MINORITY SHAREHOLDERS WATCH GROUP

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FIDUCIARY DUTY OF A DIRECTOR

AVOIDING CONFLICT OF INTEREST

A DIRECTOR owes a fiduciary duty to the company on whose board he sits. The fiduciary duty of a director is threefold. Firstly, there is a duty to act in the best interest of the company. Secondly, there is a duty to avoid conflict of interest between personal and company matters. And finally, there is a duty to refrain from any secret profit out of the director position.

None of the above duties seems to address the question of whether being a director in a competing company is a breach of the fiduciary duty. There seems to be no explicit prohibition in law. As such, it is perhaps timely for some regulatory requirements to address this issue explicitly for the avoidance of doubt.

There are general principle-based practices to avoid conflicts of interest. There are also listing requirements for conflict-of-interest situations to be deliberated by the audit committee and to make recommendations to the board.

For this to take place, the situation needs to be realised as a conflict-of-interest situation. But what happens is that some audit committees do not recognise this as a conflict of interest. Or some audit committees are not notified to address this issue.

Here, the internal audit function, the assurance provider of governance, controls and risk, can play their part and highlight the issue to the audit committee for deliberation. The company secretaries can also advise the chairman and the board to address such issues.

When a director is on the boards of competing companies, they must ensure three things.

Firstly, they must ensure that they do not do, or purport to do, anything which may adversely impact, or conflict with the interests of, either company.

Secondly, they must ensure that they act in good faith in the interest of each principal (as though they were the only principal) without intending to prejudice the other. Good faith requires the fiduciary to disclose the conflict of interest, if any, and consequently obtain the informed consent of their principals.

These are easier said than done. One is reminded of the parable of a servant trying to serve two masters.

It states that "No one can serve two masters, for either he will hate the one and love the other; or else he will be devoted to one and despise the other".

In the conflict-of-interest context, he will prefer one company to the detriment of the other.

And thirdly, they must ensure that they make good any undue advantage gained by them, or a related party (which would include a company on whose board they serve).

These broad principles that a director must adhere to when acting on the board of a competitor are fairly clear. However, they are difficult to implement in practice. For example, while a director may maintain confidentiality regarding the operations of one company, it is possible that they will apply knowledge gained from their experience with the other company to make decisions.

You cannot unknow what you already know. In fact, if you do not share what you know, you may very well be breaching your fiduciary duty to act in the best interest of the company in which you are sitting.

The counter argument for allowing directors to sit on the boards of competing businesses is that they can bring their knowledge and experience in relation to the business for the benefit of the company. But at what cost?

That knowledge and business would have been acquired while sitting as a director on the board of a competing company. Surely, there is something not so right in such a scenario. Surely it strikes at the heart of probity.

Additionally, situations may arise where an action taken by a particular company and approved by its board will, by definition, adversely impact the competitor on whose board the director serves (e.g., decisions on pricing, strategy and marketing).

Policing potential conflicts that a director on the boards of two rival companies may face is likely to be difficult to prove.

Given this and the fact that a director holds a position of probity that warrants their wholehearted loyalty to the shareholders, a director should be prohibited from acting on the board of a company that competes with a company on whose board they already serve.

For a start, in the interest of good corporate governance, boards should formulate a policy to cover such instances. The benefits of having a policy that prohibits such competing director positions have its merits.

Otherwise, there may be a constant need to recuse oneself from a board meeting as the discussion involves a conflict-of-interest situation which will entail the conflicted director leaving the meeting for a while and rejoining later several times during the meeting — hardly conducive for a cohesive and efficient board meeting or for the effective contribution by the conflicted director.

In fact, in such instances, the very contribution of the director to the board will become questionable.

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