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Conflicts of interest: Duties and consequences

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A fundamental duty of a director is to act in the best interests of the company. A key aspect of this duty is to avoid, and to deal properly and fairly in connection with matters that present conflicts of interest.

BusinessDictionary.com defines a conflict of interest as "a situation that has the potential to undermine the impartiality of a person because of the possibility of a clash between the person's self-interest and professional interest or public interest".

It is the subjective nature of this potential clash of interests that makes conflict of interest situations so difficult to deal with in practice. For this reason, as a matter of best practice, directors are advised to avoid getting into these situations in the first place.

Yet, the reality is that conflicts of interest do occur in business and, indeed, they are sometimes unavoidable.

When conflicts arise

The Singapore Institute of Directors' (SID) Statement of Good Practice 5 on Conflicts of Interest identifies the following situations that have a potential conflict of interest:

- Where directors have a direct or indirect material interest in transactions that the company enters into;
- Where directors hold positions or offices or possess property that may result in conflicting duties; and
- Where directors stand to benefit from information received by them, or opportunities are made available to them, in their capacity as directors or officers.

Some obvious scenarios that a director can, and should, generally avoid include:

- Accepting appointments on boards of companies that are trading with, or providing services to, the company of which he is a director;
- Entering into contracts with other companies in which the director's fellow board members have a substantial interest or financial stake, or who are also directors of those other companies; and

- Acting for both the buyer and seller in any capacity in a merger or acquisition.

Generally, directors should avoid situations where a reasonable person would think that there is a risk that a director's duty to the company could be adversely affected by the director's self-interest or duty to another party.

This obligation to avoid conflicts of interest, however, does not mean that a director can never contract with the company on whose board he sits, an obvious example of a situation of conflict.

If, despite the presence of a conflict of interest, the conflicted director still wishes to proceed with the transaction, both he and his board have statutory and fiduciary obligations to deal with this appropriately.

Disclosure is required

When faced with a case of conflict, the principal duty of a director is to make full disclosure. Under Section 156 of the Companies Act, the director must declare the nature and extent of his interest (including the interests of his family members) at a meeting of the directors.

Alternatively, he should send the company a written declaration as soon as practicable after the relevant facts come to his knowledge. Failure to do is a criminal offence, and the director can be held liable to account to the company for any profits made.

For instance, in *Public Prosecutor versus Yeo Geok Seng* (1999), the managing director of a company was convicted for failing to disclose his directorships and/or shareholdings in two other companies, both of which entered into contracts with his company to build a community centre.

Held accountable

In *Dayco Products Singapore Pte Ltd versus Ong Cheng Aik* (2004), the company sued its managing director Ong Cheng Aik for failing to disclose to the board or shareholders of the company that he had set up companies as nominee purchasers to buy over Dayco Products' goods, during its voluntary liquidation, at favourable prices. Mr Ong's companies then on-sold the goods at a profit.

He was held accountable to the liquidators of Dayco Products for the profits that he made. Depending on the materiality thresholds, Chapter 9 of the Listing Rules imposes additional obligations on companies listed on the Singapore Exchange (SGX): To seek the approval of their audit committees and, as required, the opinion of an independent financial adviser and/or seek independent shareholders' approval in a general meeting before the interested person transactions that amount to a conflict of interest may be executed. Such transactions must also be publicly announced.

In October 2015, SGX reprimanded a listed company, Advance SCT, its chairman and CEO Simon Eng and non-executive director Peter Choo for their breach of several listing rules, two of which related to the failure to promptly disclose and seek shareholders' approval for a payment to an associate, who was an interested person, to facilitate a securities borrowing agreement.

In November 2015, the SGX also reprimanded Sunvic Chemical Holdings for its failure to make immediate announcements or seek shareholders' approval for several interested person transactions conducted from 2013 to 2015.

Duty-bound

The above cases illustrate how directors are duty-bound to diligently and objectively scrutinise any transaction that involves a potential conflict and to ensure that the terms of the transaction are at an arm's length basis and that they do not advance the personal interest of any director at the expense of the company and its shareholders.

The regime can be quite unforgiving and a breach may result in disciplinary actions from SGX, a law suit from the company and/or a criminal charge from the authorities.

There can also be reputational impact – that will be covered in the next article.

The writer is a member of the CG Guidebooks Review Panel of the Singapore Institute of Directors. This article first appeared in BTInvest, <http://www.btinvest.com.sg/specials/boardroom/conflicts-of-interest-duties-and-consequences/>