

THE FAIRNESS DOCTRINE: A RETURN TO THE STATUS QUO?

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Legal Briefings - By **Michael Vrisakis, Tamanna Islam and Shan-Verne Liew**

In October 2019, the Full Federal Court decision in *ASIC v Westpac Securities Administration Limited* [2019] FCAFC 187 (**ASIC v Westpac**) raised questions about the scope of the obligation on AFS licensees to act efficiently, honestly and fairly. Less than 6 months later, the Federal Court's decision in *ASIC v AGM Markets Pty Ltd (in liq) (No 3)* [2020] FCA 208 (**ASIC v AGM Markets**) has reaffirmed the status quo understanding that the obligation to act efficiently, honestly and fairly is a compendious one.

The decision of Beach J in *ASIC v AGM Markets* also provides important guidance on the concept of "fairness", noting that this concept must have regard to the interests of the relevant AFS licensee as well as the interests of consumers. Critically, Beach J states that the concept of "fairness" should not be used as a "back door" to the best interests duty.

ASIC V AGM MARKETS

AGM Markets Pty Ltd, OT Markets Pty Ltd and Ozifin Tech Pty Ltd provided over-the-counter derivatives to retail investors in Australia, and provided an online platform which retail investors could use to invest in those products. Customers were encouraged by representatives of some of the defendants via email and telephone to take out particular trading positions in respect of these derivatives.

In ASIC v AGM Markets, Beach J of the Federal Court found that the defendants contravened the prohibitions against:

- statutory unconscionable conduct in connection with financial services;
- misleading or deceptive conduct;
- providing unlicensed personal advice;
- providing personal advice that was not in the best interests of customers; and
- failing to do all things necessary to provide financial services “efficiently, honestly and fairly”.

EFFICIENTLY, HONESTLY AND FAIRLY: REAFFIRMATION OF A COMPENDIOUS OBLIGATION

Section 912A(1)(a) of the *Corporations Act 2001* (Cth) (**Corporations Act**) requires a financial services licensee to do all things necessary to ensure that the financial services covered by its licence are provided efficiently, honestly and fairly. Beach J in ASIC v AGM Markets reaffirmed existing principles and case law on the obligation to act efficiently, honestly and fairly (predating the decision in ASIC v Westpac).

These principles were helpfully compiled and summarised by Foster J in *Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (in liq)* (2012) 88 ASCR 206 (at [69]), as follows:

“The words “efficiently, honestly and fairly” must be read as a compendious indication meaning a person who goes about their duties efficiently having regard to the dictates of honesty and fairness, honestly having regard to the dictates of efficiency and fairness, and fairly having regard to the dictates of efficiency and honesty: *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 at 672. ([126])

The words “efficiently, honestly and fairly” connote a requirement of competence in providing advice and in complying with relevant statutory obligations: *Re Hres and Australian Securities and Investments Commission* (2008) 105 ALD 124 at [237]. They also connote an element not just of even handedness in dealing with clients but a less readily defined concept of sound ethical values and judgment in matters relevant to a client’s affairs: *Re Hres and Australian Securities and Investments Commission* (2008) 105 ALD 124 at [237]. ([127])

The word “efficient” refers to a person who performs his duties efficiently, meaning the person is adequate in performance, produces the desired effect, is capable, competent and adequate: *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 at 672. Inefficiency may be established by demonstrating that the performance of a licensee’s functions falls short of the reasonable standard of performance by a dealer that the public is entitled to expect: *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 at 679. ([128])

It is not necessary to establish dishonesty in the criminal sense: *R J Elrington Nominees Pty Ltd v Corporate Affairs Commission (SA)* (1989) 1 ACSR 93 at 110. The word “honestly” may comprehend conduct which is not criminal but which is morally wrong in the commercial sense: *R J Elrington Nominees Pty Ltd v Corporate Affairs Commission (SA)* (1989) 1 ACSR 93 at 110. ([129])

The word “honestly” when used in conjunction with the word “fairly” tends to give the flavour of a person who not only is not dishonest, but also a person who is ethically sound: *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 at 672. ([130])”

In *ASIC v AGM Markets*, Beach J observed that these principles are consistent with the express objectives of Chapter 7 of the Corporations Act, as set out in section 760A of the Corporations Act. In particular, His Honour stated at [519]:

“With respect, I prefer to view s 912A(1)(a) as enshrining a statutory norm to be read conformably with s 760A and the other provisions of the Corporations Act and the ASIC Act, of course to be applied to an infinite variety of corporate delinquency and self-interested commerciality. But to say this is not to deny that it may implicitly pick up some aspects of what some might identify as social and commercial norms, although reasonable minds might differ as to where to ground such an otherwise free-floating concept.”

Acknowledging the statements made by Allsop CJ and O’Bryan J in *ASIC v Westpac*, Beach J in *ASIC v AGM Markets* held at [516]:

“...some members of the Full Court queried whether the phrase “efficiently, honestly and fairly” should be read compendiously (O’Bryan J at [422] to [426]). But as this was not decided by at least a majority, I am bound to apply the single judge decisions unless I consider them to be plainly wrong, which I do not.”

Beach J's support for a compendious obligation is significant in the current financial services market and in the context of ASIC's increasing reliance on the obligation to act efficiently, honestly and fairly as an enforcement tool. The statements by Allsop CJ and O'Bryan J in *ASIC v Westpac* were regarded by the industry and ASIC as continuing a pendulum swing (started by the Financial Services Royal Commission) towards a legal framework in which the obligation to act efficiently, honestly and fairly comprises 3 separate but concurrent obligations – thereby significantly widening the circumstances in which a contravention may arise. Beach J's judgment in *ASIC v AGM Markets* affirms a single compendious (or aggregate) obligation rather than 3 standalone obligations. It also indicates that while the obligation to act efficiently honestly and fairly can apply in an "infinite variety" of circumstances, properly construed, it should not be treated as a "catch all" for every case of licensee misconduct.

THE TWO-SIDED CONCEPT OF FAIRNESS

As mentioned, the statements by Allsop CJ and O'Bryan J in *ASIC v Westpac* indicated a move away from the compendious nature of the obligation to act efficiently, honestly and fairly and, in our view, a shift towards a self-standing obligation of fairness.

For example, in *ASIC v Westpac*, Allsop CJ at [170] stated that

“...if a body of deliberate and carefully planned conduct can be characterised as unfair, even if it cannot be described as dishonest, such may suffice for the proper characterisation to be made.”

Such a shift is consistent with ASIC's current regulatory strategy and enforcement approach centred on principles of fairness.

However, Beach J questions this elevation of the concept of fairness in *ASIC v AGM Markets* at [530]:

“...in my view it is not justifiable to take one word from a composite phrase, artificially elevate its significance read it in a manner asymmetrically in favour of an investor.”

While the concept of fairness is likely to continue to form the central foundation of ASIC's enforcement approach, and continue to be a central pillar of financial services law, the decision in *ASIC v AGM Markets* provides significant and essential guidance on the scope of the fairness obligation in practical terms.

Beach J dedicated several paragraphs to specifically considering the meaning of the word "fairly" in the context of the compendious obligation to act efficiently, honestly and fairly. His Honour observed at [520] that dictionary definitions of fairness could not be "adequate for the task given the intrinsic circularity with such definitions". His Honour also noted at [521] that understanding fairly by reference to its inverse attributes did not provide sufficient conditions to understand the statutory meaning of the word.

Ultimately, Beach J did not settle on the positive attributes of “fairness”, but helpfully pointed out that the word “fairness” requires an equal assessment of the interests of both parties, rather than exclusive attention to the interests of consumers:

“Fairness is to be judged having regard to the interests of both parties. Other statutory provisions may be designed to tilt the scales, but not s 912A(1)(a) and the statutory composite norm it enshrines. Disproportionate emphasis should not be given to what is the third part of a composite phrase in a manner which creates unsatisfactory asymmetry in favour of those with whom the licensee deals. This section is not a back door into an “act in the [best] interests of” obligation. Other specific provisions of the Act nicely fulfil that role. There is nothing to indicate that s 912A(1)(a) was to have that bias.”

It follows that any asymmetrical application of the obligation of fairness would be contrary to the purpose of the obligation to act efficiently, honestly and fairly. Rather, the obligation requires fairness to consumers, having sufficient regard to the legitimate legal and commercial interests of the AFS licensee. In this sense, compliance by an AFS licensee with the terms of a valid customer contract or other Corporations Act requirements would be relevant considerations when determining whether there has been a contravention of the obligation to act efficiently, honestly and fairly.

The emphasis that the obligation to act efficiently, honestly and fairly is not a “back door” to a best interests obligation reaffirms that an AFS licensee does not become a fiduciary simply by virtue of its role in providing financial services. Some other specific fiduciary relationship must exist for this purpose (eg a trustee-member relationship or adviser-client relationship).

In this regard, Beach J also states that alleged conduct must not be viewed in isolation when assessing a breach of the obligation to act efficiently, honestly and fairly. Rather, His Honour states at [525] that:

“...one is looking at the licensee’s behaviour more generally rather than with regard to any one person. After all, s 912A(1)(a) is expressed ... [with] ... language [that] is in the generality of “the financial services covered by the license”.”

This indicates that one must have regard to the provision of the relevant services more generally rather than just focusing on one particular incidence of service. This position can be contrasted to the position of a fiduciary who has a best interests obligation with respect to particular individuals (or groups of individuals).

These observations also represent a helpful development of an earlier consideration by Foster J in *ASIC v Camelot Derivatives Pty Ltd (in liq)* [2012] FCA 414 that having undue regard for an AFS licensee’s personal interests over the interests of customers can give rise to a breach of the obligation to act efficiently, honestly and fairly. In that case, Bollen J observed at [71]-[72] that:

“...the overriding consideration ... in procuring Camelot’s clients to trade as they did was the derivation of brokerage commissions by Camelot. In this sense, the commissions actually derived were excessive and could not have been justified had Camelot and Mr King paid due regard to the clients’ interests.”

Accordingly, the assessment of fairness necessitates symmetry and balance between the sometimes conflicting interests of the AFS licensee and customers.

“ALL NECESSARY STEPS” INSTEAD OF OUTCOMES

It is an established principle of statutory construction that Parliament intends each word in legislation to have a particular effect.

While not specifically referring to the phrase, Beach J’s application of the efficiently, honestly and fairly obligation in ASIC v AGM Markets emphasises that conduct by a licensee which is not efficient, honest and fair is not necessarily by itself a sufficient basis to find a breach. For a breach to occur, the licensee must also have been found to fail to “do all things necessary” to ensure that the financial services were provided efficiently, honestly and fairly. This critical step in the application of the obligation is frequently forgotten.

In this regard, Beach J highlighted that the defendants in ASIC v AGM Markets had variously failed to, among other things:

- provide or ensure adequate training to the account managers who communicated with retail clients;
- adequately ensure that representatives would have limited access to customers’ personal information;
- review a sample of calls for compliance; and
- have an adequate system for monitoring the activities and arrangements of authorised representatives, including with respect to conflicts of interest.

Beach J’s approach, which focuses on the necessary steps taken by AFS licensees rather than solely on the end outcomes of a licensee’s conduct, highlights a deliberate distinguishing factor between the efficiently, honestly and fairly obligation and some of the other obligations in section 912A(1) of the Corporations Act, which are directed exclusively at requiring AFS licensees to meet a specified outcome (eg the obligation on AFS licensees in section 912A(1)(c) to comply with the financial services laws).

TO INFINITY AND BEYOND...

In *ASIC v Westpac*, Allsop CJ commented at [166] that the obligation to act efficiently, honestly and fairly could “apply in an infinite variety of circumstances.” Beach J agreed with this analysis, stating in *ASIC v AGM Markets* at [519] that the obligation to act efficiently, honestly and fairly is “to be applied to an infinite variety of corporate delinquency and self-interested commerciality.”

However, Beach J’s decision in *ASIC v AGM Markets* reaffirms that the obligation continues to be a compendious one, having regard both to the interests of the consumer and the AFS licensee.

We note that on 25 November 2019, Westpac sought leave to appeal the Full Court decision in *ASIC v Westpac* to the High Court, which has been referred for oral hearing in April 2020. ASIC will contest this application.

For now, the pendulum has swung back to a position that focuses on a threefold compendious obligation while emphasising the need to balance the interests of consumers and AFS licensees alike.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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