Directors’ Conflict of Interest

Introduction

Despite the codification of the rules on directors’ conflicts of interest in the Companies Act 2006 (the Act) this remains a complex area for company secretaries and directors to manage. The Act requires directors to be proactive in relation to their declaration of interests, rather than reactive as in the past. Additionally as part of good governance practices there is an expectation that companies explain how conflicts of interest are managed at board level. This briefing sets out the duties under the Act and other practical considerations.


The sections in the Act relating to conflicts of interest are as follows:

- Section 175 (Duty to avoid conflicts of interest)
- Section 176 (Duty not to accept benefits from third parties)
- Section 177 (Duty to declare interest in proposed transaction or arrangement)
- Section 182 (Declaration of interest in existing transactions and arrangements)

Duty to avoid conflicts of interest (Section 175)

A director must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts or may possibly conflict with the interests of the company (these are known as situational conflicts). The duty to avoid a situational conflict is not infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest or if the directors have authorised it. Boards and directors must look at a director’s other interests (either as a shareholder, director or other position of influence e.g. as trustee) and consider whether that interest could give rise to a conflict of interest in the future.

The shareholders may, via powers granted to the board within the articles of association, give their board the power to authorise conflicts of interest. Public companies need to ensure that their articles give the necessary powers to enable directors to authorise situations of possible or actual conflict with the company’s interests.

Where a transaction with a director specifically requires the approval of members (e.g. long-term service contracts, substantial property transactions and loans to directors), it is not necessary for the director concerned also to comply with Section 175 since shareholder approval effectively sanctions any conflict.

Duty not to accept benefits from third parties

Section 176 sets out a duty that directors should not accept benefits from third parties. This provision raises issues around the receipt of corporate hospitality and gifts which potentially may cause a conflict of interest.
It is prudent for boards to have a policy on corporate hospitality and gifts which also satisfies the provisions of the Bribery Act.

**Duty to disclose interest in proposed transaction or arrangement (Section 177)**

If a director is, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare its nature and extent to the other directors. There is no infringement if the matter could not reasonably be thought to give rise to a conflict of interest or if the directors ought reasonably to be aware of the conflict already.

This provision deals with the notification of an interest. Good practice dictates that a director should disclose to a board, any interest or perceived interest, in advance or in anticipation of a conflict arising. The directors may authorise the matter, even if a conflict exists, provided that, in a private company the articles do not prohibit authorisation, and in a public company the articles expressly allow for authorisation.

**Declaration of interest in existing transactions and arrangements (Section 182)**

A director must declare an interest in an existing transaction or arrangement with the company, except if the interest has been declared under Section 177. Failure to do so is a criminal offence.

It should also be noted that there is a safe harbour provision in Section 180 of the Act where a director has acted in accordance with provisions in the articles dealing with conflicts. The safe harbour provides that a director’s general duties are not infringed by anything done (or omitted to be done) by the director by following the provisions set out in the articles of association concerning the authorisation of conflicts.

**Practical Implications**

A reactive approach is not sufficient and boards of directors need to positively engage with the declaration process. Procedures should be established to ensure that directors are aware of their declaration duties and that situational and transactional conflicts are identified. The GC100 guidance on director’s conflicts of interest is useful in helping to identify potential conflict situations.

In summary there are three types of conflicts of interest to be considered and declared:

- An actual or potential conflict of interest that cannot be avoided but has been authorised by the Board;
- An interest in a proposed transaction; and
- An interest in an existing transaction.

In order to capture all relevant interests company secretaries are strongly encouraged, by both the ICSA and GC100 guidance, to take the following steps:
Remind directors at regular intervals about their duties under the Act, especially focussing on their own proactivity and vigilance to ensure compliance with Section 175.

For current directors, seek their cooperation in preparing lists of all their positions and interests that are likely to affect the company. The position of connected parties should also be included.

For new directors, ensure procedures relating to declaring conflicts of interest are explained and understood.

Suggest to the board that it may consider appointing a committee to specifically consider conflicts that arise upon appointment (perhaps the Nomination Committee or a committee made up of independent non-executive directors) which could then report and make recommendations to the board.

Create a register of authorisations and a separate register of potential interests.

Create a register of benefits, which can be audited and transactions reported annually to the audit committee.

Report on how conflicts of interest managed in the annual corporate governance report.

The conflicts of interest register

It should be remembered that directors will be required to provide information in respect of their interests for a variety of compliance reasons including under Chapter 11 of the Listing Rules (in respect of related party transactions for Premium Listed companies) and for biographies in the annual report. It makes sense for the conflict of interest register drawn up for each director to cover all purposes so that there is no duplication of effort. In terms of gathering information for the register all directors should be required to provide a comprehensive list of their business and other interests. In respect of AIM companies the Nomad will have gathered this information as part of the admission process which can provide a useful starting point. For Premium Listed companies the register should be shared with and a process set up by the finance department in order to identify possible related party transactions. Directors are often required in their letter of engagement to seek the Chairman’s or Board’s permission before taking on any additional commitments which provides a useful check.

Preparing the register is not a one-off exercise and the register and record of authorisations for each director should be renewed and updated at regular points during the year.

Mitigation of conflicts and authorisation

A director should not allow a conflict to arise unless it has been authorised by the board in advance. However, a director who finds himself in a situation where a material conflict of interest arises should take steps to mitigate the problem, for instance, by leaving a meeting where the issue is to be discussed. The company secretary should advise directors of any provisions in the articles of association of how conflicts should be managed including the effect on quorums and voting.
Careful consideration should be given by boards when authorising conflicts. Where authorisation is sought it should only be given if it is for the benefit of the company and taking into account the director’s wider duties. The authorisation should include any restrictions thought necessary to manage the conflict such as excluding the director from having certain information or from discussions on the matter. Any such restrictions should be recorded on the authorisation register.

Written Resolutions

If a director’s conflict exists it is preferable to hold a meeting of directors to consider the matter at hand. However, a valid written resolution may be possible if a meeting cannot be arranged. If a company’s articles are based on Table A and require all the directors to sign a written resolution in order for it to be valid all of the directors should sign the resolution even though the interested director’s vote will not count. The written resolution will be valid as long as the other non-conflicted directors constitute a quorum.

Prism Perspective

Directors need to think holistically and proactively about their position in a company and how their other shareholdings, positions, directorships and interests may have an effect on the company. When considering such potential or actual conflicts, directors must consider whether these interests are likely to promote the success of the company. This is an important reminder that the conflicts of interest provisions should be seen in the context of the wider set of director’s duties rather than in isolation. Taken together these duties make it imperative for companies, particularly quoted companies, to have clearly defined processes governing the conduct of directors both individually and collectively within the boardroom.

Quoted companies will be expected to report on the procedures put in place for managing conflicts of interest. The Investment Association in particular expects listed companies to report annually that there are procedures in place to deal with conflicts and that they operate effectively and this may be considered best practice for all companies.

Useful Sources

Companies Act 2006
Listing Rules (Chapter 11)
GC100 sources http://ld.pralctallaw.com/8-380-1895
ICSA briefing on Directors Duties http://www.icsa.org.uk/knowledge?qCat=Guidance

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July 2015