

Conflicts of Interest – Practice guide

Recognising, declaring
and managing conflicts
of interest

“A conflict of interests can arise where two different interests overlap.”

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Disclaimer: This guide is not a comprehensive analysis of the laws concerning conflicts of interest for New Zealand organisations. Equally, it is not a substitute for legal advice for directors in conflicted situations. Our aim is to point the reader in the right direction and highlight the need for directors to be vigilant about conflicts of interest.

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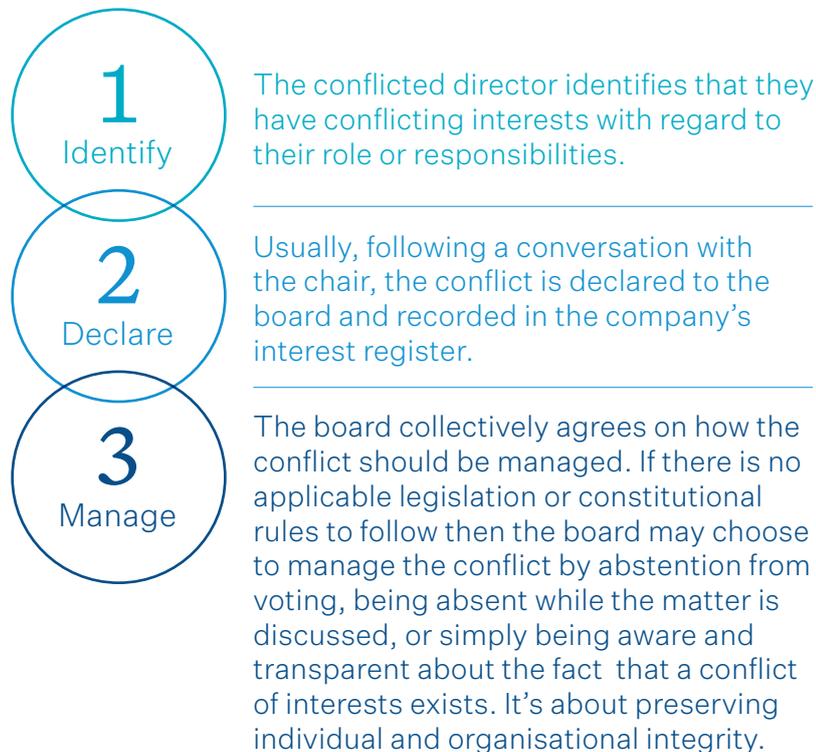
Introduction

This guide provides directors with an overview of how to recognise and manage conflicts of interest in the boardroom, along with a useful lens through which to observe and model good practice.

It's about more than just understanding legislation. Even where there is no statutory requirement to disclose interests, if the associated risks and implications are not managed, they can lead to significant consequences, including reputational damage and loss of shareholder and stakeholder value.

The existence of a conflict of interests does not necessarily mean that the director concerned has done anything wrong. What it means is that the conflict needs to be managed.

It is crucial for boards to have procedures in place to deal with conflicts of interest. The process for handling a conflict of interests or conflict of duties consists of three steps:



What is a conflict of interests?

Directors often have to make tough decisions including decisions relating to conflicts of interest or biases. For example:

- What level of board remuneration should we recommend for ourselves?
- Can I provide services to my company, beyond my role as a director?
- Will I support a company merger, knowing that the resulting restructure may cost me my position on the board?

Biases which commonly surface in board decision making include divided loyalties and self-interest. These biases can create conflict for the director and can affect professional judgement and the ability to remain impartial. Put simply, directors are often put in situations where they try to serve two interests at once.

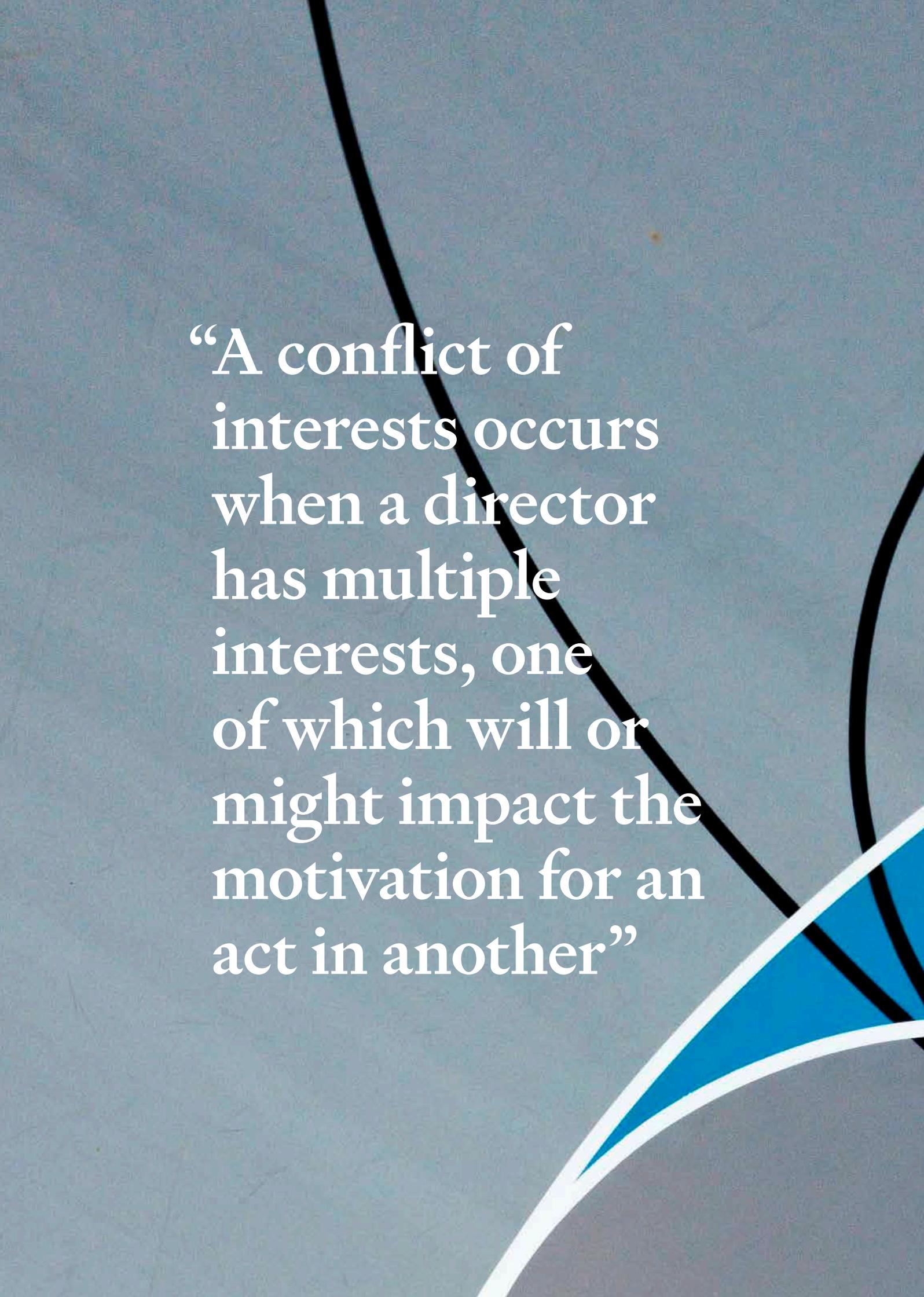
It is important to understand the New Zealand context. As a small country, New Zealand has a relatively small pool of professional directors and a highly interconnected business community. This can impact the probability of conflicts of interest occurring.

The Companies Act 1993 is clear that directors must not take improper advantage of their position and they are legally required to act in the best interests of the company. The Companies Act also contains provisions relating to the disclosure of conflicts of interests in transactions. NZX rules apply in the case of publicly listed companies.

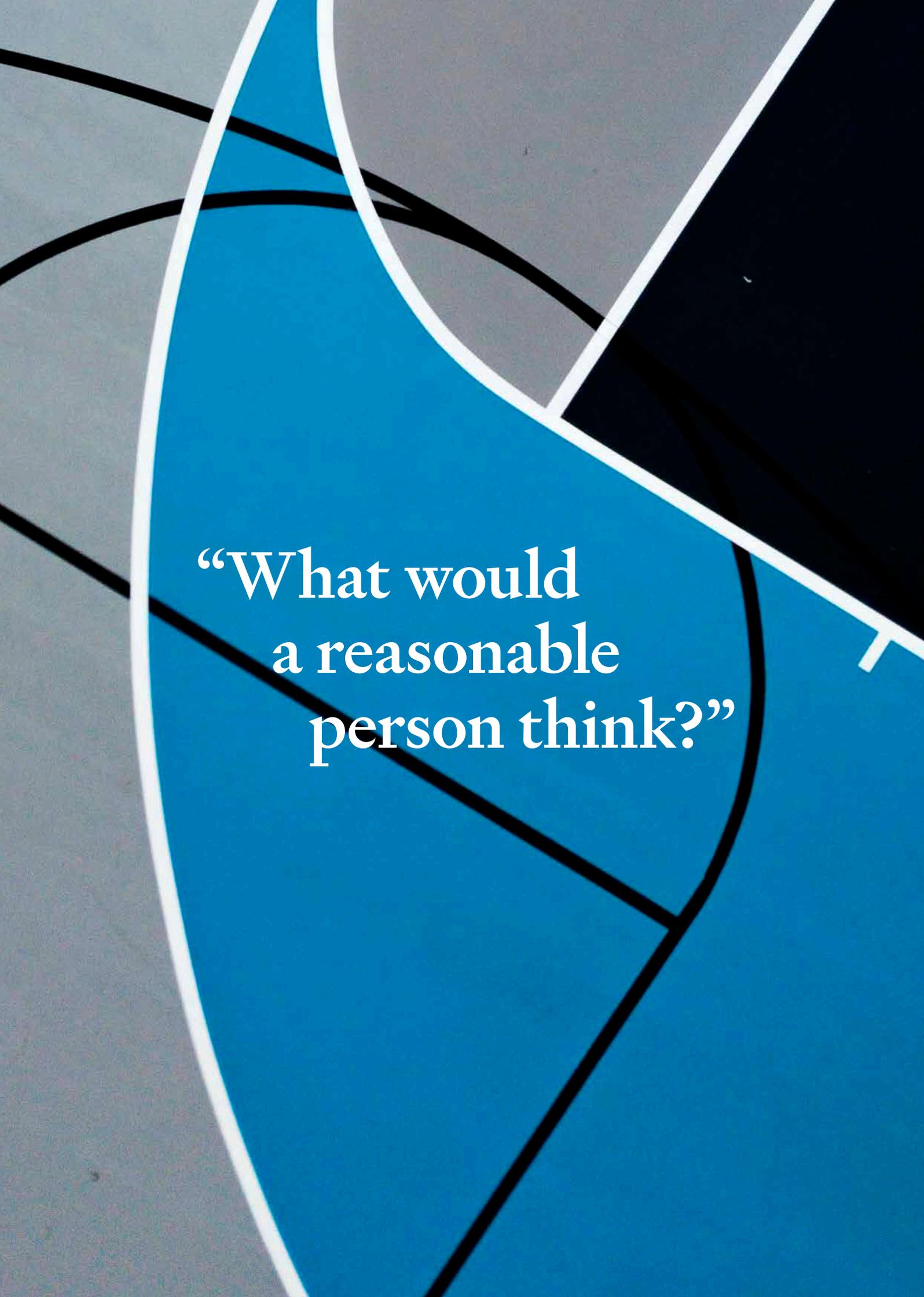
Specific legislation applies to members of the governing boards of local councils, crown entities, district health boards and education boards and bodies (school boards of trustees and tertiary education governing bodies).

Currently, there are no codified statutory obligations in the Incorporated Societies Act 1908 regarding conflicts of interest, however, the Act is being replaced with a modern statute that includes conflict of interest disclosure provisions.

However, irrespective of whether particular legislation applies, common law requires directors and other board members to carry out their duties fairly and free from prejudice.



“A conflict of interests occurs when a director has multiple interests, one of which will or might impact the motivation for an act in another”



**“What would
a reasonable
person think?”**

1 Identify

The Companies Act (section 139) defines the circumstances in which a director is “interested in a transaction.”

These include:

- where the director is a party to the transaction or has a material financial interest in another party to the transaction
- where the director or an entity they are a director of may derive a material financial benefit
- where the director is closely related to someone who may derive such a benefit or
- where the director may be otherwise directly or indirectly materially interested in the transaction.

The scope and extent of what constitutes an interest varies across the range of statutory rules concerning conflicts of interest. Directors, trustees and other fiduciaries should be aware of the legislation which applies to their organisations.

Common examples

- Directors approving transactions to which the company is a party and which directors are also a party or where directors have a direct or indirect material interest in a transaction.
- Directors using confidential information received in their capacity as directors.
- Directors owning property adjacent to the company’s property, whose value may be affected by company activity.
- Directors offering their services or acting in an advisory capacity (financial or legal) to the company, clients of the company or to a competitor.
- Directors taking up opportunities offered to but declined by the company.

One way to identify whether a conflict of interests may exist is to ask whether a “*reasonably informed objective observer would infer from the circumstances that the director’s judgement is likely to be influenced to the detriment of the company’s best interests*”. If we look closely, this tells us two things.

1. The test for a conflict of interests is an objective one. We are asking whether a reasonable observer might see a conflict.
2. That the potential for a conflict of interests is equally important to recognise. Note that the question asked is whether the circumstances make it *likely* that a director’s judgement will be influenced, not necessarily that it has been or *will* be so.



What is the difference between an actual and a potential conflict?

An actual conflict is where circumstances are or could be perceived to influence a director's judgement to the detriment of the company.

A potential conflict occurs where it is reasonably probable that in future, an actual conflict of interests will come into play.

Example:

- John is a director of Company X. Company X is currently engaged with Company Y, a supplier. John's daughter Lucy is considering applying for a role in distribution at Company Y. *While there isn't an actual conflict yet, as she has not cemented her plans with regard to the position at Company Y, if she does apply for the role a conflict will need to be managed.*

It is important to note here that an **actual** conflict is not required to present itself before the situation is treated as though it has. **Potential** or **perceived** conflicts of interest must also be addressed by a director when considering how to execute their duties.

If directors are unsure whether a conflict may exist, they should discuss the matter with the chair.



Perceived conflicts

In certain circumstances, there may be a perception of a conflict of interests where the interests come close but do not intersect. In these situations, careful management is still required. Not taking steps to manage these risks can undermine a company's reputation and hiding conflicting interests can give rise to perceptions or allegations of misconduct.

At the end of the day, shareholders and stakeholders alike should be left in no doubt that any director with conflicting interests (or potentially conflicting interests) is appropriately motivated and free from bias. Whether that bias is real or perceived is sometimes a matter of debate, but the tests remain the same:

- *What would a reasonable person think?*
- *What would this look like as headline news?*
- *Would you be willing to stake the company's (and your personal) brand and reputation on the impartiality and good faith of your decision?*



“If in doubt,
declare.”

2 Declare

Once it has been established that a director has an actual, perceived or potential conflict of interests, two things must occur.

It is the responsibility of the director concerned to declare the interest to the board. There are statutory and other rules that require disclosure in some form. Some regulations require disclosure to be in writing and recorded in the minutes of the meeting or an interests register, or both.

The board (led by the chair) is then collectively responsible for the decision regarding what action is to be taken.

Interests register

Conflicted directors of companies registered under the Companies Act must have their interests noted in the company's interests register. If there is more than one director on the board, a declaration to the board is also required. All particulars of interests register entries made during the relevant accounting period must also be stated in the company's annual report. Please see Appendix 1 for a sample interests register and disclosure template.

Maintaining an interests register as a standing board meeting agenda item is good practice.

It is also worth noting that while some organisations may not be legally bound to make declarations in writing or in a register, transparency is good governance. With the potential damage to the organisation, the imperative in a conflicts of interest situation is always, "If in doubt, declare."

| Registered companies | Crown Entities | District Health Boards (DHBs) | Education institutions |
|---|---|---|--|
| Obligations of registered companies are covered under the Companies Act 1993. NZX listing rules also apply to listed companies. | Obligations of Crown Entities are covered in the Crown Entities Act 2004. | Obligations of DHBs are covered in the New Zealand Public Health and Disability Act 2000. | Obligations of school Boards of Trustees' are covered in clause 15 of the Education (School Boards) Regulations 2020. Obligations of Tertiary Education Institution Councils are covered in clause 8, Schedule 11 of the Education and Training Act 2020. |

The background features a dark grey-blue textured surface. On the left side, there is a vertical blue gradient. Overlaid on this are several thick black lines that form a series of overlapping, curved shapes, resembling a stylized globe or a network diagram. The text is centered in the middle of the frame.

“What is in the
best interests of
the organisation?”

3

Manage

Once a real or potential conflict of interests has been identified and declared, the board has a collective responsibility to determine what course of action should be taken.

In dealing with conflicts of interests, regard should be given to legislative requirements and best business practice or convention. The IoD holds that “procedures for participating in board decisions where directors have a personal interest should ensure the protection of the legal and ethical positions of those involved while preserving the general principle that a company should be entitled to the collective wisdom of all its directors”.

Speaking broadly, in most conflict of interest scenarios, the board has two options:

1. The board agrees the conflict exists, and:
 - a. the director withdraws from the meeting for the course of discussion and doesn't vote, or
 - b. the director stays for the course of discussion and doesn't vote, or
 - c. the director stays for the course of discussion and votes.
2. The board agrees that there is no (or no significant) conflict.

It is important that boards ensure minutes accurately reflect all decisions/declarations, including the rationale for the chosen course of action. The minutes are the collective memory of the board and evidence of the decision-making process. In cases where the judgement of a board or director is questioned, they are also potentially evidentiary.

Under the Companies Act an 'interested' director is legally able to:

- attend a meeting at which the matter is to be considered
- be counted as a part of the quorum of the meeting
- sign a document relating to the transaction on behalf of the company and
- do any other thing in his or her capacity as a director in relation to the transaction.

However, some companies may also have additional procedures set out in their constitution.

NZX listing rules currently require that conflicted directors of listed companies neither be included as a part of the quorum of the meeting nor vote on the matter in question (although exceptions can apply in some circumstances).

For legal provisions relating to other types of entities see Appendix 2.

Right to participate in discussion

A classic tension in conflicts of interest scenarios occurs when the person with the best knowledge about an issue is conflicted. A director must exercise a high degree of care and thought in balancing the best interests of the company with the need to operate, insofar as is possible, free from bias.

Generally speaking, it is best practice that the conflicted directors should not participate except to the extent established by the board. Examples include stating their position, answering questions or speaking to matters of fact. At a minimum, conflicted directors should volunteer to withdraw from at least part of the meeting to facilitate full and frank discussion of the conflict matter.

It is also in the board's interests that it ensures a director is able to put their 'hand on their heart' and say they were not present in a discussion where it was not appropriate.

There may be an exception if the board consents and the conflicted director believes that the board will otherwise make an unsound decision.

In certain circumstances, requiring a conflicted director to be absent from discussion may not be realistic or practical. The Law Commission has noted that a particular conflicted individual may be key to the functioning of the organisation and have valuable information to contribute¹. In fact, a director may be appointed for their industry experience, which can result in a conflict that needs to be managed.

In such cases it is particularly important that the board is able to show it has clear and robust processes in place for managing the conflict.

Right to vote

In most circumstances it is considered best practice that even if legislation and the company's constitution permit it, a conflicted director should not vote on the conflict matter and should offer to absent themselves during the vote. The board should feel free to decline this offer (through the chair) unless the conflicted director's presence is likely to adversely affect the voting process.

Statutory provisions can differ between types of organisation, but at the end of the day they denote the *minimum* standard of response or action required from a legislative perspective. This should not be perceived as a limit to which directors may apply good governance practice and, at all times, directors should keep their duty to *act in the best interests of the organisation* top of mind.

¹ Law Commission Report: A new Act for incorporated societies, ch. 6, para 6.132 (2013)

Appendix 1

Sample templates

Interest register template:

(Useful to include in board meeting agendas/minutes for quick reference and to maintain currency)

<12/4/21> <Joe Smith>

| COMPANY | NATURE OF INTEREST |
|--------------------|--------------------|
| Grandpa Figgs Ltd. | Director |
| Blog Holdings Ltd. | CEO |
| CMPC Property | Shareholder |

Template for recording conflicts of interests:

| | | | |
|---|---|----|-----|
| Date of Disclosure | 12/4/2021 | | |
| Type of Disclosure | Conflict of Interests | | |
| Director Name | Joe Smith | | |
| Details | Family connection to tenderer for telecommunications contract | | |
| Approved by board? | Yes | No | N/A |
| Annual Report Disclosure? | Yes | No | N/A |
| If “No”, Shareholder resolution? | Yes | No | N/A |

Appendix 2

Table of legal provisions regarding board conflict process requirements

Crown Entities

Generally under the Crown Entities Act, a member who is interested in a matter relating to a statutory entity must not vote or take part in any discussion or decision of the board or any committee relating to the matter. The interested member must not sign any document relating to the entry into a transaction or initiation of the matter and does not count towards a quorum for the part of the meeting during which the matter is discussed. They must also take no part in any activity of the entity that relates to the matter in question.

District Health Boards

A member of a board who makes a disclosure under section 36 of schedule 3 of the New Zealand Public Health and Disability Act 2000, must not take part, after the disclosure in any deliberation or decision of the board relating to the transaction; or be included in the quorum for any such deliberation or decision; or sign any document relating to the entry into a transaction or the initiation of the transaction, unless the board permits otherwise.

Local authorities and committees

According to the terms of the Local Authority (Members' Interests) Act, members may not vote or take part in any discussion regarding a matter in which they have a pecuniary interest. Members are also required to disclose their interest to the committee or local authority meeting at which the matter in question is raised. This disclosure and an abstention from voting and discussion must be recorded in the minutes of the meeting.

Notwithstanding the above, the Auditor General may, by his or her own accord or upon written application by the member concerned, declare that the above should not apply where it's application would be an impediment to the transaction of business, or where it would be in the best interests of the relevant electors or district inhabitants, that the subsection should not apply.

Education institutions

The Education (School Boards) Regulations 2020 provides that a board member who has a pecuniary interest in any matter or any interest that may reasonably be regarded as likely to influence a board member must be excluded from a meeting of the board while it discusses or considers anything in relation to the matter.

In the case of conflicts occurring within the Council of a Tertiary Education Institution, the Education and Training Act 2020 states that the conflicted member shall not (unless the council decides otherwise) be present during any deliberation of the council or committee with respect to that matter; or take part in any decision of the council or committee with respect to that matter.

Trusts

The Trusts Act 2019 places a number of mandatory and default duties on trustees. One of the default duties (which must be performed by a trustee unless modified or excluded in accordance with the Act) provides that a trustee must avoid a conflict between the interests of the trustee and the interests of the beneficiaries.

References and further reading

Legal and regulatory, including particular sections used for this guide

Companies Act 1993, s131, s139 (1), s140, s144, s.145, s.148, s.161, s. 162(7) and s211 (1)e

Crown Entities Act 2004, s31 (1)c, S55, and ss62-72

New Zealand Public Health and Disability Act 2000, sch3, cl36

Education and Training Act 2020, sch 11, cl8

The Education (School Boards) Regulations 2020, cl15

Local Authority (Members' Interests) Act 1968, s6

NZX Listing Rules (1 January 2020) rule 2.10, NZX Corporate Governance Code, Recommendation 1.1

Other

Institute of Directors in New Zealand (Inc), The Four Pillars of Governance Best Practice, 2021, pg 208-214

Auditor General's *Managing conflicts of interest: a guide for the public sector, 2020*

Public Services Commission, *Conflicts of interest model standards*

Financial Markets Authority, *Corporate Governance in New Zealand: Principles and Guidelines* (2018) Principle 1: Ethical Standards

Conflict of Interest Guidance for DHBs, 2019

Te Puni Kōkiri (provides guidance on conflicts of interest)

For more information see the Governance resources section of our website iod.org.nz



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