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DIRECTORS' CONFLICTS

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1.1 Introduction

The issue of directors' accountability and responsibility is never far from the public spotlight, as recently highlighted by corporate governance reforms initiated by the UK government¹ and by the proceedings of the Banking Royal Commission in Australia.² A topic of increasing practical and regulatory complexity is the conflicts faced by company directors. Conflicts may occur between directors' self-interest and the interests of the company, between duties owed to more than one company or principal or between the interests of different stakeholders. This is a core source of concern, and of commentary, in a number of common law jurisdictions. As the complexity of commercial transactions and of corporate life in general increases, the application of the duty to avoid conflicts has necessarily become more complicated. At the same time there is a constant tension between ensuring accountability and not deterring responsible risk-taking. Concerns have been expressed that the legal and regulatory burden is too high. Providing certainty and

¹ See, eg, Financial Reporting Council, *UK Corporate Governance Code* (2018); Financial Reporting Council, *Guidance on Board Effectiveness* (2018); Department of Business, Energy and Industrial Strategy, *Corporate Governance Reform—The Government Response to the Green Paper Consultation* (August 2017).

² Commonwealth of Australia, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (2017–19).

comprehensive coverage of key aspects of the law relating to directors' conflicts is therefore vital.

- 1.02** This book provides detailed analysis of the relevant general law and statutory duties in the UK, with comparative material from Australia, Canada, New Zealand, and Hong Kong. These common law jurisdictions have been chosen due to the cross-fertilization of principles between the jurisdictions and due to common origins.³ Moreover, corporate governance codes and principles share similar elements. An analysis drawing on multiple jurisdictions therefore provides a much more complete picture of the law than an approach based on any single jurisdiction. Insights from Australian jurisprudence are particularly relevant due to the unique regulatory system, which incorporates an active regulator that enforces directors' duties, resulting in significant honing and development of these duties.

1.2 Context

- 1.03** Conflicts abound in commercial life. Directors are confronted by numerous conflicts, often involving practical and regulatory complexity. For example, many directors hold more than one board position, giving rise to potential conflicts between the interests of each company. Directors may also be appointed as nominees or to the board of one or more group companies, also raising possible conflicts. As part of their role, directors may come across attractive opportunities—the permissibility of directors exploiting such opportunities in a personal capacity or via another corporate vehicle is the subject of contention and confusion.
- 1.04** Directors' dealings with the company also raise concerns in relation to conflicts—the temptation to benefit oneself is one against which equity has long taken a stringent approach. In this respect, the fiduciary duties to avoid unauthorized conflicts and profits (the conflicts and profits rules) impose prophylactic requirements. These general law duties (arising from the common law and equity)⁴ have been supplemented in a number of common law jurisdictions by statutory duties. Indeed, in the UK, statutory duties have replaced the initial general law duties. The key duties now imposed by the Companies Act 2006 (UK) are the duty to act within powers (s 171), the duty to promote the success of the company for the benefit of the members as a whole (s 172), the duty to exercise independent

³ For example, the Australian cases involving the Bell Group companies have been significant in UK company law jurisprudence—see *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 39 WAR 1; *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1. Indeed, the relevance of the approach taken in other common law jurisdictions was highlighted in the UK case of *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45; [2015] AC 250 in which the Supreme Court conformed the English approach to bribes with that of Australia, New Zealand, and Hong Kong.

⁴ The term 'general law duties' refers to duties imposed by common law and equity.

judgment (s 173), the duty to exercise reasonable care, skill, and diligence (s 174), the duty to avoid conflicts of interest (s 175), the duty not to accept benefits from third parties (s 176), and the duties to declare an interest in a proposed or existing transaction or arrangement (ss 177 and 182). Detailed regimes are imposed in some jurisdictions regulating particular aspects of the broader prohibitions. These include statutory regimes concerning substantial property transactions, loans to directors, and related party transactions. These duties all build on the foundational fiduciary duties of directors, which continue to apply in other common law jurisdictions.

Within the maze of conflicts there is also a need to take a realistic approach. This can be seen from the fact that a director will not be liable for breaching the duty to avoid conflicts by reason only of holding shares in the company. The reality of, and benefits arising from, directors owning shares in the company have long been recognized. At the same time, however, concerns have been raised as to the linkage between directors' remuneration and share price. The topic of remuneration is complex and more properly the subject of a separate work. It will not be examined in detail in this book. **1.05**

Conflicts associated with personal interest or inconsistent duties are regulated by the fiduciary duty to avoid conflicts and its statutory equivalents. Directors, however, also face conflicts concerning benefits to third parties, such as family members, majority shareholders or other entities. Such conflicts are the province of the duty to act in good faith in the interests of the company and, to a lesser extent, the duty to act for proper purposes. In the UK these duties have been codified in sections 172 and 171 of the Companies Act 2006. **1.06**

A final form of conflict faced by directors concerns the interests of stakeholders such as creditors, customers, the environment and the community. Quite apart from the constant push for recognition, and even protection, of stakeholder interests as part of the corporate law paradigm, there are commercial advantages in forging and maintaining good relationships with stakeholders. However, conflicts between the interests of various stakeholders (and at times between the interests of the company and the interests of stakeholders) may, and do, occur. Directorial decision-making necessarily involves balancing the competing interests of stakeholders. The key question is to what extent such interests can be protected and promoted within the contours of current directors' duties. **1.07**

The particular focus of this book is conflicts that are relevant to directors and conflicts that have eluded clear guidance—namely corporate opportunities, multiple and competing directorships, and stakeholder conflicts. It is in relation to such conflicts that a multijurisdictional approach is particularly beneficial. **1.08**

1.3 Outline of This Work

- 1.09** These issues transcend international boundaries and confront the corporate community in many countries. In addition, there are gaps in the case law in each of the jurisdictions. These gaps can be filled by consideration of the law in other jurisdictions. Although full convergence (and comprehensive coverage) is unrealistic as a result of different statutory and regulatory regimes, there are significant benefits to a multijurisdictional analysis. For example, an analysis of the law relating to corporate opportunities is more complete when cases from a number of jurisdictions are surveyed. This allows the factual situations from the cases to be placed on a spectrum, providing clear guidance.
- 1.10** The topic of conflicts encompasses a number of more specific sub-topics. These include conflicts of interest, conflicts of duties, corporate opportunities, multiple directorships, competing directorships, nominee directorships, and unauthorized profits. In addition to detailed coverage and analysis of general law duties, relevant statutory duties are outlined and analysed. This outline includes an overview of more specific statutory regimes such as those regulating loans and related party transactions.
- 1.11** There are also often differences between the coverage of the statutory provisions and that of the general law duties. Highlighting such differences is important in providing certainty and in comprehensively stating the legal position. Moreover, the role played by other duties in proscribing and regulating conflicts is at times overlooked. For example, the duty to act in good faith in the interests of the company (also known as the 'best interests rule' and now the duty to promote the success of the company in section 172 of the Companies Act 2006 (UK)) both proscribes conflicts and imposes additional requirements such as extended disclosure and even positive action to prevent a transaction from proceeding.⁵
- 1.12** The following is a brief outline of each of the chapters.

1.3.1 Chapter 2

- 1.13** Chapter 2 provides important background to the subsequent analysis of conflicts by discussing the theoretical underpinnings of fiduciary law, and of company law, and by presenting the rationale of conflicts regulation within that landscape. This is important given that the regulation of conflicts stems from the fiduciary nature of the relationship between director and company. Although some of these issues are at times specific to corporate law jurisprudence, the relevant principles

⁵ See, eg, *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244; [2005] 2 BCLC 91 [41]; *Adler v Australian Securities and Investments Commission* (2003) 46 ACSR 504, 618 [539]; see further Sections 2.2.5.2, 4.9, 7.5, 10.2.2.2, and 10.2.2.3.

have their origin in, and continue to be informed and shaped by, fiduciary jurisprudence. This is in fact specifically mandated by section 170 of the Companies Act 2006 (UK). The fiduciary concept has evolved and developed since its initial application to trustees. A critical examination of fiduciary principles is therefore vital in any comprehensive analysis of directors' conflicts.

Chapter 2 outlines the original fiduciary duties of directors (namely the duties to avoid unauthorized conflicts and profits and the duties to act in good faith in the interests of the company and for proper purposes, and to retain discretions), as well as the duty of care. It includes discussion of the topics of whether directors are trustees and to whom directors owe their duties. This includes an examination of the duties of directors of trustee companies and cases in which directors owe duties to individual shareholders. **1.14**

1.3.2 Chapter 3

Chapter 3 lays the foundation for detailed analysis in subsequent chapters. It provides an overview of important definitions, including the term 'director'. The application of directors' duties is not limited to those who are formally appointed as directors but extends to others. Moreover, duties vary depending on the type of director involved. **1.15**

Chapter 3 also provides an overview of key statutory provisions. It critically analyses the interaction between statutory and general law duties, and underlines the importance of coherence in the sense of integration of statutory and general law principles. This topic has attracted considerable academic attention. The scheme of statutory directors' duties found in the Companies Act 2006 (UK) has highlighted the importance of an integrated model of directors' duties. The relevance of this model to other jurisdictions is assessed. **1.16**

1.3.3 Chapter 4

Chapter 4 provides a detailed outline of the regulation of conflicts of interest, again laying a foundation for detailed analysis in subsequent chapters. The contours of the term 'conflicts' are explored—this term includes conflicts of interest and conflicts of duties. The chapter incorporates detailed commentary on the precise nature of the conflict necessary to engage the rule—is it a 'real sensible possibility' of conflict, 'actual' conflict, or 'pursuit' of a conflict that results in breach? The role of the duty to avoid unauthorized profits and of the duty in section 176 of the Companies Act 2006 (UK) not to accept benefits from third parties are scrutinized in detail. The relationship between the two duties—a topic of contention—is explored. The application of the duties to avoid conflicts and profits as regards third party interests is introduced and the law concerning directors' fiduciary duties to individual shareholders is appraised. Relevant statutory duties, as well as conflicts in the context of takeovers, are examined. **1.17**

1.3.4 Chapter 5

- 1.18** Chapter 5 outlines and critically analyses conflicts of duties. Such conflicts occur where a director owes a duty to someone (or some entity) other than the company which may conflict with the director's duties to the company. Particular focus is placed on nominee directorships and group company directorships, as well as on critical evaluation and application of underlying equitable principles. The chapter also examines how the best interests rule is applied and how breach of this duty is assessed.

1.3.5 Chapter 6

- 1.19** Chapter 6 engages in thorough examination and critical analysis of multiple directorships. Regulation of multiple directorships has been a topic fraught with uncertainty and clearer solutions can be sourced from in-depth multijurisdictional analysis. This is particularly the case concerning competing directorships, in relation to which similar approaches can be found in the jurisdictions covered in this book. The chapter provides extensive guidance on the regulation of multiple directorships.

1.3.6 Chapter 7

- 1.20** Chapter 7 critically analyses duties relating to disclosure and declaration of interests. Disclosure plays a key role in the context of directors' conflicts. The duties to declare interests (in ss 177 and 182 of the Companies Act 2006 (UK)) and statutory requirements in relation to disclosure in the other jurisdictions are reviewed. Disclosure is also a necessary precondition to obtaining informed consent to a breach of duty. This aspect of disclosure is critically examined. Wider issues considered include whether a 'fiduciary duty of disclosure' exists or should be recognized. Duties requiring disclosure to shareholders are also analysed.

1.3.7 Chapter 8

- 1.21** Chapter 8 concerns corporate opportunities. Corporate opportunities are opportunities which arise as a result of a director's position or which are relevant to the company's business. The taking of corporate opportunities by directors is regulated at general law principally by the duty to avoid profits, but also by the duty to avoid conflicts. The law concerning corporate opportunities is uncertain due to competing policy considerations, making a multijurisdictional analysis particularly apposite. This chapter dissects cases drawn from all the jurisdictions covered by this book with a view to establishing a coherent framework of analysis. It considers factors such as the director's resignation, the role of the relevant director, the nature of the opportunity, and the connection between the opportunity and the director's position or the company's business. Clear guidance is presented by way of a spectrum analysis.

1.3.8 Chapter 9

Chapter 9 gives an overview of specific statutory regimes which require shareholder approval where directors are conflicted. These include related party provisions, as well as detailed regimes governing directors' service contracts, substantial property transactions, loans and quasi-loans, credit transactions and related arrangements, and payments for loss of office. This chapter is included for completeness rather than providing comprehensive analysis. **1.22**

1.3.9 Chapter 10

Chapter 10 examines the role of other duties in situations in which directors are conflicted. Where a conflict or profit involves the interests of a third party (such as a director's spouse or family member, a creditor, a friend, or a major shareholder) the fiduciary duties to avoid conflicts and profits do not necessarily apply.⁶ Instead, the duties to act in good faith in the interests of the company and for proper purposes are engaged. What is sometimes overlooked is the role of other duties in proscribing conflicts and in imposing extra requirements on directors who are placed in situations of conflict. Of special relevance in this context is the duty to act in good faith in the interests of the company. **1.23**

The second part of the chapter provides comprehensive examination and critical analysis of conflicts concerning stakeholders in each jurisdiction, with particular focus on section 172 of the Companies Act 2006 (UK) and recent reforms. **1.24**

1.3.10 Chapter 11

Chapter 11 provides an outline of authorization and ratification—as a fiduciary duty, breach of the duty to avoid conflicts may be excused by the company. The doctrine of ratification is complex, given that there are categories of cases in which ratification is seen to be impermissible. The contested issue of ratification of breach of statutory duty in jurisdictions such as Australia is also addressed. The chapter then discusses other mechanisms that may relieve a director from liability and outlines pertinent statutory provisions. **1.25**

1.3.11 Chapter 12

The consequences flowing from breach of the duty to avoid conflicts at general law and under statute are discussed in Chapter 12. This chapter discusses the law concerning third party liability based on the rule in *Barnes v Addy*,⁷ which is also the subject of policy and conceptual debate. It appraises the role of the unfair prejudice (or oppression) remedy concerning directors' conflicts. Given that this remedy is favoured by shareholders, and that a number of cases concern directors' **1.26**

⁶ Note, however, that ss 175 and 177 of the Companies Act 2006 (UK) include indirect interests.

⁷ (1874) LR 9 Ch App 244 (CA).

conflicts, it is important to outline the contours of this remedy and its relevance to directors' conflicts. Indirect enforcement, and any significant differences in enforcement mechanisms between jurisdictions, are also briefly considered.

1.4 Practical Application

- 1.27** The following scenario illustrates a number of the potential conflicts discussed in this book and the legal questions posed.
- 1.28** Suppose a director of a large mining company is playing tennis with a relative on the weekend and overhears a conversation detailing a lucrative opportunity for a new mine in another location. Will the director be in breach of duty if they incorporate a new company to take up the opportunity, rather than presenting it to the board of the large mining company? Does it matter whether the company is public or private, listed or unlisted?
- 1.29** The answer to this question depends on a number of factors. The opportunity was clearly discovered whilst the director was acting in a private capacity, rather than in the course of their directorship (as would be the case if the director were entertaining clients at the company's expense in playing tennis). However, an argument could be made that the director would only be aware of the value of the opportunity by reason of their directorship of the mining company. This may not be the case if the director is an experienced participant in the industry. Are fiduciary principles, which have traditionally operated strictly, relaxed in such contexts?
- 1.30** Would it make a difference if the director came across the opportunity whilst negotiating a deal on behalf of the mining company or whilst taking a few days of leave at the end of an overseas trip paid for by the company? Would it be significant if the mining company had insufficient finances to pursue the opportunity or if the opportunity was only tangentially related to the company's normal line of business (such as an opportunity to purchase an earthmoving equipment business)? What if the director resigns and then takes up the opportunity? Does it matter whether the director is an executive or non-executive director? Lastly, does it make a difference if the board rejects the opportunity (but the director does not obtain authorization from the shareholders)?⁸
- 1.31** Suppose the director incorporates another company to operate the new mine, which ultimately competes with the first mining company—is the director in breach of duty by virtue of being a director of competing companies (quite apart from any issue of corporate opportunities)? If the companies do not directly compete but operate in similar areas, is membership of the boards of two such companies problematic? At what point does the law draw a line, given the frequency

⁸ For analysis see Chapter 8.

of multiple directorships and the fact that such directorships continue to be allowed?⁹ What if the director is provided with confidential information by virtue of their directorship of one company, which is highly relevant to the other company, and which it would be their duty to disclose to that other company? Which company's interests prevail in such circumstances?¹⁰

A question also arises as to whether the director can avoid the imposition of duties by refraining from being appointed as a director of the second company but continuing to be involved in the management and direction of the company.¹¹ **1.32**

Suppose the director also runs another business concurrently with their directorship of the mining company and seeks a contract between this business and the mining company for the supply of goods and services. How are such conflicts regulated? Moreover, how extensive does the conflict need to be to attract regulation? For example, is an interest as a shareholder of the supplying entity sufficient and is it enough that the director ensures commercial fairness?¹² **1.33**

If one of the companies involved in the above scenarios is a trustee company, a question arises as to whom the director owes duties (namely, the trustee company or the beneficiaries of the trust) and as to the interplay between the interests of each.¹³ Likewise, if the director subsequently approaches a shareholder of one of the companies to buy or sell shares in that company, does the director owe duties to the shareholder or are directors' duties owed solely to the company?¹⁴ **1.34**

If the director incorporates a company to take up the opportunity, but has family members as its directors and shareholders—so that the director personally does not benefit—is there any breach of duty, given that the duties to avoid conflicts and profits are designed to prevent directors from being swayed by self-interest? It will be shown that in such situations attention must be paid to the operation of the best interests rule, which regulates such conflicts and which may impose liability on directors.¹⁵ Quite apart from proscribing unauthorized conflicts and profits, this duty imposes additional requirements (such as extended disclosure), regulates third party conflicts, and operates despite authorization of a conflict or profit.¹⁶ Moreover, third parties receiving property arising from, or assisting a director in, breach of fiduciary duty may also separately be liable under the rule in *Barnes v Addy*.¹⁷ **1.35**

⁹ Chapter 6 critically analyses multiple and competing directorships.

¹⁰ Such conflicts are also frequently encountered by nominee and group company directors for whom certainty has been lacking. Chapter 5 provides comprehensive analysis.

¹¹ Chapter 3 examines the reach of directors' duties and the definition of the term 'director' in each jurisdiction.

¹² These issues are analysed in Chapters 4 and 7.

¹³ See Sections 2.3.2 and 10.4.3 for discussion.

¹⁴ See Sections 2.3.3, 4.12, and 7.6 for analysis.

¹⁵ See Sections 2.2.5.2, 4.5.2, 7.4.1.4(d), 10.2.3, 12.3.2.2, and 12.3.2.3.

¹⁶ See Sections 2.2.5.2, 4.9, 7.5, 10.2.2.2, and 11.6.

¹⁷ (1874) LR 9 Ch App 244 (CA). See Section 12.4 for discussion.

- 1.36** Suppose the director, via a newly incorporated company, does proceed with the mine, which is located on the edge of suburbia and therefore unpopular with local residents, and also a threat to local fauna and flora. Shareholders investing in the company are looking for a high rate of return and employees have been lured from other jobs on the promise of generous salaries. Apart from complying with governmental laws and regulations in relation to the environment and workplace relations, can the director take into account (and, moreover, are they bound to take into account) the interests of stakeholders such as the community and the environment, or is the director bound to maximize profit? What if the interests of certain sections of the community (say, in gaining employment) conflict with the interests of other sections (say, in maintaining the quiet nature of the area)—how does the director balance such conflicting interests? If all the shareholders are in fact committed to environmental protection, can the director prioritize this cause over profit-maximization? Do creditors have any protection in such settings apart from contractual protection? This is a complex issue given the number of stakeholders affected by a company's conduct.¹⁸
- 1.37** What can a director do if they realize that there are inescapable conflicts and seek to deal with these properly? What disclosure duties apply?¹⁹ Can the director obtain authorization or indemnity from the company?²⁰ Finally, if the director does not adequately manage relevant conflicts, what can shareholders do and what sanctions will the director face?²¹

1.5 Conclusion

- 1.38** The myriad conflicts inherent in the above scenario are dissected and critically analysed in this book and extensive guidance is provided. It will be shown that the key consideration is that directors be able to act in good faith in the interests of the company. Directors should be wary of (and, in appropriate circumstances, disclose) any factor—whether self-interest or the interests of a third party or stakeholder—which inhibits them in a not insignificant way from considering, and then acting, in good faith in what they consider to be the best interests of the company. Directors' fiduciary mandate is to act in what they consider to be the best interests of the company and it is this core mandate that is protected by the duties outlined in this book.

¹⁸ The complex interplay of conflicts relating to stakeholder interests is addressed in Chapter 10.

¹⁹ The law relating to disclosure is presented in Chapter 7, which also discusses the separate duties of disclosure that exist in some jurisdictions and the duty of disclosure imposed as part of the best interests rule.

²⁰ Authorization and other excusal mechanisms are outlined in Chapter 11.

²¹ These issues are canvassed in Chapter 12.



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