



Every decision made by a board must be impartial and in the best interests of the company and its owners. If a particular decision is likely to benefit a director in some way, or benefit someone close to a director, that director is no longer in a position to make an impartial decision; he or she has a conflict of interest.

The term 'conflict of interest' is widely used, often misunderstood and commonly confused with conflict of duty, which Dr Simon Longstaff, Executive Director of St James Ethics Centre, describes as its much more common cousin.

"This is where you have a duty to a company or other entity which is incompatible with the duty you owe to the company on whose board you are serving," he explains.

Whether of Interest or duty, conflict is an inevitable part of business and something that will confront most directors at some point in their career.

"You have a potential conflict if you're on the boards of two companies that have formed any kind of relationship," says Colin Galbraith AM FAICD, a Special Adviser at Gresham Partners whose directorships include Commonwealth Bank of Australia, CARE Australia and Onesteel Limited. "For instance, one might be a supplier or a customer of the other, or you might be on the boards of both a bank and a company that would like to borrow money from that bank. There is nothing fundamentally wrong with conflicts of interests or duty; any problems that do arise inevitably relate to poor handling of the issue or basic impropriety."

The process of handling conflicts is well understood.

"It's pretty straightforward and the principles are clear," says Longstaff. "As soon as a conflict has been identified it must be disclosed and, from the moment you disclose the conflict, you are no longer capable of exercising judgement on how it should be resolved – it passes into the hands of those whose interests are at stake. They then decide which of a number of measures are to be taken. The person with the conflict may be excluded from any further discussion, or be allowed to be present but not permitted to vote. The board may also reduce the papers provided so that the conflicted director receives no information on the issue."

Helen Conway is Company Secretary & General Counsel at Caltex. She says that, at Caltex, directors' interests are regularly disclosed and recorded in a register so that, if necessary, she can alert to any potential conflict as it arises.

"The directors invariably take a very conservative position, instructing me not to send them the relevant paper and leaving the room rather than participating in the discussion and the decision," she says. "I would consider this good practice in any situation where they may not be able to bring an independent mind to the matter."

Like Longstaff, Conway believes that a conflict is more likely to arise in the area of duty.

"There is a lot of focus on material personal interest but I don't think that's where most conflicts arise," she says. "Generally speaking, if a particular activity of a potential director is going to lead to a fundamental conflict, it will be flushed out before the director is appointed. A director is more likely to have some sort of association with a particular matter that comes up for consideration by a board, such as also being on the board of a company competing for a large contract, for instance."

Even where the most meticulous protocols are in place, managing a conflict can give rise to its own set of serious problems.

"If you have directors who are so deeply conflicted that they are excluded from most of the decision-making of the board, the question arises whether they can still discharge their duties," says Longstaff. "It is possible to reach a point where they're no longer effective and therefore they're in breach of their primary obligation. In this case, it may be that they have to eliminate the conflict completely or resign from the board."

While resignation is the last resort, in some cases it is the only option.

Black, white and grey

Conflict is sometimes black and white – in a take-over situation, for example, a director is clearly incapable of acting in the best interests of both the bidder, whose goal is to buy at the lowest price, and the target, whose goal is to achieve the highest price or not to sell at all. Grey areas are more common – indeed, they're integral to the laws themselves. 'Material personal interest' is not actually defined in the Corporations Act or any other relevant legislation.

The sensible path is to err on the side of caution.

"Where a director is aware of any information that might possibly entail a conflict of interest or duty, it's incumbent on them to inform their fellow directors fully and not hide behind some personal assessment that it's not 'material'," says Galbraith. "Their fellow directors are then in a position to make their own assessment about that."

Erik Mather, Managing Director of Regnan Governance Research, says that some directors make the mistake of assuming that a transaction or relationship is not material when it is.

"Too often, they misuse an accounting-style five per cent definition," he says. "But, while a \$20,000 consultancy with the managing director's spouse or nephew may be fraction of a multi-billion dollar annual spend, it is highly material in a governance context."

Other mistakes include failing to recognise that a transaction is between related parties, though Mather suggests that wilful blindness might also fall into this category.

"It's hard to see something one does not actively look for," he says.

Some directors would rather not see their commitment to self-preservation as a conflict.

"Directors who want to maintain their position and income may be very compliant – reluctant to voice a challenge for fear of rocking the boat or making themselves unpopular," says Conway. "It's a subtle conflict but a conflict nevertheless because you're favouring yourself over the interests of the company. You're not capable of independent thought."

Longstaff says that a conflict of interest is first and foremost an ethical issue.

“The law does make it clear the director must act in the best interests of the company and be free from any conflict but, most of the time, it’s a question of whether or not the individual director faithfully engages, with good conscience, to identify relationships that may give rise to a conflict,” he says.

Inevitably, some directors lack the self-awareness necessary to grapple successfully with complex issues of ethics and morality. While we all experience emotions like avarice, jealousy and envy, it takes a reasonable level of self awareness to be able to see and understand how this can create conflict.

Jane Walton FAICD, principal of The Walton Group, is a lawyer, ethicist, teacher and presenter who specialises in corporate governance, board performance and organisational culture. She acknowledges that, even with the best will in the world, these are extremely difficult issues to deal with.

“When we want something badly enough we can convince ourselves of anything,” she says. “As human beings our power to delude ourselves can be breathtaking. I’ve known directors state categorically that they don’t have a conflict of interest when it’s very clear that they do. Others acknowledge a conflict but insist they’re managing it, even as confidential information from one company is up on the white board of another. I have actually come up against a situation where three members of a board of five, including the chair, joined the board of a competitor. The CEO was beside himself, but they’d had legal advice and been told that, as long as they didn’t pass confidential information, it was OK. It may have been legal but the ethical and moral damage was massive.

“People do bizarre things and you can’t legislate for people to be rational. All you can do is put checks and balances around it. You need an environment where conflicts of interests are discussed as a matter of course and the whole group takes responsibility for them. At the very least you need to keep a register and ask the question at every meeting.”

Blowing the whistle

Boardrooms are populated with strong personalities. When a director suspects that a ‘strong’ colleague has a conflict of interest it might seem altogether safer to keep quiet than to face the consequences of speaking out. But keeping quiet is both a breach of duty to the company unlikely to be unsustainable over the long term.

“A suspicion of conflict of interest is a challenging situation – there are no simple rules,” says Mather. “Non-executive directors should seek counsel from the chairman or, if the chairman is the subject of the potential conflict, from the lead independent director.”

Directors also have access to legal advice, and the St James Ethics Centre provides a national freecall number, 1800 672 303, for directors who would like to speak to an advisor.

When issues have been raised in the boardroom, there are still some who would argue they should stay there.

“My view is that a conflict of interest cannot be kept within the boardroom, nor should it be,” says Conway. “We’re here for shareholders so why wouldn’t we be transparent? Transparency and honesty engender confidence.”

Under the Corporations Act, public companies need shareholder approval in order to give related parties any financial benefit that is not ‘at arms length’. ASIC’s Executive Director Policy and Markets Regulation, Malcolm Rodgers, emphasised the importance of transparency when he announced the interim results of a review of company documents sent to shareholders, stating that “ASIC will act when it considers that shareholders need further information.”

Front page news

Sports ethicist and sociologist Dr Emma Sherry has researched conflicts of interest on the boards of AFL football clubs in every state where the game is played. She found that, while the issues are much the same as those arising in any other boardroom and are handled in the same way, there is one major point of difference – the level of community involvement.

“The community cares passionately about its teams and the reputation of a football club is paramount,” she says. “The community has always expected their players to be good role models and now that expectation has moved up to the board.”

As a result, directors are subject to far higher levels of scrutiny than most of their colleagues in the commercial world – the vaguest hint of a conflict is likely to feature prominently in the media. Sherry suggests that directors of commercial organisations could consider measuring themselves against the same yardstick.

“They might ask themselves how they would feel if they knew their behaviour would be reported on the front page of every newspaper,” she says. “Would they still do it?”

