

Conflicts of Interest: Perceptions are Everything

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Introduction

Like all trustees, employee benefit plan trustees are bound by common law standards of fiduciary conduct in the administration of a trust. The specific fiduciary duty known as the conflict-of-interest rule requires a trustee to act principally for the benefit of the trust and never for himself or herself while carrying out his or her duties. In joint employer/union employee benefit plans arising from collective bargaining relationships, it is often the case that trustees who are appointed by the employer or the union will face conflict of interest between their obligations to the body which appointed them, on the one hand, and their obligations to the employee beneficiaries of the plan, on the other hand. Such conflicts are inherent in this scheme, whatever the identity of the trustees.

Generally speaking, employee benefit plan trustees and other fiduciaries are required to avoid not only *actual* conflicts of interest but also *potential* conflicts of interest. In terms of considering specific instances of employee benefit plan administration that may *potentially* give rise to a conflict-of-interest situation, the possibilities are seemingly endless in that it can stretch as far as the human imagination can take it. In this respect, trustees are encouraged to continually place themselves in the shoes of the “reasonable person” and assess whether an objective person could view the situation as creating a real or *potential* conflict of interest. It is in this sense that “perceptions are everything” in terms of avoiding conflicts of interest.

The following paper will review the conflict of interest doctrine generally and as it relates to employee benefit schemes. The first part of this paper will review the general legal and ethical paradigms in which the conflict of interest rule arises. Next, it will consider forms in which conflicts of interest may surface with a view to being able to identify such conflicts. Lastly, it will offer suggestions on how to avoid and handle conflicts when they arise.

The Ethical and Legal Paradigm

The reason why the trust relationship is called a *trust* is that the trustee is entrusted by the person who sets up the trust (the settler) to administer the assets of the trust for the benefit of the beneficiaries, rather than for the trustees's own benefit.¹ The trustee is regarded as being in a position of trust and confidence. In law, a person on whom trust or confidence is bestowed is termed a *fiduciary* and is impressed with a duty of loyalty to those placing their trust in him or her.

It is a tenet which goes to the foundation of trust law that unless a trustee is authorized by the trust instrument, or by the court, a trustee must not place himself/herself in a position where his/her duty as a trustee might conflict with a personal interest, or with a duty to a third party.² Accordingly, under trust law, a trustee who chooses to prefer the interests of the employer or the union could be held accountable in an action for breach of trust.

Generally speaking, a trustee will be in breach of the conflicts of interest rule where he or she secures a personal benefit as a result of his or her status as a trustee. It makes no difference that that the benefit the trustee received was not secured at the expense of the trust or that it was a benefit that the trust was incapable of obtaining.³

A classic example of the courts applying the conflict of interest rule is found in *Regal (Hastings) Limited v. Gulliver*.⁴ In that case, trustees who acted in the interest of the trust but incidentally made a profit from the transaction were required to surrender the profit they

¹ Raymond Koskie et al. "Introduction and Background of Employee Benefit Plans" Employee Benefits In Canada, 3rd ed

² *Bray v. Ford* [1896] A.C. 44.

³ Roberto Tomassini, "Fiduciary Responsibilities" in Raymond Koskie et al. Employee Benefits In Canada, 3rd ed.

⁴ *Regal (Hastings) Limited v. Gulliver* [1941] 1 All E.R. 378 (H.L.).

received. In regard to the content and breadth of liability for the breach of duty, the court went on to state:

The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to a plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefitted by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made.⁵

Moreover, trustees are required to avoid not only *actual* conflicts of interest but also *potential* conflicts of interest. With respect to the principle that a fiduciary must avoid *potential* conflict, the English court in *Boardman v. Phillips* stated:⁶

In my view it means that the reasonable man looking at the relevant facts and circumstances of the particular case could think that there was a real sensible possibility of conflict.

The underlying rationale of the conflict of interest rule is said to be to deter trustees and other fiduciaries from allowing themselves to be placed in ambiguous situations. Thus, if the trustee or fiduciary allows himself to be placed in a situation where a conflict of interest and duty does occur, then he may neither retain any profit which he made for himself, nor repeat the act which made the profit.

⁵ *Ibid.*, at p. 386.

⁶ *Boardman v. Phillips* [1967] 2 A.C. 46 at 124.

The second theory is that the courts are concerned with examining all the facts and to discover whether the benefit that the trustee made was acquired in his/her capacity as fiduciary to the beneficiaries. It is believed that a strict application of the conflict of interest rule achieves the desirable end of maintaining confidence in the fiduciary role, and high standards of conduct in fiduciaries.⁷

Identifying Conflicts

Conflicts of interest may come in a number of different forms and it is necessary to be vigilant to the many situations where conflicts of interest may arise. Some examples include:

- Direct financial gain or benefit to the trustee:
 - Acquisition of benefits from the trust office e.g. profits made through use of the office; acceptance of secret commissions; acceptance of a personal gift; bribes;
 - The trustee benefits from, or is reasonably perceived by the public to have benefited from, the use of information acquired solely by reason of the position as trustees;
 - the award of a contract to an organization in which a trustee has an interest, or *potential* interest, and from which a trustee will or may receive a financial benefit;

⁷ D.W.M. Waters, "Law of Trusts in Canada" 2nd ed. (Toronto: The Carswell Company Limited, 1984).

- any sale of land or lease to a trustee to someone closely connected to a trustee, even if it is at full market value;
 - the trustee selling or loaning his own assets to the trust;
 - loans by the trust to the trustee; or
- Indirect financial gain, such as:
 - Employment/appointment of a spouse or close relative of a trustee, where their finances are interdependent. By being involved in the appointment or payment, the trustee could be perceived to benefit, at least indirectly, from the appointment and resulting payment.

The above list is only a sample of the varied circumstances where conflicts of interest may arise. Moreover, all trustees need to be sensitive to not only *actual* conflicts of interest but also *perceived* conflicts of interest which they might have. Accordingly, trustees should continually think about and attempt to identify conflicts of interest that others may perceive them to be in. This can be achieved through looking at any given situation with an objective lens to determine whether a reasonable person could view the situation as creating a conflict of interest for the trustee. As referred to above, this may seem like a tremendous task for the trustee, but the overriding goal is to avoid any appearance of impropriety, given that the trustee's position is obtained through the utmost trust and confidence of the beneficiaries.

How to Avoid Conflicts and How to Handle Conflicts Once They Arise

Employee benefit trustees, particularly those on boards consisting of both union and employer nominees, will inevitably be faced with situations in which the trustees' loyalty to the beneficiaries conflicts with their loyalty to the body which appointed them. Employee benefit trustees should always bear in mind that when they are dealing with the business of the trust, their overriding duty is to act in the best interests of the beneficiaries, that is, the members of the trust. As far as possible, they should put their own considerations to one side.

A key to minimising the effects of a conflict of interest is to be open and transparent about such situations when they arise. It is generally recommended that all employee benefit trustees advise their fellow trustees of any *actual* or *potential* conflicts of interest of which they are aware, as soon as they arise.

It is good practice at the beginning of a meeting for every trustee to declare any private interest which he or she may have in an item to be discussed, and certainly before any discussion of the item itself. If the trustee's interest is major, the trustee should leave the room and not take part in the discussion or vote on the matter which gives rise to the conflict (assuming the scheme rules do not require a unanimous decision by the trustees). Declaring that a conflict exists and withdrawing from the discussion and any decision making will be all that is required if the trustee is not receiving any material benefit as a result of the conflict of interest.

The Board of Trustees may also consider the delegation of the particular issue to a sub-committee. It would also be prudent for the trustee who is in a real or perceived conflict to distance him/herself from the follow up work as it could appear that he or she is seeking to influence the matter.

Overall, it is considered good practice for the trustees to have a conflicts policy in place which includes a procedure to deal with conflicts of interest. This procedure will also deal with whether disclosure of the conflict is sufficient, or if a more active form of management is required. If the conflict is particularly serious or fundamental the resignation of the trustee may be necessary.

Finally, a register of conflicts/interests (and this should include any perceived conflicts) should be maintained. This would provide the trustees with a better understanding of how to deal with conflicts as and when they arise.

While the foregoing suggestions are important to managing conflicts of interests generally, there is not a 'one size fits all' approach. Conflict management procedures and policies will need to be specific to the plan in question.

Conclusion:

The managing of conflicts of interest for Boards of Trustees is therefore very much a pre-emptive and practical measure. Upon accepting a position on a Board of Trustees, trustees must arrange their private affairs in a manner that will prevent conflicts of interest, or the perception of conflicts of interest, from arising. A method for identifying and avoiding conflicts of interests by continually looking at any given situation with an objective lens of the "reasonable person", and assess whether a conflict of loyalty can be reasonably perceived in the given situation. Inevitably, conflicts will arise. The key to dealing with these conflicts is in properly identifying and managing them. It is imperative that the Board of Trustees have a conflict management procedure and policy in place to help properly deal with both real and perceived conflicts of

