

When duties collide

Introduction

There is an old adage that we cannot serve two masters. For us, this is reflected in the equitable obligation, that we cannot serve two clients at the same time in the same transaction or a related transaction, unless we secure the informed consent of both to the double employment. A failure by us to recognise the potential for duties to collide can have an outcome where equity will exact from us compensation for a breach of our fiduciary duties. The case note below highlights once again the tight rope we as solicitors walk when acting for more than one party in the same or a related transaction.

***Eiszele v Hurburgh* [2011] TASSC 65**

There were two plaintiffs, a husband and wife, for brevity they will be referred to jointly as “E” who sued their former solicitor, H, for equitable compensation and/or common law damages, alleging breaches of duty in relation to two loan transactions. This note looks at the consequences of a breach of fiduciary duty only.

E borrowed \$57,000 from a company (CWS) associated with H’s legal practice. E gave mortgages as security for the two loans. E then lent the proceeds of these loans, without security, to their daughter and her partner T, who were to make monthly payments to CWS. The daughter and T were not capable of making any payments, with the result that E had to repay most of the borrowed money and interest.

The partners in the law practice were directors and shareholders in CWS, the lender.

E sought to recover from H, \$65,999.86 as compensation.

E contended the following:

- before acting in the transactions described above H had acted for T and was aware of T’s difficult financial position;
- H acted simultaneously for T and E in relation to the unsecured loans, and for E and CWS in relation to the mortgage loans;
- H had a duty to inform E of T’s financial difficulties, or else decline to act for E;
- H neither informed E of any of T’s financial difficulties, nor declined to act for E. He acted in relation to the loans without saying anything to them as to T’s financial position or the risks associated with making unsecured loans to T and their daughter.

The evidence established that H had acted for T in two prior conveyancing transactions and the related mortgage loans. T had previously borrowed from CWS. At about the time E came to see H, H was aware that T was behind in his mortgage payments, the properties he owned had second mortgages to a bank encumbering them and that T had little equity in either property.

Fiduciary duties

Two forms of conflict arose from these facts: firstly, the conflict in duties owed between E and T and secondly, the conflict of interest H had as a solicitor and as a director and shareholder in CWS.

The Court noted that it was in H's interests for the transactions to proceed. H stood to benefit from the legal fees associated with the purchase of property, the two mortgages and the two unsecured loans. CWS stood to gain to the extent of income it would earn as a result of the making of the mortgages.

Blow J noted:

- the extent of the fiduciary duties we owe depend on the circumstances of the case: *Maguire v Makaronis* (1977) 188 CLR 449 at 463-464;
- that when acting for both parties to a transaction, we have a fiduciary duty to disclose to one party any material facts within our knowledge relevant to that party's interests, including facts relating to the other party: *Clark Boyce v Mouat* [1991] 1 AC 428 at 437. In the past equitable compensation has been awarded against solicitors who have acted for parties with different interests and breached the duty of disclosure by not disclosing information to one client: *Farrington v Rowe McBride & Partners* [1985] 1 NZLR 83;
- our duty of loyalty must be undivided;
- if we attempt to act for more than one party in a transaction we must obtain the informed consent of both to so acting. There will be circumstances (even where informed consent has been obtained) where it will be impossible to act fairly and adequately for both and we must decline to act for either of them;
- we will bear the responsibility of securing informed consent. What is informed consent is fact sensitive.

H did not disclose to E the facts known to him about T's financial position. H owed a duty of confidentiality to T.

H was in a position where he had a duty to disclose to E what he knew of T's financial position, and a duty to T not to make any disclosure without T's consent. There was no evidence before the Court that H sought such consent. H was therefore conflicted. H was therefore under an obligation not to act for E, but H chose to continue to act for the parties. The Court concluded that H breached his fiduciary duty to E by acting for them when the relevant mortgages were given, the relevant loan transactions were entered into, and the relevant loan funds advanced, without disclosing to them the facts that he knew in relation to T's financial position.

The Court was not satisfied that there was any material non-disclosure as to the benefits that H's firm and CWS would receive if the mortgage/loan transactions proceeded. Even if disclosure was less than perfect he Court concluded that any non-disclosure did not cause or contribute to E's losses in any way.

H was therefore, liable to pay equitable compensation on the basis of a material non-disclosure of information about T's financial position.

Equitable compensation

A claim for equitable compensation based on a breach of fiduciary duty is not subject to common law principles of causation, foreseeability and remoteness.

Equitable compensation is designed to make good a loss in fact suffered and which using hindsight and common sense, can be seen to be caused by the breach (Lord Browne-Wilkinson in *Target Holdings Ltd v Redferns* [1966] 1 AC 421 at 439).

On occasions when using hindsight and common sense to determine whether a loss has been caused by a breach of fiduciary duty the Courts will apply the *Brickenden* principle.

This principle was articulated by Lord Thankerton in *Brickenden v London Loan & Savings Co* [1934] 3 DLR 465 at 469:

"When a party, holding a fiduciary relationship, commits a breach of his duty by non-disclosure of material facts, which his constituent is entitled to know in connection with the transaction, he cannot be heard to maintain that disclosure would not have altered the decision to proceed with the transaction, because the constituent's action would be solely determined by some other factor, such as the valuation by another party of the property proposed to be mortgaged. Once the Court has determined that the non-disclosed facts were material, speculation as to what course the constituent, on the disclosure, would have taken is not relevant."

Blow J concluded after an examination of various authorities that the *Brickenden* principle applied to cases of conflicts of duty and duty as well as conflicts of interest and duty (his Honour preferred to follow the decision of the Full Court of the Federal

Court in *Commonwealth Bank of Australia v Smith* [1991] FCA 375 over a number of New South Wales authorities).

The Court concluded by applying *Brickenden* it did not need to make any finding as to what course E would have taken if H had made a full disclosure of the information about T's financial position. The non-disclosed facts were material and therefore E was entitled to recover equitable compensation. Judgement was entered against H for \$63,999.86 (this was the loss E sustained).

Comment

1. Our duty to our client is primarily contractual and its scope depends on the express or implied terms of our retainer (Lord Walker of Gestingthorpe in *Hilton v Barker Booth and Eastwood* [2005] 1 All ER 651 said at paragraph 28);
2. We are fiduciaries. It is a relationship where our client reposes confidence and trust in us;
3. We owe a duty of single-minded loyalty to our client's interests. We also owe a duty to respect our client's confidences. Both duties can be scoped by the terms of our retainer (or as Lord Walker of Gestingthorpe in *Hilton v Barker Booth and Eastwood* [2005] 1 All ER 651 said at paragraph 30 "moulded and informed by the terms of the contractual relationship");
4. At the core of the duty of loyalty is an obligation to avoid situations where duties owed to different clients come into conflict. The foundation for this is that we owe duties to each client independently (*The Baby Hammock Co Limited v AJ Park Law* [2011] NZHC 686 at paragraph [87]). The duty of loyalty will on many occasions make it improper for us to act for two clients with conflicting interests in a transaction. To overcome the conflict we will need the informed consent of both parties. The consent must be consent given in the knowledge that there is a conflict between the parties and that as a result the parties will need to understand that we may be unable to disclose to each party the full knowledge which we possess as to the transaction or may be unable to give advice to one party which conflicts with the interests of the other (*Clark Boyce v Mouat* [1994] 1 AC 428 at 435);
5. Where a conflict arises and informed consent cannot cure the conflict we are under two duties; one, to inform our client that we cannot act; and two, that the client should seek legal advice from other solicitors, starting a fresh (and not relying on any advice previously given by us). A bare refusal to act, without giving clear advice about going to new solicitors, will not be a sufficient discharge of our duty (*Hilton v Barker Booth and Eastwood* [2005] 1 All ER 651 per Lord Walker of Gestingthorpe at paragraph 32);

6. The Courts have held time and time again if we put ourselves in a position where we have irreconcilable duties (in the case noted above the duty to inform E as to the financial position of T came into conflict with the duty to retain the confidences owed to T) then it will be seen as our fault;
7. Where we have conflicting duties to two clients we cannot prefer one to another;
8. We must be careful not to put ourselves in a position in which our contractual duties owed to one client will be inconsistent with the contractual duties owed to another client;
9. Informed consent is difficult to obtain and structuring a retainer to avoid inconsistent contractual duties will also be difficult. The best course is avoiding the collision of duties by serving only one master.

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If you wish to comment on or discuss any of the issues raised by this note or require guidance on any other ethical issue, contact the Ethics Centre on 07 3842 5843 or ethics@qls.com.au