PART I

General

1

Conflict of interest as a cross-cutting problem of governance

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1. Introduction

Conflict of interest occurs on all levels of governance, ranging from local to global, both in the public and the corporate and financial spheres. Such conflict can influence decision-making in the management of corporations, town councils, parliaments, bureaucracies, national and international courts and tribunals, and in international conferences, organisations, and expert committees. There is increasing awareness that conflict of interest may distort decision-making processes and generate inappropriate outcomes, and thereby undermine the well-functioning of both public institutions and markets. But the current strong worldwide trend towards regulation which seeks to forestall, prevent and manage conflict of interest has its price. Drawbacks may be the stifling of decision-making processes, a loss of expertise in the person of the decision-makers and a vicious circle of distrust.

So conflict of interest abounds – or is at least perceived to abound. But what are we actually talking about? This chapter first seeks to counter the fundamental objection that the concept of conflict of interest is overbroad and meaningless (section 2). It then gives an overview of current conflict of interest regulation on all levels and spheres of governance: domestic, regional and global, and governmental and self-regulation (section 3). After recapitulating the law as it stands, the concept is probed more in depth: conflict of interest is a problem only in fiduciary (principal–agent) relationships (section 4). A typology is established: there may be a conflict between due and undue (especially personal and/or financial) interests, a conflict due to multiple roles of the agent, and a conflict arising from the

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existence of multiple principals (section 5). Section 6 goes on to show that conflict of interest management is desirable to prevent corruption and bribery, which can occur in all spheres of governance: public, corporate, and global. Section 7 reviews existing scholarship on conflict of interest and explains which economic and legal phenomena have increased the potential for new forms of conflict of interest. It is then pointed out that a holistic regulatory approach involving private, administrative, and criminal law, domestic and international law, hard and soft law is obviously needed to manage the risk field of conflict of interest. However, insecurity about the correct regulatory mix, about the rules' quality, and their density persist. These questions can only be answered on the basis of cross-cutting analyses of the issue, which do not limit themselves to the traditional legal departments. Therefore, it is submitted, conflict of interest must be studied in a comparative fashion, across different levels and sectors of governance. This book seeks to implement this agenda. The purpose of this chapter is to establish a common cross-disciplinary understanding of conflict of interest, which still allows the authors of this volume, who have a background in law, sociology, social anthropology, political science, philosophy and economics, to highlight and elaborate on definitional and conceptual aspects which are particularly relevant or unique to their discipline.

2. Conflict of interest: an elusive concept

'Conflict of interest' as a legal term is much younger than the idea it expresses. The old adage that one cannot serve two masters describes one particular type of conflict of interest (arising out of a plurality of principals). In the judicial sphere, the requirements of independence and impartiality of the judiciary are traditional concepts for managing conflict of interest in the person of the judge. *Nemo judex in re sua*, no one should be a judge in his own cause, is an ancient principle which expresses this idea. Likewise, the term 'capture', when speaking of 'regulatory capture' or of '*richterliche Befangenheit*' ('judicial capture'), conveys the image of a rule-maker or a decision-maker being caught by certain interest groups.

Conflict of interest has been defined as 'a situation in which some interest of a person has a tendency to interfere with the proper exercise of his judgement in another's behalf'.[1] The concept of conflict of interest in that

[1] Michael Davis, 'Conflict of Interest', p. 589. See on the notion of interest, p. 20 below.

sense relates to situations of decision-making with a practical relevance, such as a court's or tribunal's deliberation and adoption of a judgment, administrative activity, decisions of a board of directors of a corporation, medical decisions of a doctor, or even of surrogate decision-makers for comatose patients who lack decisional capacity.[2] So the conflict we are dealing with is an *intrapersonal* conflict arising within a human or an institution which is entrusted with such decision-making. It is not a clash between different actors.[3]

Additionally, and most importantly, it is submitted here that a conflict of interest is not per se present when a professional or official decision-maker is required to take into account various, often antagonist, interests of different sectors of society. On the contrary, a judge, a regulator, an administrator, and a company director, should consider those various interests. In fact, attempting to reconcile conflicting interests is a core element of any regulation and administration. In particular, law is what comes out when conflicting interests meet in the political arena, and is itself a tool to deal with such interests.

If all situations where a public, corporate, or professional decision-maker takes conflicting interests into account were qualified as a 'conflict of interest', then every assessment of costs and benefits, and every balancing decision would involve a conflict of interest. Such an (overly) broad conception then leads to the misleading statement that every decision-making based on consequentialist moral reasoning (and hence on an estimation of the relevant costs and benefits) necessarily implies a conflict of interest for the decision-maker.[4]

But such a broad definition, on such a high level of abstraction, does not help in the understanding of the issue. If any decisions subject to multiple objectives were described as conflicted, there would be hardly any non-conflicted settings left.[5] The concept's explanatory value would be reduced to zero.

It is therefore preferable to pitch the concept less broadly. For example, the EU implementing Directive on investment firms of 2006 mentions 'detrimental' conflict of interest, and thereby implies that

[2] See Shapiro, 'Conflict of interest at the bedside: surrogate decision-making at the end of life', Chapter 18 in this volume.
[3] Conflicts between different actors are the theme of Axelrod, *Conflict of Interest*. The present book has nothing to do with such conflicts.
[4] See in that sense Frank, 'Conflict of Interest', pp. 270–271.
[5] See Issacharoff, 'Legal Responses', p. 191.

some conflicts may be neutral or benign.[6] A different terminology for distinguishing 'ordinary' situations from detrimental ones might be to call the former one of 'conflicting interests' (mostly vested in diverse actors or groups confronting each other).[7]

Contrary to the terminology suggested here, Jean-Bernard Auby, in this volume, espouses a broad notion of conflict of interest which encompasses situations in which the administrator balances conflicting interests.[8] Erhard Friedberg likewise criticises the distinction between 'conflict of interest' and 'conflicting interests'.[9] For him, the concept of conflict of interest includes three key elements: the existence of different spheres of action, the idea of 'bridging, brokering, coordinating of positions' that are at the intersection of these spheres of action; and thirdly, the 'use of resources drawn from one sphere of action to gain influence in the other'.[10] Friedberg objects that the 'essentialist orientation' of distinguishing 'conflict of interest' and 'conflicting interests' does not contribute to the understanding of the phenomenon.

Admittedly, my distinction excludes from scrutiny a large bulk of situations, and risks to reify constellations where conflicting interests might run or not run into a situation of conflict of interest in the narrow sense. On the other hand, a broad notion of conflict of interest leads to finding conflict of interest everywhere in social life. It is no coincidence that the author who espouses such a broad notion finds that the issue (broadly as he conceives it) is largely one of perception and one which cannot be eliminated. The real problem is, according to Friedberg, controlling the behaviour of those who benefit from their position. So rather than pursue a definitional search, it is perhaps more useful to identify a *legally significant* conflict of interest, a conflict in which the risk of inappropriate judgements – or in the perspective of the principal–agent theory, the risk of agency opportunism – is most acute.[11]

[6] Art. 23 of Commission Directive 2006/73 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ 2006 L 241/26).

[7] Margolis, 'Conflict of Interest', gives Antigone as the classic example of a person subjected to conflicting interests, or conflicting obligations. She is torn between king Kreon's commands (to leave the brother unburied) and her obligation towards the gods (to bury the brother) p. 361.

[8] See Auby, 'Conflict of interest and administrative law', Chapter 8 in this volume.

[9] See Friedberg, 'Conflict of interest from the perspective of the sociology of organised action', Chapter 2 in this volume, pp. 40–41.

[10] Ibid., p. 41.

[11] Issacharoff, 'Legal Responses', p. 191.

3. Proliferation of conflict of interest regulation

Regulation of conflict of interest has recently been proliferating, both on the level of national legislation, and on the level of global governance. In many countries, traditional patterns of self-regulation in the professions have been complemented or substituted by statutory conflict of interest legislation.

3.1 Regulation on the domestic level

The United States is probably the country with the oldest and today most developed conflict of interest regulation.[12] In 2006, a new law, the Honest Leadership and Open Government Act was adopted in the US.[13] In the same year, Canada enacted a comprehensive modern conflict of interest statute, which is frequently referred to as a model.[14]

With regard to the EU member states, the main empirical findings of a comparative study of 2007[15] are as follows: most states have different and separate rules on conflict of interest for their different institutions. Only rarely are there specific conflict of interest rules applying to the entire government sector. An example is the Seven Principles of Public Life, a not strictly binding code for all UK government officials. The first principle is 'selflessness', and states: 'Holders of public office should act solely in terms of the public interest. They should not do so in order to gain financial or other benefits for themselves, their family or their friends.'[16]

The new EU member states are generally more regulated than the old member states, with Latvia and Bulgaria, followed by Poland and Romania, having the highest regulation density in Europe, based on the

[12] The first law that we would now think of as a conflict of interest law was Part 2 of the Act to prevent Frauds upon the Treasury of the United States of 1853 (18 USC § 283, 10 Stat 170). According to the Office of Government Ethics, *Report to the President and to Congressional Committees on the Conflict of Interest Laws Relating to Executive Branch Employment* (Washington DC, January 2006), p. 3, this law was the first attempt to address the ethical problems that arise when a public employee misuses his official position to benefit his private clients.

[13] Honest Leadership and Open Government Act of 14 September 2007 (Public Law 110–181; 121 Stat 735). See for federal employees the US American Government Ethics Reform Act of 30 November 1989 (Public Law 101–194).

[14] Conflict of Interest Act, Statutes of Canada 2006, chapter 9, section 2, in force since 9 July 2007, last amended on 11 July 2011.

[15] Demmke et al., *Regulating Conflicts of Interest*.

[16] Adopted by the Committee on Standards in Public Life. Available at www.public-standards.gov.uk/About/The_7_Principles.html (last accessed 15 December 2011).

US model.[17] Among the old member states, Portugal is highly regulated, followed by the UK and Spain. Italy[18] and Turkey[19] have recently enacted or thoroughly revised regulation in the field. Countries with the least conflict of interest issues regulation are Austria, Denmark and Sweden.

Following Demmke et al., four types of existing 'hard' regulation on conflict of interest can be distinguished. First, relevant provisions are found in laws applying to all institutions of a given state, such as the constitution, the penal code, the laws on the administration, or the civil service act. Secondly, the general statutes for specific institutions, such as central bank acts, or court of auditors acts may contain provisions relevant for managing conflict of interest. Thirdly, states have adopted specific legislation on conflict of interest applicable to all institutions in a state, such as the Slovenian Prevention of Corruption Act,[20] or the Irish Ethics in Public Office Act.[21] Finally, states have enacted specific conflict of interest rules applicable to individual institutions, for example the Austrian Incompatibility Act for Government and Parliament.[22]

As to the institutional comparison in Europe, the highest regulatory density can be found with regard to the national central banks and for governments, the former institutions being often regulated by codes of ethics only. Parliaments are the least regulated institutions.[23] The comparative study by Demmke et al. concludes that parliaments are in part structurally under-regulated.[24]

[17] Demmke et al., *Regulating Conflicts of Interest*, pp. 43 and 48. Demmke et al. consider these states to be perhaps over-regulated. See the country profiles of twenty-seven EU member states in ibid., pp. 157 *et seq.*, on Bulgaria pp. 172–178; on Latvia pp. 244–253.

[18] Legge n 215, *Legge in material di risoluzione dei conflitti di interessi* (Rules for the resolution of conflicts of interest, the 'Frattini Law') of 20 July 2004, Gazetta Ufficiale No. 193 of 18 August 2004; English translation in Council of Europe, Venice Commission, Opinion No. 309/2004, Doc. CDL(2004)093rev. The law only deals with conflict of interest of persons holding government office (such as the Prime Minister and ministers).

[19] Law No. 5176 related to the Establishment of a Council of Ethics for Public Service and Making Modifications on Some Laws of 25 May 2004. Available at www.tbmm.gov.tr/etik_komisyonu/belgeler/kanun_5176_eng.pdf (last accessed 15 December 2011). The Council of Ethics prepared ethical guidelines which were adopted in form of a regulation by the Prime Ministry on 13 April 2005 (Regulation on the Principles of Ethical Behaviour of the Public Officials and Application Procedures and Essentials, No. 25785, Official Gazette of 13 April 2005. Available at www.etik.gov.tr (last accessed 15 December 2011).

[20] Resolution on the Prevention of Corruption in the Republic of Slovenia (RePKRS) of 16 June 2004, No. 212–05/04–33/1.

[21] Ethics in Public Office Act of 22 July 1995, No. 22 of 1995 (Irish Statute Book).

[22] Demmke et al., *Regulating Conflicts of Interest*, p. 26.

[23] Ibid., p. 48.

[24] Ibid., p. 49.

As to specific conflict of interest-related principles and issues, the rules on impartiality, on the incompatibility of posts, and on loyalty are most often codified, and financial disclosure is also well regulated.[25] In contrast, the field of post-employment is least regulated. In this regard, rules in some European states, in the US (strong regulation), and in Canada differ considerably. This issue is probably under-regulated.[26]

Legal comparison reveals that France stands out. Here, legislation relating to conflict of interest appears outdated. The preventive aspect is not developed; the existing French norms focus on repression, and even those norms are rarely applied in practice. Against this background, the French President in 2010 established a 'Commission of reflexion on the prevention of conflict of interest in public life'. Under the heading 'towards a novel deontology of public life', the commission's report highlighted glaring lacunae in the French legal system and strongly urged for reforms.[27] Recent French scholarship has pressed in the same direction.[28] In this volume, two French contributions analyse the issue from a legal and sociological perspective, respectively.[29]

3.2 *Global and European benchmarks for states*

Conflict of interest has become a matter of international concern. For example, the UN General Assembly has, in the course of its action against corruption, adopted an 'International Code of Conduct for Public Officials' in 1996. The Code's first principle is that a 'public office, as defined by national law, is a position of trust, implying a duty to act in the public interest'.[30] Principle 2 of that Code deals at length with conflict of interest and disqualification. Furthermore, the Council of Europe adopted a set of recommendations for national public administrations.[31] The Organisation for Economic Co-operation and Development (OECD) has published a

[25] Ibid., pp. 52, 55, 57. [26] Ibid., pp. 55–59.
[27] Commission de réflexion pour la prévention des conflits d'intérêts dans la vie publique, *Pour une nouvelle déontologie de la vie publique* (26 January 2011). The three-person Commission was chaired by Jean-Marc Sauvé, vice-president of the *Conseil d'Etat*, and consulted sixty individuals, who are listed in an annex to the report.
[28] Hirsch, *Pour en finir avec les conflits d'intérêts*.
[29] Auby, 'Conflict of interest and administrative law', Chapter 8; Friedberg, 'Sociology of organised action', Chapter 2 in this volume.
[30] Annex to General Assembly resolution 51/59 of 12 December 1996, para. 1.
[31] Council of Europe recommendation on Codes for public officials, Recommendation No. R (2000) 10 E, of 11 May 2000, Art. 13 – Conflict of interest.

'toolkit',[32] and entertains an 'Observatory on Ethics and Codes of Conduct in OECD Countries'.[33] Moreover, the European Union (EU) has commended the above-mentioned comparative study of the Rules and Standards of Professional Ethics for the Holders of Public Office in the EU-27.[34]

The EU Directive on Markets in Financial Instruments (MiFID) of 2004 obliges the EU member states to require investment firms to take all reasonable steps to *identify* conflicts of interest between themselves (including their managers, employees and tied agents and persons under the firms' control) and their clients, or between one client and another, that arise in the course of providing investment services, and to maintain and operate organisational arrangements so as to *prevent* them. MiFID and its implementing directive also provide that, where organisational or administrative arrangements to *manage* such conflict of interest are not sufficient, the investment firm must *disclose* the nature and/or the source of the conflict to the client before undertaking business.[35] MiFID also obliges member states to require that investment firms take all reasonable steps to obtain the best possible results for their clients, and thus indirectly enshrines a fiduciary obligation of loyalty.[36]

3.3 *Self-regulation of global and European institutions*

Recently, the international institutions have realised that conflict of interest is a vital issue for themselves and a problem not only of domestic but of supranational and global governance as well.[37] For example, the UN General Assembly in 2005 urged the Secretary-General to develop a UN system-wide Code of Ethics.[38] This code should become the principal document outlining the ethical standards to be upheld by United

[32] Organisation for Economic Co-operation and Development (OECD), *Managing Conflict of Interest*.

[33] Available at www.oecd.org/document/57/0,3746,en_34645207_34744738_35521657_1_1_1_1,00.html (last accessed 15 December 2011).

[34] Demmke et al., *Regulating Conflicts of Interest*.

[35] Arts. 13(3) and 18 of Directive on Markets in Financial Instruments (Directive 2004/39/EC of the EP and the Council of 21 April 2004), OJ 2004 L 145/1; implementing Directive 2006/73 of 10 August 2006 (OJ 2006 L 241/26), Arts. 21–23: conflict of interest potentially detrimental to clients; conflict of interest policy; and record of services or activities giving rise to detrimental conflict of interest.

[36] Art. 21 MiFID.

[37] See in detail Nganga Malonga, 'Conflict of interest of international civil servants', Chapter 4 in this volume.

[38] See 2005 'World Summit Outcome Document' (GA Res. 60/1 (2005)), and 'Review of the efficiency of the administrative and financial functioning of the United Nations'