

# Duty to Avoid a Conflict of Interest

Issue: Has X breached a duty to [company] to avoid a conflict of interest?

**Conflict Rule:** X is not permitted to have an interest in a contract, trust or other transaction with [the company], unless X makes full disclosure of the nature of the transaction to the members of the company in general meeting, and they approve of it by ordinary resolution: **Aberdeen Railway**

Looking at the circumstances objectively, is there a 'real sensible possibility of conflict'?: **Phipps v Boardman**

**[What sort of breach is it]:**

Here, the breach would be a direct breach as X has **contracted personally with [company]**, and has obtained a direct benefit. X may be liable unless full disclosure has been given.

**OR**

Here, the breach would be an indirect breach as X is **also a shareholder, and contracts with [company]: *South Australia v Clarke***. An indirect breach will still be considered a breach of conflict. X may be liable unless full disclosure has been given.

**OR**

Here, the breach would be an indirect breach as X is **a partner in a partnership which is contracting with [company]: *Aberdeen Railway Co v Blaikie Bros***. An indirect breach will still be considered a breach of conflict. X may be liable unless full disclosure has been given.

**OR**

Here, X **receives a salary from the other company**; however this in itself will be insufficient to constitute a conflict: ***Baker v Palm Bay***. There needs to be something more than an ephemeral association and X being personally involved in both transactions would suffice: ***QLD Mines v Hudson***.

**OR**

Here, X has dealings with [company], which is contracting with [contracting company], which may **result in an indirect benefit from the contract: *QLD Mines v Hudson***. Whether this conflict is sufficient will depend on the extent of X interest. Generally the more involved X is the more likely there will be conflict: ***ANZ v Bangadilly***.

It is not necessary for conflict to cause either a loss to the company, or a profit to the director for there to be a breach: ***Gemstone v Grasso***. There are qualifications on the strictness of the application of the conflict rules.

1. As a director, X has a **duty to exercise power for a proper purpose** under general law and under s181(1)(b) CA.

- a. The purpose of the power granted was to... (*Howard Smith*) eg: issue shares
- [Look to the constitution for the purpose of the power being granted or limits on the power – does it authorise what was actually done?]
  - Unless there is a restriction on the power to issue shares in the Constitution, the Board and directors are generally free to issue shares: (s124(1)(a)RR) but this must be done for a proper purpose.
- b. Here, X would argue that the power was exercised to:
- **Raise capital required by company:** It has been held that this is a proper purpose, but it would be too narrow a purpose to be the only reason to issue shares: *Howard Smith*
  - **Secure the financial security of company:** It has been held that this is a proper purpose: *Harlowe's Nominees*.
  - **Because it was a good commercial opportunity to issue shares:** It has been held that this is a proper purpose: *Pine Vale Investments v McDonnell*.
- c. However [plaintiff] would argue that the:
- **Power/act manipulates voting power in favour of one shareholder or group:** This has been held to be an improper power: *Whitehouse*. Shares are **not** supposed to be issued with a motive to defeat the voting power of existing SH by creating a new majority SH group (*Howard Smith*)
  - **Power/act destroys a majority interest:** If the directors are motivated by a desire to relegate a majority interest into a minority power by issuing more shares it will be held to be an improper power: *Ngurli v McCann; Howard Smith*.
  - **Power/act is used to avoid a take over bid.**
- d. Applying the 'but for' test – would the power have been exercised BUT FOR the improper purpose? (*Whitehouse*)

**[IF purpose to secure the financial security of company]:**

- Here, [directors] have **pursued other means of raising capital**, such as loan capital or selling assets. This evidences that the financial factor was main reason behind the share issue, and the issuing would have occurred even without the effects on the majority voting control: *Howard Smith*. **OR**
- Here, [directors] **have not pursued** any other means of raising capital, such as loan capital or selling assets. This would indicate that **but for the improper purpose** the shares would not have been issued: *Howard Smith*.

**[IF power destroys a majority interest]:**

- Here, it will be relevant that the directors support the majority voting power which shows an intention to carry out the issuing despite the affect on majority power.

### **[If power avoids a takeover bid]:**

- Where takeover bid is unsatisfactory, directors should offer alternative at a better price where in interests of company as a whole: *Darvall*. ALSO, if an issue of shares is to avoid a take over bid, this is not authorised BUT if it is in the BF BI of Company and Company's interests are furthered, then no breach of duty.

Conclude: It is likely the court will determine that the power was/was not used for a proper purpose. This will/will not amount to a breach of director's duties.

If there is a breach, X's action is voidable at the instance of company.

X may also be liable under a breach of s181(1)(b), which mirrors the general law above, requiring directors to act for a proper purpose.

## **Corporations Act Remedies**