



AVOIDING CONFLICT - NEW LAWS FOR COMPANY DIRECTORS

In previous bulletins and in Education Brief we have considered the implementation of the Companies Act 2006 and its relevance to education institutions. On 1 October 2008 new provisions governing directors' conflicts of interest come into force. This is a complex area of law that will be of interest to institutions involved in limited companies.

The Law

Both the current and new law have two limbs, the duty to declare interests in transactions with the company, and the duty to avoid conflicts generally.

Under the current law, a director who is in any way (whether directly or indirectly) interested in a contract or proposed contract with the company has a duty to declare the nature of his interest at a board meeting of the company (section 317 of the Companies Act 1985). From October, directors will be required to declare their interests in proposed and existing transactions and arrangements (and not just "contracts"). Whether this is a material distinction will depend upon the facts in any particular case. The other change is that the declaration must be of both the nature and extent of the director's direct or indirect interest (not just the nature as under the 1985 Act). There will however be no need for directors to disclose anything the other directors already know about (or ought reasonably to have known), or to declare a matter which could

not reasonably be regarded as likely to give rise to a conflict of interest. Under the 1985 Act the declaration was required to be made at a board meeting, but from October the declaration may also be by way of new notice procedures which provide for the giving by directors of notice in writing which may be general or specific.

In addition to the duty to disclose interests in contracts, directors are currently under a common law duty to avoid conflicts of interest. The 2006 Act codifies this duty and the new law is set out in section 175. Under this section, directors must avoid situations in which they have, or can have, a direct or indirect interest that conflicts with, or may conflict with, the company's interests. The previously mentioned exception as to matters which cannot reasonably be regarded as likely to give rise to a conflict of interest is also applicable. In reality, the new codified duty is much the same as the current law. However, the key change is that the other directors may have the ability to give their prior authorisation to a conflict situation (whereas under the current law, only shareholder approval would be capable of sanctioning or ratifying such a breach). Directors of existing companies will need to be granted this power by their shareholders, but directors of new private companies incorporated from October will automatically have this power. Such board authorisation will only be effective if the required quorum

is met without including the interested director or directors.

Implications

It is important to note that the wording of the legislation is intentionally wide and that (subject to the exceptions for inconsequential matters), a wide variety of circumstances might amount to a 'situational' conflict. It is not possible to fully consider the nature of such circumstances here, but we would hope it would be apparent to directors if and when their interests or the interests of their institution were at odds with that of their company. A classic example of a conflict affecting a university would be where a director of a 'spin-out' company seeks to develop a business or technical opportunity outside that company, whether alone or with another venture. However, it should be noted that the new law covers situations which may lead to conflicts and as such is very wide in scope.

In our experience, the directors of companies which are connected with education institutions will often be senior members of the institution's executive. However, that is not always the case and academics and other staff may hold board positions with associated companies.

If the company is a wholly-owned subsidiary of the institution, then potential breaches of the legislation by that institution's personnel resulting from the employment with the

institution may not be of material concern. This is because these provisions are principally designed to protect the company's shareholders, and as long as the individual is acting in the interests of their employing institution, then there is unlikely to be any objection to the conflict. That said, it is of course good practice for the legislation to be properly complied with.

The provisions are likely to be of much more significance where the institution has a stake in a company with other parties, particularly if that is a minority stake. Commonly this might be a joint venture with other education institutions, public bodies or the private sector, or a 'spin-out' company incorporated to exploit technology developed by the institution. Often companies of this nature will have one or more directors appointed by each of their shareholders, with a view to representing that party's interests at board level. Whilst there is nothing wrong with this practice per se, the individuals concerned need to remember that their duties are owed to the company in question and where conflicts arise between their employing institution and the company they will need to follow the appropriate procedures (including, if necessary, obtaining board approval for the conflict).

Institutions appointing individuals to the boards of their companies should remember that it is the duty of that director to act in the best interest of the company in question (for the benefit of all shareholders). They should therefore fully consider the implications and suitability of any appointments made to companies in which they are interested. They should also bear in mind that the board of that company may (subject to necessary shareholder approvals being passed) now be able to approve the acts of other directors who may be acting in a way that is contrary to the institution's interest. They may wish to

think carefully before granting their directors that ability, although it can also be seen as a useful way of approving minor 'conflict' situations which might otherwise result in numerous breaches by directors of the new law.

Boards of associated companies will want to consider prior to October whether they need to be granted the power to approve conflicts and whether any actual or potential conflicts of interest exist. When considering whether or not to approve a situational conflict each situation should be considered separately on its particular facts, but directors might want to bear in mind the following:

- Their need to consider not only their own interests but the interests of any connected persons which might amount to an indirect interest.
- Each director's situation should be considered by the board who should decide whether to approve the conflict (taking account of their general duty to act in the best interest of the company for the benefit of its members as a whole).
- Where the board is asked to approve a potential conflict that brings clear benefits to the company (for example, a director is involved with a competitor but brings with him/her access to industry or sector expertise which outweighs any potential detriment), approving the conflict may well be in the best interests of the company. A board should be able to approve a conflict or potential conflict if, on balance, the directors think it is in the interests of the company for it to retain that director. Boards should also consider whether the matter they are approving would adversely impact on the relevant director's ability to act in

accordance with his wider duties.

- Boards should consider the scope of any approval. A board may decide to approve the director holding a particular conflicting role (e.g their role with the institution) but may not want to sanction all the circumstances that flow from that role. As such, any conflict approvals should be carefully considered and worded.
- We recommend that companies keep a list of approvals granted to directors, including the date the approval was granted, the date (if any) on which it expires, its scope and any limitations or special circumstances.
- If a real conflict arises post authorisation and the director has clearly conflicting interests, the board will need to consider its options which may include excluding the director from the relevant discussion and information, suspending them from the board or requiring them to resign.

This Bulletin is intended to be a general guide to the law. If you have any specific questions about your own circumstance's, these should be referred to a member of martineau Education team for a definitive response.

For further information please contact John Nicholson, Solicitor, Corporate Group
T: 0870 763 1434
E: john.nicholson@martineau-uk.com

