

Directors' Conflict of Interest

by Aaron Gerard Sankar and Christie Wong Yi Shen

The Malaysian Code on Corporate Governance 2017 ("the Code") recommends that companies establish a code of conduct and ethics that should, *inter alia*, stipulate measures to deal with conflict of interest.¹ While the Code does not have legislative effect, listed companies are required, pursuant to the Listing Requirements, to include in their annual report a statement of their corporate governance practices.² Effectively, listed issuers with financial year ending on 31 December 2017 are expected to report their compliance around April 2018.³

In addition, and more importantly, the Companies Act 2016 ("the 2016 Act") embodies common law principles on the duty to avoid conflict, requiring directors to exercise their powers for the purpose of which they are conferred, and not to advance any personal interest by reason of their position as directors.⁴ The 2016 Act has increased the fines and terms of imprisonment for directors who breach their duty.⁵ Directors must, more than ever, be mindful of circumstances where conflict may arise.

Identifying conflict

Directors potentially face conflict:

- (a) when the director's duty is compromised or potentially compromised due to the director's personal interest; or

- (b) when the director's duty conflicts with another duty.

Duty and interest conflict

A duty and interest conflict arises when directors engage in self-dealing or gain profit from their position:⁶

- Self-dealing relates to situations where a director has an interest in a transaction involving the company. Therefore, a director who enters into a contract on behalf of the company with his own firm is in a position of conflict and, for this reason, the contract may be rendered unenforceable.⁷
- Directors, as fiduciaries, must not profit from their position. When directors knowingly further their personal interest or profit by taking advantage of their office, they are in breach of their fiduciary duty as a result of the conflict that has arisen between their duty and interest.⁸

Duty and duty conflict

A duty and duty conflict arises in circumstances where a director accepts engagements from more than one principal and subordinates the interest of one entity in favour of the other. Such a situation may arise when a director sits on the board of several companies.

Conflicts are also likely to arise when a director is involved with another company in the same line of business, or

1 The MCGG featured a new "Comprehend, Adopt and Recommend" (CARE) approach, encouraging companies to identify a clear thought process in practising good corporate governance: Malaysian Code on Corporate Governance <<https://www.sc.com.my/wp-content/uploads/eng/html/cg/mccg2017.pdf>>

2 Bursa Malaysia Main Market Listing Requirements (as at 1 July 2016), para 15.25

3 "SC Releases New Malaysian Code on Corporate Governance to Strengthen Corporate Culture" (26 April 2017) <https://www.sc.com.my/post_archive/sc-releases-new-malaysian-code-on-corporate-governance-to-strengthen-corporate-culture/>

4 Companies Act 2016, s 218(1)

5 As compared to s 132(2) and (3) of the now repealed Companies Act 1965

6 This is commonly known as the profiteering/no-profit rule: *Bray v Ford* [1896] AC 44 (HL)

7 *Aberdeen Rail Co v Blaikie Brothers* [1843-60] All ER Rep 249 (HL)

8 *Regal (Hastings) Ltd v Gulliver and Others* [1967] 2 AC 134 (HL)

which is in some other way a competitor of the company. It is noteworthy to mention that, unless prohibited by the internal regulations or articles of a company, there is no rule at common law preventing a director from being involved in the business of a competitor, notwithstanding an apparent conflict.⁹

The 2016 Act, however, prohibits a director from deriving benefits by engaging in any business that is in competition with the company, unless he has obtained consent or ratification at a general meeting.¹⁰ Perhaps recognising that it may not be practicable to impose an absolute restriction on directors serving on multiple boards, the Listing Requirements stipulate that a director of a listed issuer is not to sit on the boards of more than five listed companies.¹¹

While multiple directorships are not absolutely prohibited in Malaysia, a director should nevertheless be mindful of conflict, given that a director has a statutory obligation to always act in the best interest of the company.¹²

Addressing conflict

There is no universal definition of conflict, and it is difficult to detect, measure or determine when a conflict arises.¹³ Whether the no-conflict rule has been breached is a question of fact, and the best approach to determine this would be for companies to undertake a realistic assessment of the risk of conflict. Although not mandatory,

it is recommended that boards of directors adopt a conflict policy that provides measures for the board and individual directors to effectively deal with conflict situations. With such a policy in place, directors would arguably be more cognisant of potential conflicts, and enable boards to effectively resolve conflict when it does arise.

When disclosure is required

When directors have an interest in a contract or proposed contract with the company (whether directly or otherwise), they are required to declare such interest at a directors' meeting.¹⁴ Additionally, disclosure is required if a conflict may potentially arise by virtue of a director's office or property.¹⁵

A disclosure of conflict is still required, notwithstanding other directors would already have actual knowledge of the subject matter involved.¹⁶ Also, the defence of good faith, or the defence that the company would not have been affected notwithstanding non-disclosure does not exempt a director's duty to disclose.¹⁷

When ratification is required

Where a director may benefit or gain profit from his position, he is required to obtain consent or ratification at a general meeting.¹⁸

9 *London and Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd* [1891] WN 165

10 Companies Act 2016, s 218(1)(e): A director who commits an offence under this section shall, on conviction, be liable to imprisonment or a fine or to both

11 Bursa Malaysia Main Market Listing Requirement, para 15.06

12 Companies Act 2016, s 213(1)

13 *Dato' See Teow Chuan & Ors v Ooi Woon Chee & Ors (including Can One International Sdn Bhd as the 15th respondent) and other appeals* [2010] 6 MLJ 459 at 514 (CA)

14 Companies Act 2016, s 221(1)

15 *Ibid*, s 221(6), "property possessed by the director"

16 *Tan Kang Hai v Slimming Sanctuary Sdn Bhd* [2016] 1 LNS 595 (HC). For dissenting judgment, see *Tneu Beh v Tanjong Kelapa Sawit Sdn Bhd & Ors* [1995] 1 CLJ 741 (HC).

17 *Supra* n 8

18 Companies Act 2016, s 218(1)

Managing disclosure

Once disclosure is made, notwithstanding whether consent or ratification is required, the board should review and deliberate whether the conflict of interest concerned would subject the company to regulatory non-compliance or breach of legal obligation. The board is also entitled to obtain advice and recommendations from external experts which will assist the directors in determining the viability of the transaction concerned. However, during such deliberation, the interested director shall not participate or vote.¹⁹

Separately, the board could also introduce measures to address scenarios where an officer, shareholder or other director believes that a director has not disclosed a conflict of interest. For instance, if the chairman is informed that a director is conflicted, the chairman should notify the board including the director concerned and offer him an opportunity to be heard.

Conclusion

There is an increased emphasis placed on the development and internalisation of a corporate governance culture. With this comes the expectation that directors must guard against conflict of interest. It is suggested, therefore, that the board or companies adopt strategies or policies to ensure that potential conflicts are identified, declared and managed in an efficient and transparent manner. **LH-AG**

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19 *Ibid*, s 222