

Legal Cases – Conflicts of Interest

Prince Jefri Bolkiah v KPMG (1999)

Synopsis/Facts

Brunei Investment Agency (BIA) was established in 1983. Its principal objects were to hold and manage the general reserve fund of the Government of Brunei and all external assets and to provide the Government with money management services. From the formation of BIA, KPMG acted as the auditors of a substantial part of BIA's assets and investment portfolios. KPMG also carried out certain associated advisory and consultancy work. Prince Jefri Bolkiah was the Minister of Finance of Brunei until he resigned in February 1997. He was also Chairman of BIA until removed, together with the rest of the Board, by the Sultan of Brunei on 16 July 1998.

In July 1996, Prince Jefri engaged KPMG to provide litigation services in a personal matter and to act as an expert witnesses for a company controlled by Prince Jefri (code name "Project Lucy") which entailed a very detailed inquiry into the financial affairs and dealings of Prince Jefri. This litigation settled on 14 March 1998 but, the forensic accounting department of KPMG's London office continued working on other personal projects for Prince Jefri after mid March 1998.

In June 1998, KPMG was asked by the Brunei Government to become involved as investigators on behalf of BIA to determine the whereabouts of assets suggested to have been utilized by Prince Jefri for his own benefit (code name "Project Gemma"). KPMG decided that they were able to construct "information barriers" to protect confidential information which they held on behalf of Prince Jefri. Specifically, KPMG tried to install *Chinese Walls* in the operation of Project Gemma and Project Lucy. According to the case, KPMG was able to provide different partners for the two projects. KPMG noted that Project Lucy was placed in an isolated area in the forensic department. Along with this, KPMG added that the majority of the operations of Project Lucy took place in a separate level of the building and partners were given instruction to keep documents from leaving their portion of the building. The firm also indicated that those working on Project Lucy were kept from working on Project Gemma.

KPMG therefore accepted the engagement/investigation but did so without informing Prince Jefri. Once Prince Jefri learned of the investigations being carried out by KPMG he commenced the proceedings.

On 15 September 1998, the House of Lords granted an injunction restraining KPMG from doing the following acts (a) continuing to carry out the investigation known as Project Gemma, or (b) carrying out any work covering any of the same subject matter as Project Gemma for the Brunei Investment Agency (BIA), or any other agency of the Government of Brunei, or any member of the Royal Family of Brunei, ... (or certain companies)...or any person purporting to be their executive managers."

Issues/Considerations

The House of Lords held that KPMG had the duty to keep the information on Prince Jefri confidential. Accordingly, KPMG's attempts to keep the information from being disclosed by taking on certain measures did not suffice legally. Nevertheless, the Court also mentioned that the use of Chinese Walls may have worked "in some instances" particularly in instances where this concept is plainly established, unlike that provided by KPMG. The problem, according to the Courts, was that the arrangements involving the case of Prince Jefri and KPMG were confined within one department of the firm and that physical separation would simply not suffice. This was because the interaction between the staff and management in the department is essentially inevitable which also places unwarranted risk of confidential information being disclosed.

The House of Lords further pointed out that the issue of preserving confidentiality is not even a qualified duty in this case considering there was an apparent conflict of interest on the part of KPMG even before Project Gemma was accepted. The Court held that KPMG should have considered that accepting such an engagement for the Brunei Government essentially placed the confidential data that they had on Prince Jefri at risk.

The House of Lords also made a clear distinction between the duties owed by an accounting firm requested to perform forensic services adverse in interest to an existing as opposed to a former client. It was stated that with respect to existing clients, "...a fiduciary cannot act at the same time both for and against the same client...His disqualification has nothing to do with the confidentiality of client information. It is based on the inescapable conflict of interest which is inherent in the situation."

The decision of the House of Lords made it clear that the duty to an existing client is more comprehensive than the duty to a former client. The duty to an existing client includes both the duty of confidentiality and the duty of undivided loyalty. The duty to a former client is the duty of confidentiality. This distinction was made clear when the court discussed the different basis for intervention on behalf of an existing client and a former client:

Duties to Existing Client

"...It is otherwise where the court's intervention is sought by an existing client, for a fiduciary cannot act at the same time both for and against the same client, and his firm is in no better position. A man cannot without the consent of both clients act for one client while his partner is acting for another in the opposite interest. His disqualification has nothing to do with the confidentiality of client information. It is based on the inescapable conflict of interest which is inherent in the situation. This is not to say that such consent is not sometimes forthcoming, or that in some situations it may not be inferred."

Duties to Former Client

"Where the court's intervention is sought by a former client, however, the position is entirely different. The court's jurisdiction cannot be based on any conflict of interest, real or perceived, for there is none. The fiduciary relationship which subsists between solicitor and client comes to an end with the termination of the retainer. Thereafter the solicitor has no obligation to defend

and advance the interests of his former client. The only duty to the former client which survives the termination of the client relationship is a continuing duty to preserve the confidentiality of information imparted during its subsistence.”

CONFLICTS OF INTEREST AND CONFIDENTIALITY

Guidance issued in January 2000 by the Business Law Committee of the Institute of Chartered Accountants in England and Wales on the implications of the decision in the case of Prince Jefri Bolkiah vs. KPMG.

1. This Guidance has been prepared primarily for members in practice. It should be read in conjunction with the Guide to Professional Ethics and in particular Statements 1.203, “Corporate Finance Advice”, 1.204, “Conflicts of Interest” and 1.205, “Confidentiality”. Members should be aware that at the date of issue of this Technical Release, the Chartered Accountants Joint Ethics Committee are undertaking a review of Statement 1.205 and should be alert to the issue of a revised Statement which will also have been prepared taking into account the implications of the Prince Jefri case and subsequent relevant cases.

2. The House of Lords judgement in Prince Jefri Bolkiah v KPMG highlighted the responsibilities of members in circumstances where the interests of two clients or of a client and a former client conflict and where the member is holding confidential information about one which could be used to the benefit of the other.

3. The judgement stresses that where an accountant is acting as a fiduciary, he cannot act for two clients with conflicting interests without their informed consent. The law is presently unclear as to when accountants are acting as fiduciaries and it is therefore safest to assume that where there may be conflicting interests between two current clients, their consent should be obtained. This does not apply to former clients since any fiduciary duty will cease on termination of the retainer, although duties of confidentiality will, of course, continue.

4. It is also unclear what is meant by conflicting interest and whether this extends to clients who are not in a directly adversarial relationship but who are, for example, competitors in the same market. It would therefore be prudent for members to include in their engagement terms a clause which allows them to act for two clients with opposing interests at the same time, subject always to keeping the clients’ confidential information secure. An example of such a clause is:

Conflict

“You agree that we may reserve the right to act during this engagement for other clients whose interests are or may be adverse to yours, subject to the following paragraph.” (see para. 8 below)

5. Where consent has not been obtained, it is possible for a Chinese wall to be effective within a firm, following Bolkiah v KPMG, provided it has the following characteristics:

(i) the physical separation of the various departments in order to insulate them from each other - this often extends to such matters of detail as dining arrangements; (ii) an educational programme, normally recurring, to emphasise the importance of not improperly or inadvertently divulging confidential information; (iii) strict and carefully defined procedures for dealing with a situation where it is felt that the wall should be crossed and the maintaining of proper records

where this occurs; (iv) monitoring by compliance officers of the effectiveness of the wall; and (v) disciplinary sanctions where there has been a breach of the wall.

6. Additionally, Lord Millett said that an effective Chinese wall needed to be an established part of the organisational structure of the firm, not created ad hoc. He said that physical segregation would probably not be adequate where the wall was erected within a single department.

7. Where members are acting for two clients with conflicting interests with their consent, adequate steps should be taken to ensure that the confidential information held on behalf of each client is not transmitted to or used for the benefit of the other client. Where consent has been obtained, it is not necessary for any Chinese wall to have the characteristics set down by Lord Millett in *Bolkiah v KPMG*.

8. In order to remove the need to erect a Chinese wall of the type described by Lord Millett, members might like to introduce a clause into their engagement terms along the following lines:

Confidentiality

“We confirm that where you give us confidential information we shall at all times keep it confidential, except as required by law or as provided for in regulatory, ethical or other professional pronouncements applicable to our engagement.

“You agree that it will be sufficient compliance with our duty of confidence for us to take such steps as we in good faith think fit to preserve confidential information both during and after termination of this engagement.”

9. This would have the effect of leaving the member liable for any actual breach of confidence but otherwise he would have no obligation other than to take such steps as he thinks fit, bearing in mind this guidance, to keep confidential information secure.

Drabinsky vs. KPMG (1998)

Synopsis/Facts

In *Drabinsky v. KPMG*, the plaintiff sought an injunction restraining the accounting firm KPMG (of which the plaintiff was a client) from further investigating the financial records of a company (Livent, Inc.) of which the plaintiff was a senior officer. The Ontario Court (General Division) granted his motion for an injunction against KPMG.

The Court agreed with Drabinsky's argument that KPMG, his personal accountants for nearly two decades, breached their fiduciary obligation to him when they accepted a retainer to conduct a forensic engagement on behalf of Livent, Inc. (The forensic engagement was designed to gather evidence against Drabinsky.) The Court ruled that KPMG's ongoing fiduciary obligation to Drabinsky imposed a duty of loyalty and good faith upon them, and obligated KPMG not to act contrary to his interests.

Issues/Considerations

In upholding the injunction granted by the motions court judge, which precluded not only the disclosure of confidential information the firm may have received from Drabinsky but also the disclosure of information directly adverse to the interest of Drabinsky obtained in their investigation of him, the Divisional Court said:

“In the circumstances of this case, the Motions Judge found that the duties imposed on KPMG extended beyond the duty not to disclose confidential information and included a duty of loyalty and good faith and a duty not to act against the interests of the client. The combination of the following circumstances is of particular importance:

- (1) Garth Drabinsky was an existing and long-standing client of KPMG, who were his personal accountants and tax advisors and as such, KPMG had acquired and had an intimate knowledge of his financial affairs; and
- (2) KPMG was not Livent's auditors and had no on-going relationship with Livent, but was now asked to conduct a wide-ranging forensic investigation into suspected irregularities with Garth Drabinsky as the main target.”

While the Ontario Divisional Court did refer to the decision in *Bolkiah*, it was less definitive about the auditor's fiduciary duty being narrower than the duty of a forensic accountant.

“Although in other circumstances (where, for example, the client in question is a former client, or where the accounting firm is engaged as the company's auditors), the fiduciary duty owed to the client may be narrower and may be limited to a duty to preserve confidentiality only, in the unique circumstances of this case, there is a reasonable basis to believe that the duty may be sufficiently broad to prohibit KPMG from taking on the forensic mandate from Livent which would be directly adverse to the interests of Garth Drabinsky, its on-going client. Thus, the scope of the duty and

whether there has been a breach are serious issues to be tried and the Motions Judge did not err in this respect.”

“I am of the view that the fiduciary relationship between the client and the professional advisor, either a lawyer or an accountant, imposes duties on the fiduciary beyond the duty not to disclose confidential information. It includes a duty of loyalty and good faith and a duty not to act against the interests of the client. “

MacDonald Estate v. Martin (1990)

Synopsis/Facts

The *MacDonald Estate* case involves the issue of whether a law firm should be prohibited from acting for the plaintiff in an action, when one of its associates had, several years before joining the firm, acted as junior counsel for the defendant in the same matter. It was alleged that the lawyer who had joined the firm had confidential information which would prejudice the defendant. The defendant (i.e., the client of the former firm) challenged the right of the new firm to continue to act as counsel in an action against him.

The Supreme Court of Canada ordered the firm to withdraw, not being satisfied that all reasonable measures (such as "Chinese walls" and "cones of silence") had been taken to ensure that no disclosure would occur. The Court held that there was a conflict of interest but in an aside said that there may be circumstances in which the knowledge of one partner is not attributed to all members of the firm.

Issues/Considerations

The Court concluded that...

- There is a strong inference that members of a firm do share confidential information entrusted to them by clients; and
- This inference should be taken, unless the court is satisfied that all reasonable measures have been taken to protect the confidential client information.

Specifically, the Court held that there were two fundamental questions which had to be addressed:

1. Did the lawyer receive confidential information attributable to a solicitor and client relationship relevant to the matter at hand? and
2. Is there a risk that the confidential information will be used to the prejudice of the client?

With respect to the first question, the Court established the principle that if the retainers are sufficiently related, there is a presumption that confidential information has been imparted.

With respect to the second question, the majority of the Court rejected the conclusive “imputed knowledge test” which has been accepted in the United States. Specifically, the American principle, that once a substantial relationship is established there is an irrefutable presumption

that confidential information will be shared, was rejected as too rigid as it failed to take into account the relevant interests which include:

- The client's right to services of the professional of his choice,
- The professional's right to offer services to the public generally,
- Mobility within the profession by individuals of firms merging,
- The interest firms had in merging,
- Access to expertise and special services; and
- Market competition.

However, the Court made it clear there was a presumption that lawyers [and accountants] who work together do share the confidences of their clients and they have the onus of satisfying the Court that there will be no disclosure of that information.

In particular, the Supreme Court of Canada said:

In addition, the Court noted that since the professions were self-regulating institutions, it was for the professions themselves (e.g., not the courts) to specify the circumstances and conditions in which the use of institutional mechanisms (e.g., Chinese Walls) might be appropriate.

Young v Robson Rhodes [1999]

Synopsis/Facts

In *Young v Robson Rhodes*, the plaintiff was part of a syndicate of companies that had commenced actions against the syndicate's auditors (PKF). The defendant, Robson Rhodes, was the accounting firm which assisted in the action by providing forensic accounting services to the syndicate. Some 15 months after Robson Rhodes was appointed, it sought to merge with PKF. Robson Rhodes proposed a solution to implement a "Chinese Wall" enabling the litigation support team to continue while the merger went ahead. The plaintiff brought proceedings seeking to impose undertakings that there would be no contact, whether professional or social, between the persons on the defendant's team assisting with the action against PKF and the members of PKF involved with the same or, failing that, to restrain the merger.

The injunction was refused. However, the Court ordered physical separation between the two teams ensuring that they work in different premises and do not have any professional contact with each other.

Issues/Considerations

In considering this matter, the English High Court of Justice considered the case of *Bolkiah v KPMG* and rejected the argument that ad hoc Chinese Wall arrangements were unacceptable. The Court noted that the crucial question was, 'will the barriers work?' However, it further noted that as a question of efficacy, a barrier that was part of the fabric of the institution was more likely to be efficacious than one artificially put in place to meet a one-off problem.

The Court held that so long as the members of the two firms involved in the litigation worked alongside or were in regular professional contact, there was a risk of inadvertent leakage of confidential information. The Court recognized the duties of confidentiality and loyalty and

allowed the merger to proceed on the condition the merged firm would establish an information barrier that segregated the engaged professionals from the firm until they completed the engagement. The information barrier (Chinese Wall) the Court designed, in effect, completely segregated the engaged accountant and his team from the rest of the firm.

Work cited:

The information discussed above came from the Canadian Institute of Chartered Accountants – *Conflicts of Interest a Task Force Report* as well as various Web sites containing additional information on these cases:

http://www.cica.ca/multimedia/Download_Library/About_the_Profession/HOPPEN_CICA_oCT31.pdf

<http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWCA/Civ/1998/1563.html>

http://www.icaew.com/index.cfm/route/121322/icaew_ga/pdf

<http://www.lawgazette.com.sg/2001-12/Dec01-focus3.htm>

http://www.lawsociety.bc.ca/publications_forms/bulletin/1990-99/91-01.htm