

# Directors' Conflicts of Interests and Declaring Interests

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**The Companies Act 2006 (the "Act") sets out for the first time a statutory statement of the general duties owed to a company by its directors. Most of these came into force on 1 October 2007, except the following provisions that came into force on 1 October 2008:-**

- **the duty to avoid situations giving rise to a conflict of interest (section 175)**
- **the duty not to accept benefits from third parties (section 176)**
- **the duty to declare interests in proposed transactions and arrangements (section 177)**

These duties are owed to the company and only the company is able to enforce them. The codified duties apply to all directors of a company, including shadow directors and, in the case of sections 175 and 176, to former directors of a company.

## **Duty to Avoid Conflicts of Interests: section 175 of the Act**

The duty under the Act is very broad and can catch a wide variety of situations. It does not apply to transactions or arrangements with the company, which are dealt with specifically under section 177 of the Act.

The duty will not be infringed if "the situation cannot reasonably be regarded as likely to give rise to a conflict of interest". Given the breadth of the duty, it is advisable for directors to seek authorisation of a potential conflict wherever possible.

## **What has changed?**

For companies incorporated on or after 1 October 2008, the Act allows the directors to authorise any matter giving rise to a conflict for a director, unless there is a provision in the company's articles stating otherwise.

For companies incorporated prior to 1 October 2008, there is the option to pass an ordinary resolution to authorise a specific conflict, or a private company can alternatively pass a special resolution to amend its articles to expressly permit the board to authorise conflicts in accordance with the Act. Opting to amend the company's articles represents an ideal opportunity to incorporate other necessary provisions to reflect other developments in company law, for example, provisions enabling a company to indemnify directors and new means for communicating with members and dealing with general meetings.

The Act allows a public company's articles to contain specific provisions to deal with conflicts, including expressly permitting its board to authorise directors' conflicts.

A conflicted director will not count towards the quorum and is not entitled to vote at a board meeting to authorise his conflict.

The decision to authorise any conflict should be taken on a case-by-case basis and subject always to a duty to act in the company's best interests for the benefit of its shareholders.

## **What action should companies take?**

The Act preserves the ability of shareholders to pre-authorise conflicts of interest that would otherwise be a breach of duty. The key change, as mentioned above, is that non-conflicted directors can be empowered to authorise the conflicts of other directors. The approach taken by any company will depend on its type.

## **Listed companies and large private companies**

If a company has a large shareholder base, it will want to avoid the impractical process of obtaining shareholder consent for each potential director's conflict.

To the extent it has not already done so, it should consider amending its articles to include an express power for the board to authorise conflicts. It may be worth including a specific statement that a director will not be in breach of his duty if he does not disclose to the company confidential information obtained in another capacity, even if that information might be beneficial to the company.

#### ***Wholly-owned subsidiaries***

Often the same individuals sit on the boards of wholly-owned subsidiaries as those who sit on the main operating company. Given the new duty to avoid situations where a director can have actual or potential conflicts, it is therefore now possible for a conflict to arise intra-group, for example, from an intra-group asset sale.

One option would be to amend the articles of all subsidiary companies. Alternatively such subsidiary companies should consider passing a members' resolution approving certain general and foreseeable conflict situations, such as holding other group company directorships and foreseeable intra-group transactions. The relevant company could then obtain shareholder approval for more unusual conflict situations as and when they arise.

#### ***Joint venture/private equity investee companies***

Investors often have the right to appoint one or more nominee directors to the board. If an investor is entitled to appoint several directors, each with the same conflict of interest to declare, each of those investor directors would be prevented from approving each other's conflict. Only the remaining company directors would be entitled to participate. This could prove problematic if the company's articles prescribe a quorum including at least one of those investor directors. To avoid being in a situation where a company cannot hold a quorate meeting, it should consider including an express provision in its articles to vary any prescribed quorum for board meetings convened to approve directors' conflicts of interest. Alternatively, the company could require conflict of interest matters to be approved by the shareholders.

#### ***How long should the authorisation last?***

The length for which a board authorises a conflict is at its sole discretion. It may wish to impose an expiry date, renew it annually or grant it indefinitely. Whichever approach is adopted, the board should consider implementing a policy of regularly reviewing authorisations.

#### ***Some practical guidance***

The directors should be briefed on the new statutory regime relating to situational conflicts and be made aware of the positive requirement to disclose any situations, relationships or interests that may give rise to a conflict of interest.

The main board of directors should work through a questionnaire to identify potential situations that could give rise to a conflict, for example, directorships of other companies, in particular those within the same industry/sector.

The duty extends to indirect interests, so directors should consider whether a conflict of interest arises through a "connected person". Section 252 of the Act defines who is a "connected person", which essentially includes certain family members, certain companies with which the director is connected, trustees of a trust, certain partners and certain firms with legal personality.

At the board meeting at which a director's conflicts are presented for approval, that conflicted director should not be counted towards the quorum for the meeting nor vote on the resolution to approve his conflicts. Wherever possible, full board meetings should be convened and detailed written minutes taken.

A board may consider that, in light of its duty to act in the manner most likely to promote the company's success, it cannot authorise a conflict of interest. A company could consider establishing, and delegating, certain tasks to a sub-committee. Companies should consider seeking legal advice to ensure that delegation is possible and that the sub-committee's acts will be binding. In extreme situations, a director may have to consider stepping down

from the board, for example when he is a director of a trustee company of a pension scheme considering making a demand for a contribution from an employer company in financial difficulties of which he is also a director/employee.

On appointment, all new directors should be briefed upon their duties under the Act and asked to complete a conflicts questionnaire.

Directors should be aware that the duty to disclose conflicts is an ongoing one and should be kept under constant review. Board authorisation cannot be retrospective.

#### **Disclosable situations**

Examples of situations for which a director must disclose an interest include where he, or any person connected to him:-

- is a competitor of the company
- is a major shareholder in the company
- is a major customer (or potential customer) of the company, or a supplier to the company
- owns property related to the company's property, the value of which could be affected by the activities of the company
- has an advisory relationship (for example, financial or legal) with the company or a competitor
- is in a situation where he can make a profit as a result of his directorship

#### **Accepting benefits from third parties: section 176 of the Act**

A director must not accept a benefit from a third party conferred by reason of his being a director, for example, corporate hospitality, unless acceptance of the benefit "cannot reasonably be regarded as likely to give rise to a conflict of interest". It would be sensible from a risk management point of view for a board to review and/or set internal guidelines for directors regarding the receipt of benefits, and potentially to establish a register of benefits.

#### **Declaration of interests: section 177 of the Act**

Directors must declare the nature and extent of their interest in proposed transactions and arrangements with the company (to the extent not previously disclosed) prior to entering into them.

A director should submit a general notice stating it has an interest in a specified company or is connected to a specified person and, accordingly is to be treated as interested in any transactions or arrangements that may be made with that company or person.

A board noting the authorisation arrangements should also note receipt of any declarations of interest.

#### **Summary**

The statutory duties are essentially the same as the existing duties at common law. However, to ensure compliance with the Act, a company should review its current policies and procedures for authorising and monitoring conflicts, and in particular, consider whether to amend its articles to permit its board to authorise conflicts. A company - and its directors - should seek external advice where necessary.

A company's directors should continue to obey the company's constitution, deal with the company honestly and disclose a potential conflict of interest whenever in doubt.

This briefing note sets out a summary of the law at the time of writing and is for information purposes only. It should not be regarded as legal advice but if you would like more information please contact:



**Walter Clark, Associate**  
**+44 (0)131 473 6195**  
**walter.clark@burness.co.uk**



**Steven Hannah, Solicitor**  
**+44 (0)131 473 6167**  
**steven.hannah@burness.co.uk**

If you would like to opt out of future e-bulletins please contact [webmarketing@burness.co.uk](mailto:webmarketing@burness.co.uk)

**Burness LLP**

Edinburgh 0131 473 6000  
Glasgow 0141 248 4933

**[www.burness.co.uk](http://www.burness.co.uk)**

50 Lothian Road, Edinburgh EH3 9WJ Fax: 0131 473 6006 DX ED73 LP60  
120 Bothwell Street, Glasgow G2 7JL Fax: 0141 204 1601 DX GW154 LP5  
Burness LLP is a limited liability partnership registered in Scotland (SO300380).

The registered office is at 50 Lothian Road Festival Square Edinburgh EH3 9WJ. Lawyers with offices in Edinburgh and Glasgow at which a list of partners is available for inspection.

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