023 – requires target market determination, market conduct ++ by Regulated Persons – broadens retail investor to financial consumer – contracts void *ab initio* – all financial products regulated by CA, AA, NCCPA applies to issuers, distributors, sellers & advisers
- Mortgage Broker best interest duty *NCCPA* s 158LA,LE ASIC RG 0000 (2020) – No Safe Harbour – No contracting out

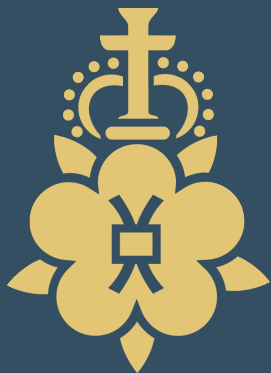


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## Best Interest & Fiduciary Duties in Superannuation Entity Trustees

- *SIS Act 1993* & Your Future, Your Super Bill (2021)
- Best financial interest of beneficiaries test proposed – does not replace other best interest tests – meant to clarify
- Adds to best interest interpretation for Choice & MySuper Default Funds (best long-term financial interest)
- Non-financial beneficiary interests cannot be at expense of financial interest
- Strikes at ‘trustee directed products’ – impacts on vertical integration
- Annual beneficiary outcome tests – long term investment performance – failure means failure of financial best interest test
- Restrict use of funds by trustee without ‘robust quantitative analysis’ – no materiality threshold
- Statutory (2021) financial interest is not: non-financial benefits, counselling, some third-party payments & payments to intermediaries, discretionary payments
- Reversal of onus of proof
- Strict liability with large civil liability
- Trustee duties apply to directors personally including SMSF trustee directors – no corporate veil
- Legislation refers to financial interest, interest, & fiduciary duty of trustee
- Applies to SMSF trustees but different penalties
- Statutes do not replace general law fiduciary obligation & liability remains if statutory remedies fail



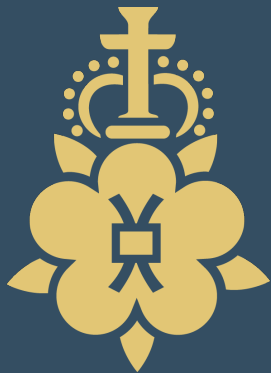
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## Best Interest & Fiduciary Duties in Confidential Information

- Traditional distinction between confidence/confidential information in equity and intellectual assets as property
- Becoming blurred – confidential information, trade secrets is intellectual property (*Stephen John Coogan v News Group Newspapers Limited* [2012] EWCA)
- Digital economy will result in more conflict over ownership & usage rights... but these Intangible Assets are the key to success in a digital economy
- Best interest & fiduciary obligations arise in multiple situations

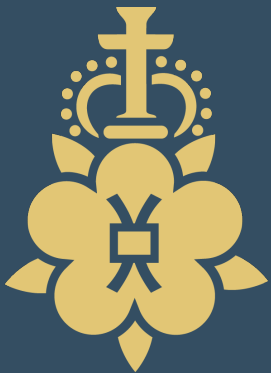


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## Best Interest & Fiduciary Duties in Employment

- Given uncertainty of application of fiduciary law, impose fiduciary obligations in contracts
- Broaden the scope of contractual fiduciary duties – eg control, discretion, autonomy, client facing, supplier facing, related parties, conflicts of interest, hiring delegations, specific skills
- Employment and director and fiduciary duties are different and limited (in employment)
- Conflicts of interest register for senior employees



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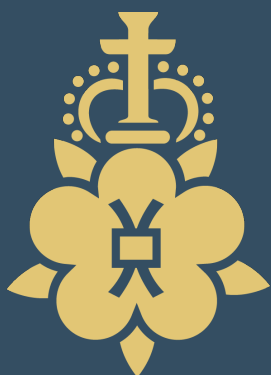




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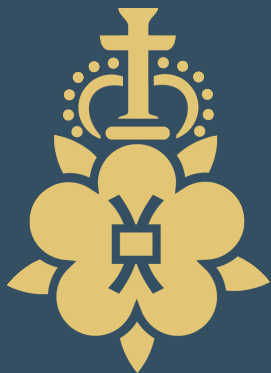
## Best Interest & Fiduciary Duties in Shareholder Class Actions

- Class action financing now a Managed Investment Scheme with a licensed corporate trustee (Responsible Entity)
- RE directors have fiduciary duty to trustee company
- Trustee company has best interest duty to members of the MIS
- MIS promoters are fiduciaries in general law (*Babcock & Brown DIF 111 Global Investment Fund LP v Babcock & Brown International Pty Ltd* 2017)
- Promoters can be – the RE, financier, or law firm advising... but lawyers have established fiduciary and best interest duties to clients
- Many sources of conflicts of interest affect financial outcomes of class action beneficiaries & company defendants
- Major law reform expected in 2021 (Paterson Inquiry) – uses best interest, interests, fiduciary & fiduciary-like throughout report
- DDO overlay may apply



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## Strategies for Counsel – How to Untangle the Gordian Knot

- Define the context
- Define the jurisdictions, especially cross-border
- Define related parties
- Identify conflicts of interest
- Define who is a fiduciary
- Analyse the existence of fiduciary obligation
- Define who and which entity owes a best interest duty
- Analyse the application of statutory best interest duties
- Define to whom duties are owed
- Analyse director personal best interest liability in superannuation trustee entities
- Review organisational and governance practices to fully document liabilities (and opportunities)
- Be clear whether you are defending, prosecuting, divesting, acquiring, or investing
- Spend time on strategy development at board level

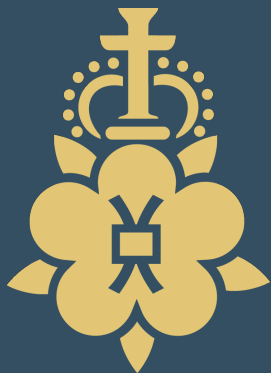




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## Government: Does it Listen to Advice?

- The Australian Government is in receipt of four landmark reports: the Heydon Royal Commission, Productivity Commission (superannuation and financial sector competition), and the Hayne Royal Commission.
- Each of them points to deep systemic and cyclical problems in the provision of financial products and financial services.
- A common thread is poor culture leading to poor conduct, diffusion of poor culture (taint), the distinction between compliance-based law and morality (what can be done is not what should be done), and re-establishment of trust.



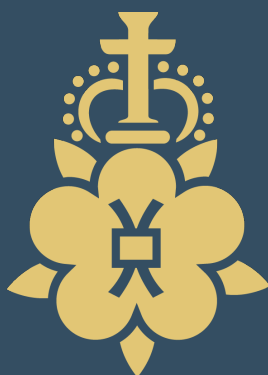
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## The Future of Law Reform

- Haynes' required reform is buried in pp 494-496 of Volume 1. This is the need to simplify the law and implement its intent
- Hayne notes: 'because the law is now spread over so many different Acts and is as complex as it is ... the very size of the task shows why it must be tackled'
- Jeremy Cooper - Stronger Super Review : 'directors should not have to collate their duties from multiple sources'
- The Productivity Commission propose a new 'duty of care and a 21st century disclosure regime "based on trust"'



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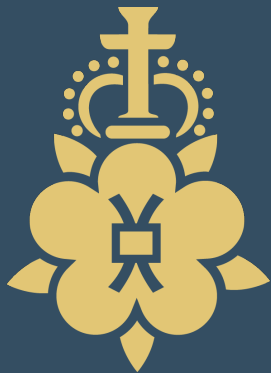
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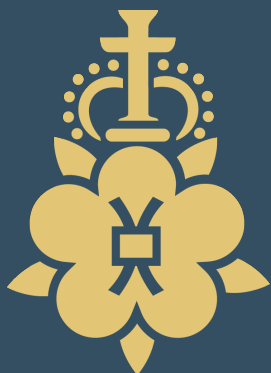
## Hayne's Real Message

- Hayne wants an 'integrated solution' linking law and morality, noting that 'Regulatory gaming occurs when gaps open, an inevitable consequence of piecemeal change'
- This is Hayne's real message
- What we presently have due to time and political constraints is more piecemeal tactical change, in a torrent of new legislation



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## Publications

- Corporate Governance in Non-Bank Financial Entities 2019 (LexisNexis)
- W[h]ither Australia? Will Parliament Act? (2020) 14(2) *Law & Financial Markets Review*
- Empirical Analysis supports the Hayne long run reform thesis (2019) 13(2-3) *Law & Financial Markets Review*
- From Campbell to Hayne: W[h]ither Australia? Australian Financial regulation and supervision at a cross-roads (2019) 13 (2-3) *Law & Financial Markets Review*
- Directors & Officers – Strategic Leadership or Bondage? (2020) *Enterprise Governance eJournal* Bond University Faculty of Law
- Best Interest Duties of Financial Advisers – More Law, More Confusion (2020) *Enterprise Governance eJournal* Bond University Faculty of Law

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