

# Corporate News

## December 2009

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### DIRECTORS' CONFLICTS OF INTEREST: ARE YOU COMPLIANT?



#### Introduction

It is now a little over a year since the new directors' duties relating to conflicts of interests were introduced by the Companies Act 2006 ("the Act") and our experiences have shown that a significant number of companies have failed to put in place systems to adequately deal with this issue, which has led to potential exposure to the directors concerned.

By way of example, are you a director of a company formed prior to 1 October 2008 and do any of the following apply to you:

- do you hold any other directorships?
- are you a significant shareholder in, or are you yourself a supplier to or customer of the company?
- are you a director of the company's pension trustee company or a trustee of the pension fund?

If the answer to any of these questions is "yes", then unless the situation has been authorised by the company prior to 1 October 2008, or, where the circumstances have occurred after this date, by the shareholders of the company, then you have potentially breached your director's duties.

The aim of this note is to remind directors of their duties, and to recommend practical steps that can be taken to ensure compliance.

#### Current Law

A new statutory regime was introduced by the Act on the 1 October 2008 dealing with both directors' conflicts of interest involving an ongoing situation, and also dealing with conflicts involving a transaction or arrangement with the company. These duties apply to both executive and non-executive directors and to shadow directors. Failure to comply with the duties could result in the directors having to pay compensation for any loss suffered by the company, and for the director having to account for any profits or benefits he receives.

#### Situational Conflicts

The Act now states that a director must avoid a situation in which he has, or can have a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.

This replaces the previous no-conflict rule, under which a director must not, without the company's consent, place himself in a position where there is a conflict or possible conflict between the duties he owes the company and either his personal interests or other duties he owes to a third party.

Examples of the type of situations which may be caught by this duty include directorships in other companies (whether or not members of the same group), shareholdings (usually majority or controlling), and circumstances generally involving the exploitation of any property, information or opportunity which are potentially in conflict with the interests of a company. It also covers interests that may be held by related parties to the director (eg his spouse, civil partner, parent or adult child). The duty is extremely broad in its potential application, and will also continue when a director is no longer in office, insofar as it relates to the exploitation of property, information or opportunities that he became aware of whilst he was a director.

The new regime does provide that situational conflicts may be authorised either by the shareholders of the company, or dependent on the precise circumstances of the company and provided the correct procedures are complied with, by the board (comprising non-interested directors of the company). In the latter circumstances, the non-interested directors must be clear as to the scope and extent of what they authorise, whether they wish to impose any terms to such authorisation, and must also ensure they consider their general duties to the company.

A company may amend its articles of association to set out the procedure which is to be followed when dealing with situational conflicts. This can include how the matter is to be proposed to the board and how it is to be authorised, the quorum requirements, any conflicts which the directors cannot approve, and the treatment of any confidential information received by a director.

If there has been a breach, then this can be ratified by the shareholders by means of an ordinary resolution. The votes of any shareholder connected with the director will not count for the purposes of a ratification resolution.

### Transactional Conflicts

A director must declare the nature and extent of any direct or indirect interest that he has in any arrangement or transaction with the company to the other directors. This requirement extends to both proposed and existing arrangements, and to circumstances involving both the director and persons or companies connected to him.

In relation to proposed arrangements, the directors must declare the nature and extent of their interest before the company enters into the transaction or arrangement. If a declaration proves to be, or becomes inaccurate or incomplete, then a further declaration must be made. Failure to comply with this obligation could render the contract voidable at the option of the company, and the director could be required to account for any profits made.

For existing arrangements for which a declaration has not already been made (for example transactions with the company which were entered into before the individual became a director), then the director must also declare to the other directors the nature and extent of his direct or indirect interest. Failure to comply with this duty is a criminal offence, punishable by a fine.

A declaration is not required under the circumstances set out above in the event either the director is not aware of the transaction or arrangement in question, if his interest cannot be reasonably regarded as giving rise to a conflict of interest, or if the other directors are already aware of the interest.

### Help is at hand

We are able to help you assess whether any of your company directors have any conflicts of interest which need to be declared, and if necessary, approved by the company. We can ensure the declarations are in the correct format, and can amend your articles of association to provide a practical conflict approval mechanism.

### Contact details



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If you would like to receive more information regarding the contents of this newsletter or information on any other company law related matters then please do not hesitate to contact one of our Company / Commercial partners on 0161 832 4666.

Julian and John specialise in all aspects of company / commercial work, mainly acting for SMEs but also undertaking international work such as joint ventures and manufacturing agreements.

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