Chapter 11
Directors' Duties II: Conflicts of Interest

Here, basic guidance to the end-of-chapter questions will be provided.

1. Define the following terms:
- **corporate opportunity doctrine;**
- **substantial property transaction;**
- **non-cash asset;**
- **quasi-loan.**

Term	Definition
corporate opportunity doctrine	The rule which provides that a director breaches his duty (notably the duty in s 175 of the CA 2006) if he takes advantage of property, information or an opportunity and, in doing so, his interest conflict with those of the company
substantial property transaction	A transaction between a director (or a person connected with the director) and the company that requires member approval under s 190 of the CA 2006
non-cash asset	Any property or interest in property, other than cash
quasi-loan	Where the company agrees to pay a sum on behalf of the director, or where the company reimburses expenses incurred by another party due to the actions of the director, on the understanding that the director (or someone acting on his behalf) will later reimburse the company

2. State whether each of the following statements is true or false and, if false, explain why:
- **the s 175 duty applies only in relation to transactions or arrangements between a director and the company;**
- **a director of a company cannot also act as director for a competing company;**
- **a s 175 conflict can only be authorised by the members;**
- **a s 176 third-party benefit can only be authorised by the members;**
- **s 177 provides that a director who has an interest in a proposed transaction/arrangement with the company must obtain the authorisation of the other directors;**
- **a breach of s 182 is a criminal offence;**
- **if a director fails to obtain member approval for a service contract over two years in length, then the contract is void;**
- **a loss of office payment made to a director of a quoted company will only be valid if it is approved by a resolution of the members.**

- **The s 175 duty applies only in relation to transactions or arrangements between a director and the company:** This statement is false. The s 175 duty will not apply in relation to a conflict of interest arising out of a transaction or arrangement with the company.
- **A director of a company cannot also act as director for a competing company:** This statement is false. There is no general rule prohibiting a director from acting for a rival company.
- **A s 175 conflict can only be authorised by the members:** This statement is false. It is possible for a s 175 conflict to be authorized by the members, subject to specified limitations.
- **A s 176 third-party benefit can only be authorised by the members:** This statement is true.
- **Section 177 provides that a director who has an interest in a proposed transaction/arrangement with the company must obtain the authorisation of the other directors:** This statement is false. Section 177 merely requires the director in question to disclose the interest to the other directors.
- **A breach of s 182 is a criminal offence:** This statement is true.
- **If a director fails to obtain member approval for a service contract over two years in length, then the contract is void:** This statement is false. The contract will remain valid, but the term relating to contract length will be void.
- **A loss of office payment made to a director of a quoted company will only be valid if it is approved by a resolution of the members:** This statement is false. A loss of office payment made to a director of a quoted company will be valid if (i) it is approved by a resolution or the members, or; (ii) it is consistent with the approved remuneration policy.

3. 'The treatment of conflict of interest duties in the CA 2006 is inelegant and serves to render the law more complex and confusing that was the case under the common law. The no-conflict and no-profit rules were much easier to understand.' Do you agree with this statement? Provide reasons for your answer.

Introduction

- Every essay should begin with a succinct introduction that demonstrates that you understand the essay question. Briefly explain what the essay is about and set out what the essay will discuss and how it will be structured.
- This essay requires you to discuss the conflict of interest duties found in the CA 2006.

The common law duties

- It is worth beginning by looking at the how the common law dealt with conflict of interest, which was primarily to impose two duties upon directors.
- The first was the 'no conflict rule', which provided that a director could not have an interest which conflicted with that of the company.
- The second was the 'no profit rule', which provided that a person in a fiduciary position (such as a director) was not entitled to make a profit from their office.

- These two duties have been abolished and replaced with three (or possibly four) general duties.

The statutory conflict of interest general duties

- There is no doubt that the conflict of interest general duties are more complex than their common law predecessors. There are a number of issues to focus on, but focus on areas of complexity.
- The duties do have some notable overlaps, so more than one duty might be relevant. It may therefore not be easy to determine which duty is relevant.
- Each duty has different rules regarding authorization or disclosure. Some duties (e.g. s 177, s 182) require mere disclosure of the conflict, whereas others require authorization (e.g. s 176). The s 175 duty requires authorization, but the rules differ for public and private companies.
- As regards duties that require disclosure, when disclosure is required differs.
- The status of s 182 is rather unclear. It is unlikely to be a general duty in its own right, but it is arguably as important as the duty in s 177.
- Table 11.1 on p 265 sets out the principal difference between the duties.

Conclusion

- Every essay should end with a conclusion. Briefly summarise the main points/arguments and, if possible, come to a conclusion regarding the essay topic (i.e. which of the opposing views has the stronger arguments).

4. At a recent board meeting, the directors of Dragon plc discussed several potential transactions and other matters, including:

- **Jude, who chairs the remuneration committee, recommended that all directors of Dragon be provided with a £5,000 payment when they leave office. This term would be added to the directors' service contracts as they were renewed. Jude notes that his contract is due for renewal in a few months' time and, to demonstrate his long-term commitment to Dragon, he states that he would be willing to sign a five-year contract.**
- **The board discussed the need to build a new factory and Ivan stated that he found a suitable piece of land upon which the factory could be built and that the asking price was £130,000. Ivan did not disclose that the land was owed by his wife and, if the sale went ahead, Ivan would be paid £13,000 commission.**
- **The board has authorised Sajid to negotiate and conclude a supply agreement with TechGoods Ltd. However, unbeknownst to Dragon's board, Sajid is a major shareholder in TechGoods. Sajid informed the board of TechGoods that, if they followed his instructions, he could secure a contract with Dragon.**

Discuss the lawfulness of the above transactions and, if any duties or laws would be breached by entering into the transactions, what steps could be taken to avoid

breaching the law?

- The bullet points indicate the three transactions that require discussion, so base your structure around these.

The £5,000 loss of office payment and five-year contract

The loss of office payment

- As regards loss of office payments, there are different rules for quoted and unquoted companies.
- An unquoted company cannot make a loss of office payment to a director unless it has been approved by a resolution of the members (s 217 of the CA 2006). However, member approval will not be required where a payment is made in good faith is discharge of an existing legal obligation (e.g. a loss of office provision in a service contract).
- A quoted company cannot make a loss of office payment to a director unless it has been approved by a resolution of the members or is consistent with the company's approved remuneration policy (s 226B(1)).
- If the relevant loss of office rules apply and are not complied with, any contravening payment made will be held on trust for the company. Further, any director who authorized the payment will be liable to indemnify the company for any loss resulting from the pyment.

Jude's service contract

- Jude has stated he would be willing to sign a five-year service contract. Such a contract would require member approval, as it is over two years in length (s 188 of the CA 2006).
- If member support was not obtained, the contract would still be valid, but the term regarding the length of the contract would be void. The contract would also be deemed to contain a term allowing the company to terminate it by providing reasonable notice (s 189).
- If Dragon is subject to the UK Corporate Governance Code, then Provision 39 provides that contract periods should be one year or less.

The purchase of land

- Ivan has recommended to the board a piece of land that can be purchased, but has not disclosed the fact that his wife owns the land.

The s 177 duty

- Section 177(1) of the CA 2006 provides that if a director is interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of the interest to the other directors.
- Ivan clearly has an interest in the proposed contract for the sale of land between Dragon and his wife. Accordingly, he should disclose this to the other directors.

- A failure to disclose his interest would render the contract voidable at Dragon's instance.

Substantial property transaction

- As noted above, Ivan should disclose his conflict to the other directors. However, if the transaction involving his wife is a substantial property transaction, member approval will also be required (s 191(1) of the CA 2006).
- Two types of transaction constitute substantial property transactions, of which the relevant one here is a transaction where a company acquires, or is to acquire, a substantial non-cash asset, from director or a person so connected. Dragon is to acquire land from a person connected to Ivan, so this would qualify.
- The question is whether the land is a 'substantial non-cash asset.' The answer is yes, as it is over £100,000.
- Accordingly, member approval would need to be obtained. If member approval is not obtained, the contract will be voidable at Dragon's instance. Ivan and his wife will be required to account for any gains made and to indemnify the company for any loss sustained.

The s 176 duty

- If Dragon agrees to purchase the land from Ivan's wife, Ivan will receive a commission payment of £13,000.
- Section 176(1) states that a director must not accept from a third party a benefit conferred by reason of his being a director. The commission payment would constitute such a benefit.
- A benefit such as this cannot be authorized by the board – authorization can only come from the members. If the sale goes ahead and Ivan does not obtain member approval for the receipt of the benefit, Dragon can rescind the contract of sale and recover the benefit from Ivan. It could also claim damages from Ivan and/or terminate his contract.

The supply agreement with TechGoods

- Sajid is negotiating a contract with TechGoods, but has not informed the board of Dragon that he is a shareholder in TechGoods. This is a clear conflict of interest.
- The relevant duty is s 177(1) of the CA 2006, which provides that if a director is interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of the interest to the other directors.
- Accordingly, Sajid must disclose the nature and extent of his interest (i.e. that he is a major shareholder in TechGoods). A failure to disclose his interest would render the contract voidable at Dragon's instance.