CONFLICTS OF INTEREST

The common law and 2008 Act

Robinson v Randfontein 1921 AD

- Robinson buys mining property for £60 000 and on-sells to co for £275 000 – profit of £215 000 – co sues for the profit.
- Innes CJ: *"Where one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to make a secret profit at the other's expense or place himself in a position where his interests conflict with his duty…".*
- Eg, agent/principal; solicitor/client, guardian/ward.
- Except with free consent of his principal.
- No-conflict rule & no-profit rule. And best-interests rule.
- Conflict of interest or duty with duty to co.

Randfontein – court's approach

- The board as agent
- An individual director not usually an agent.
- Fiduciary duty when selling to co (stage 2).
- Fiduciary duty at time of initial acquisition (stage 1).
- Detailed assessment of way co was governed to determine whether Robinson a true agent – yes, complete delegation, board allowed him to dictate all important matters.
- Alternatively, Robinson the puppet-master of the group.
- *Burland v Earle* 1916 PC. Burland was co's MD.

Questions

- Is the approach in *Randfontein* and *Burland* correct?
- Flag three issues:
  - Whose fully informed consent?
  - What if co could not or would not have made the profit?
  - What if profit not made by director but by an associated entity?

Regal (Hastings) v Gulliver 1942 HL

- Regal owns a cinema. Wants to buy leases for two new cinemas.
- Establishes Amalgamated as subco to buy leases with share capital of £2000.
- Landlord demands rent guarantee unless share capital = £5000. Regal lacks funds to subscribe more. Directors not willing to sign guarantees.
- So the 5 directors & co solicitor subscribe the additional £3000 (60% of Amalgamated).
- Soon afterwards, a buyer purchases all shares in Regal and Amalgamated – directors & solicitor make profit of £8100.

Regal – court's approach

- 4 of the 5 directors liable to account for profit on basis of no-profit rule (not no-conflict rule).
- Strictness of the rule: Doesn't matter that they acted in best interests of Regal – either get shareholders' consent or forgo the transaction.
- Shareholders' consent – can be modified by articles.
- Irrelevant that Regal couldn't have made the profit.
- What of Gulliver – he didn't take up shares personally?

Peso Silver Mines v Cropper 1966 SCC

- Cropper = Peso's MD.
- Third party offers speculative mining property to Peso. Full board (including Cropper) reject it.
- Few weeks later, third party approaches Cropper privately with same property. He and his associates take it up through Cross Bow.
- Turns out well. Peso sues Cropper for transfer of his Cross Bow shares at cost.

Peso – court's approach

- Claim fails.
- Peso's bona fide rejection of property eliminated any potential conflict on Cropper's part. So no-conflict rule not breached.
- Subsequent offer to Cropper was made to him personally – he did not use his position as director of Peso to make the profit. He had received no confidential information as Peso director when property initially offered to Peso. So no-profit rule not breached.
- Criticism of *Peso* – court's approach might cause director to down-play attractions of the opportunity?

Boardman v Phipps 1966 HL

- Boardman = solicitor to family trust which owns minority stake in Lester & Harris.
- To unlock value, desirable for family to obtain controlling stake in L & H.
- But an independent trustee firmly against trust buying further shares in L & H.
- So Boardman & Phipps buy the further shares.
- Turns out well, to benefit of both trust and Boardman & Phipps.
- Disgruntled family member demands an account of profits.

Boardman – court's approach

- Held (by 3/2 majority) that Boardman and Phipps must account for profit.
- Decision based on no-profit rule – advantage from position as solicitor.
- Lacked consent from all trustees (the senile widow).
- Irrelevant that trust itself could not have bought the additional shares and made the profit.
- Lord Cohen's additional justification based on no-conflict rule. Difference between *Peso* and *Boardman?*
- Lord Upjohn(dissenting): Was there a *"real sensible possibility of a conflict"*?

IDC v Cooley 1971

- Cooley (the MD) lays ground work for project he intends pursuing after resigning.
- Third party not willing to give the project to IDC. No-conflict rule still applicable?
- Roskill J: *"Plainest conflict of interest"*. Cooley had been under duty to pass on info re project to IDC.
- Why a plain conflict, if IDC had no prospect of getting the project? Also, no-profit rule not implicated on the facts.
- Roskill J's approach to alternative claim for damages – 10% chance. Enough to implicate no-conflict rule?

Back to *Randfontein* and *Burland*

- Was approach right and was all the evidence necessary?
- Doubtful - criticism of *Burland* in Canada.
- In corporate opportunity situation, each director has same duties - can't compete with his company.
- Not followed in practice. See, eg, *Bhullar v Bhullar* 2003 CA. Two-family letting company with 5 directors. Agree in principle to part ways. 2 directors learn that adjacent property on offer and buy for themselves.
- 2 directors not agents or puppet-masters. But ordered to transfer property to co at cost. There was a *"real sensible possibility"* of conflict.

Profit by associated entity

- Nowadays opportunities typically exploited through companies or trusts, not personally.
- *Barnes v Addy* 1874 CA:
  - Dishonest/knowing assistance.
  - Knowing receipt of trust property.
- *Ultraframe* 2005 (England) and *Farah Construction v Say-Dee* 2007 (Australia).
- Clean slate in SA. Should co be confined, in this situation, to claim for delictual damages?
- Courts probably will allow claim for profits, with similar test as in cases of delictual damages for inducing breach of contract or participating in breach of trust – *dolus*.

Legislation – three paradigm cases

- Three paradigm cases of conflict:
  - Case 1: Contracts with company in which director interested (eg *Randfontein* stage 2) - self-dealing.
  - Case 2: Appropriation of corporate opportunity (intermediate or permanent).
  - Case 3: Involvement in two competing businesses.

The 1973 Act

- Sections 234-241: Scope – ‘significant’ contracts in which director ‘directly or indirectly materially interested’ (paradigm case 1).
- Contracts concluded by board resolution or by director with board authorization.
- Procedural in nature. Non-compliance = criminal offence. Common law still determines director’s fiduciary duties and legal consequences of breach. Common law preserved by s 234(5) and s 237(4).

2008 Act

- Sections 75 and 76 codify directors duties. Section 77 deals with remedies.
- s75 conceptually has same scope as old provisions – interest in a matter (typically a contract) which is subject of board decision – paradigm case 1.
- Wider:
  - Any ‘matter’ – not only contracts.
  - No ‘significance’ qualification.
  - Interests of director or related person.
- Narrower:
  - Only matters considered by board itself.
  - Restrictions arising from definition of *“personal financial interest”.*

Section 75 continued

- Non- compliance decriminalised.
- Duty of disclosure regulated by s75(5): disclose interest, answer questions and withdraw.
- Section 75(7): *"A decision by the board, or a transaction or agreement approved by the board … is valid despite any personal financial interest of a director or person related to the director, only if (a) it was approved following disclosure of the said interest in the manner contemplated in this section…".*

Effect of compliance with s75

- Section 75 is a substantive no-conflict rule in paradigm case 1. If s 75 complied with, contract valid and director may retain profit. Common law no longer applies to paradigm case 1.
- See s77(2)(a) which speaks of breach of s75 as breach of fiduciary duty.
- Remaining directors should proceed cautiously. See s75(5)(f) – withdrawing director included for quorum purposes.

Nature of declarable interest

- *"Personal financial interest"* (PFA) by
  - director
  - related person.
- *"PFA"* defined in s1: *"direct material interest … of a financial, monetary or economic nature, or to which a monetary value may be attributed".*
- *"Related person"* defined in s2(1):
  - Individual to individual - blood/marriage.
  - Individual to juristic person – control as per s 2(2) – majority of votes.
  - Juristic person to juristic person (not relevant to director).
- Amplified by s75(1): a 2nd co/cc of which director or related person a director/member.

Is the PFA definition an improvement?

- 1973 test: whether director "*directly or indirectly materially interested*".
- Common law test: *"real sensible possibility of conflict"*.
- Example: X is a director of A Co and 25% shareholder (but not director) of B Co. A Co's board is considering a contract with B Co. May X vote?
- X's shareholding in B Co is a direct financial interest in B Co but only an indirect interest in the contract.
- B Co has a PFA in the contract but is not a related person to X.
- So hit by 1973 Act and common law but not by s75.
- Difficult to argue that common law can fill the gaps.

Where is the rest of the no-conflict rule?

- No-conflict rule wider than s75 (eg paradigm cases 2 and 3; also case 1 where contract not concluded by board decision). But s76 contains no general no-conflict rule.
- s76(2)(a)(i): mustn't use position to gain an advantage (no-profit rule).
- s76(2)(a)(ii): mustn't knowingly cause harm to co.
- s76(2)(b): must pass on info unless he reasonably believes it is immaterial or generally available to public.
- s76(3): must act (i)in good faith and for proper purpose; (ii) in the best interests of co; (iii) with due care, skill and diligence.
- s76(4) safe-haven: compliance where applicable with s75.

Solution to apparent omission?

- Live with the omission and hope that in most cases one will find a simultaneous breach of a s76 duty?
- Or treat ss75-76 as non-exhaustive, so common law can fill the gaps? Maybe. Presumption against amendment of common law.
- Or interpret *"good faith"* broadly to include avoidance of conflict? This would be against convention wisdom.
- ss 170-177 of 2006 English Act. Prefaced with reference to common law and equity. General no-conflict rule in s175, excluding interest in contracts which is dealt with separately in s177 (= our s75).
- Note: s76 draws no distinction between different types of directors.

Is there still a shareholder function?

- In s75, shareholders by ordinary resolution can ratify if s75 procedure not properly followed.
- What about other no-conflict situations (if still preserved) and no-profit cases (eg s76(2)(a)(i))? Can they still be legitimised by shareholder approval as per common law?
- s76 does not contain a shareholder qualification.
- Would common law fill the gap? Is this consistent with 2008 Act's conception of board as having original rather than delegated power (s66)?

Remedies – s77

- s77(2) – director's liability:
  - In cases of breach of due care, skill and diligence – liable *"in accordance with the principles of common law relating to delict for any loss, damage or costs sustained by the company".* (Makes sense.)
  - In all other cases (including s75) – liable *"in accordance with the principles of common law relating to breach of fiduciary duty for any loss, damage or costs sustained by the company".*
- But where is alternative remedy of accounting for profit? (s178 of English Act simply preserves all common law and equitable remedies.)
- Perhaps preserved unwittingly by s218(3).
- New Act does not cast light on liability of associated entities.

Warning: Prescription

- s77(7): *"Proceedings to recover any loss, damages or costs for which a person may be held liable in terms of this section may not be commenced more than three years after the act or omission that gave rise o the liability."*
- Ousts s12 of Prescription Act with two adverse consequences for companies.
- Actual or constructive knowledge of the breach (s12) no longer trigger for prescription to start running.
- Likewise, co can no longer claim benefit of s13(1)(e) – deferral of completion of prescription to one year after director has ceased to hold office.