



Corporate Briefing

Companies Act 2006:

Directors' conflicts of interest

This briefing note is a reminder of the implications for both public and private companies of the new Companies Act 2006 provisions on directors' conflicts of interest which come into force on 1 October 2008.

This new regime will be of relevance to listed and unlisted public companies, private companies and groups

Introduction

Potential and/or actual conflicts of interest – "situational conflicts"

It has always been a requirement of UK company law that directors should not place themselves in a position where they are actually or potentially in conflict with the duties owed to their company. From 1 October 2008, section 175 of the 2006 Act will come into force and codify the position. The most important change to the law is the action required to be taken to allow a conflict situation to persist.

Section 175 states that if a director has an actual or potential conflict of interest which involves a third party, i.e. a "situational conflict" (but which does not amount to a transaction or arrangement with the company, which would be caught instead by a separate regime in the 2006 Act (see below)), this situational conflict would normally need to be approved by the other non-interested directors *before* such a conflict arises.

The definition of "conflict" for these purposes is very wide and situations with even the slightest potential for a conflict of interest, direct or indirect, would be caught. The GC100 have published guidance and a questionnaire to assist directors in identifying relevant conflict situations, which will be a helpful reference point. Companies may wish to ask their directors to complete this questionnaire or some form of declaration of interest so that they are fully aware of actual or potential conflict situations which will require board approval with effect from 1 October 2008.

Interests in transactions or arrangements – "transactional conflicts"

As mentioned above there is a separate regime under the 2006 Act for conflicts which relate to an existing or potential transaction or arrangement with a company (although a situation which was caught by the "situational conflicts" regime under section 175 may evolve into a "transactional conflict", if and when the company contracts or enters into negotiations to contract with the relevant third party). The law on transactional conflicts is not changing significantly. As now, directors must declare any interests to the board at the first board meeting at which the relevant arrangement is discussed. One change, which we recommend be reflected in companies' articles, is that the declaration can be made in writing (and could be in advance of the meeting) rather than at the meeting itself.

Recommended Action

Private Companies

- *Pass a shareholder resolution to allow the board to authorise "situational" conflicts*
- *Consider whether articles need to be amended*

Public Companies

- *Take steps to record and identify actual or potential conflicts*
- *Check conflicts wording in articles addresses "situational" conflicts*

Practical implications

PLCs

Under the 2006 Act a situational conflict is capable of sanction by the non-interested directors, although in the case of a public company (quoted or unquoted) the articles must expressly permit board authorisation of directors' conflicts. We have recommended that public companies adopt new articles containing this permission (or amend their existing articles) on or before 1 October 2008, if they have not already done so, so that the board can exercise its new powers from the commencement date.

Private companies (including wholly-owned private company subsidiaries)

For private companies incorporated before 1 October 2008 shareholders must pass a one-off ordinary resolution to enable the new situational conflicts regime under section 175 to apply. That resolution may be passed before 1 October 2008.

Private companies are only required to change their articles if the existing articles expressly prohibit directors' authorising conflicts of their fellow directors, which would be unusual. However, for clarity, private companies could take this opportunity to amend their articles to reflect the statutory regime whereby situational conflicts may be approved by the board, subject to whatever limitations the board decides are appropriate in the circumstances. In the case of wholly-owned subsidiaries it might be appropriate to include in the articles the ability for the parent company to override the need for board approval by directing that the conflict be approved by the parent as sole shareholder. Wording could also (depending on the constitution of the holding company) be included to pre-approve any conflicts arising as a result of a director holding multiple directorships throughout a particular group.

We can supply the necessary wording for the shareholder resolution and for the changes to the articles.

What if the Articles are not amended and/or the shareholder resolution not approved?

Until the shareholders of an existing private company pass the necessary one-off resolution, the directors will have no authority to approve any situational conflicts. In the case of public companies who have not amended their articles, similarly, the directors would have no authority to approve any situational conflict. In both cases a director with a "situational conflict" which is caught by section 175 of the 2006 Act would be likely to be in breach of that section unless he can take action to remove the conflict (which in some cases may only be achieved by his resignation from the board), because the safe harbours under the 2006 Act would not be available to him.

Travers Smith LLP August 2008

10 Snow Hill
London EC1A 2AL
T +44 (0)20 7295 3000
F +44 (0)20 7295 3500

www.traverssmith.com

We have prepared briefings on other aspects of the 2006 Act, including generally on directors' duties all of which are available at our website at www.traverssmith.com

If you would like further advice on any aspect of this briefing, or on how to prepare for the changes, please contact your usual contact at the firm.