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Conflicted Directors

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Framework

Imagine This.....

- You're a director of a funds management company (Target)
- The company (Target) is the RE of the Global Growth Fund (GGF), specialising in investment in global equities
- The company's (Target's) parent is acquired by Bidder
- Following scheme implementation, it's proposed that the company (Target) be replaced as RE of GGF by another company in Bidder's group

The all Important Point of View

- Bidder?
- Outgoing RE?
- Incoming RE?

Or a director of one (or more) of them?

The background features a dark blue field filled with numerous glowing, semi-transparent cubes. Some cubes are brightly lit with a cyan or light blue glow, while others are dimmer or have a warm orange-red glow. The overall effect is a sense of depth and digital complexity. In the upper portion, there are soft, out-of-focus bokeh lights in various colors, including blue, orange, and purple, creating a dreamlike atmosphere.

Why it Matters



with great power comes great responsibility

Peter Parker



Why it Matters

- Entire economy is based on the notion of stewardship / guardianship – control over assets without an interest in the assets
- Strict rules have developed
- Fiduciary: a person who is in a position of trust or confidence, must act in the interests of another person and are held to the highest standard of conduct



What's a Conflict?

What's a Conflict?

- Duty v duty – Duty as director of Company A versus duty as:
 - Director of Company B
 - Employee of Company B
 - Trustee of Trust C
 - with whom Company A is transacting
 - Or a statutory duty
- Duty v interest - Duty as director of Company A versus interest as counterparty or investor in counterparty (eg personal interest)
- But not interest v interest?

The background features a dark blue field with numerous glowing, semi-transparent cubes in shades of cyan and orange. These cubes are arranged in a perspective that creates a sense of depth. Interspersed among the cubes are soft, out-of-focus bokeh lights in various colors, including blue, orange, and purple, which add a dreamlike, ethereal quality to the scene.

Conflict Rules

Conflict Rules – Director Duties

Director duties:

- Act in good faith in the best interests of shareholders (section 181 CA)
- Not use position (section 182 CA) or information (section 183 CA) improperly
- Avoid conflicts (family, friends and "affiliates") (fiduciary duty)
- Disclose material personal interest (MPI) (section 191 CA) and not be present during discussion or vote if have an MPI (section 195 CA)
- If director of RE, act in the best interests of members (and if conflict with shareholders' interests prefer members) (section 601FD(1)(c))

Conflict Rules – RE / Trustee Duties

- RE / trustee duties
- Act in the best interests of members (and if conflict with own interests prefer members' interests) (section 601FC(1)(c))
- Avoid conflicts (trustee duty)
- Not use information improperly (section 601FC(1)(e))
- Ensure have adequate conflict management arrangements (section 912A(1)(aa))

Test for Conflicts

Common sense – everyone can have a view, don't need a law degree:

- Might be influenced by personal interests or external influences when making decisions?
- Can you exercise objective or impartial judgement in relation to the relevant matter?
- Real and sensible possibility of a conflict considered objectively

Tests for Conflicts (Less Common)

- *Kerrigan v The Crown* (HC) 1997: [all constitutional lawyers know this case] (it's the vibe of the thing)
- The "pub" test - collective opinion of everyday Australians on the conduct and reputation of public figures
- The "smell" test - informal method for determining whether something is authentic, credible, or ethical, by using one's common sense or sense of propriety

Conflict Rules – Related Party Transaction (RPT) Provisions

- Chapter 2E:
 - Prohibition on public company or RE
 - Providing financial benefit
 - To a related party
- unless exemption applies
ASX listing rules – LR 10.1 (acquisition or disposal of substantial asset from or to a person in a position of influence) and LR 10.11 (issue of securities to related party)

The background features a dark blue field with out-of-focus, colorful bokeh lights in shades of orange, yellow, and cyan. Overlaid on this are several semi-transparent, 3D-style rectangular blocks in various colors (blue, green, orange) that appear to be floating or arranged in a grid-like pattern.

Conflict Management Process

Observations on Conflict Management

- Rules are technical and results binary
- But conflicts tend to be messy
- Importance of mechanically working through rules
- Managing up front much easier than after the fact
- Process and due and reasonable consideration and management is key
- Conflict not necessarily fatal – about management not necessarily prohibition
- Disclosure critical and, in most cases, worst result is approval requirement

Overview: Conflict Management Framework

- Identify:
 - Transaction
 - Parties and capacities
 - Duties and to whom owed
 - Decision-makers, decisions and decision-making process
 - Interests of all stakeholders
 - Conflicts
 - RPTs
- Determine the process (including disclosure and approval if required)
- Manage the process

Scenario One – Executive Director of Outgoing RE POV

Ben (executive director) has built the Global Growth Fund (GGF) into an AU\$10 billion flagship fund and is Australia's pre-eminent global equities investment manager – the Incoming RE is not - conflict or no conflict?

Ben has been granted performance rights in the GGF under an LTIP.

Scenario Two – NEDs of Outgoing RE POV

The NEDs of the Outgoing RE have formed the view that global equities is a non-core specialisation for the Outgoing RE:

- Options?
 - Wind-up GGF?
 - Sell “management rights” / replace Outgoing RE?
 - Appoint external manager?
 - Scheme?

Conflict or no conflict?

Scenario Three – Outgoing RE’s POV

The Outgoing RE’s chair is approached by Opportunistic Investments which proposes it take over as the RE – conflict?

They offer Bidder – Not Outgoing RE? – a facilitation fee – conflict?

Plan B - Opportunistic proposes GGF be [AMP China Growth Fund 253E] wound up – conflict?

Use of Framework

- Use the framework for all parties
- Today we will focus on the Outgoing RE because conflict issues more likely to arise for it and its directors

In the table below, the sections in orange highlight are more contentious.

Step One – Identify the Transaction

- Bidder has acquired Outgoing RE
- Proposed that Outgoing RE ceases to be RE of GGF and replaced by another subsidiary of Bidder (Incoming RE)
- Generally, members remove and appoint RE
- ASIC relief for related REs - terms of relief

Step Two – Identify the Parties, Capacities and Duties

Entity / Person (Capacity)	Duty	Duty Owed to
Outgoing RE Director: <ul style="list-style-type: none"> • Generally • Of public co • Of an RE (as director) 	<ul style="list-style-type: none"> • Act in best interests and avoid conflicts • Disclose material personal interests, don't vote • Act in best interests of members and prefer over shareholders' interests 	Shareholders Statutory Scheme members
<ul style="list-style-type: none"> • Of an RE (as director) 	<ul style="list-style-type: none"> • Act in best interests of members and prefer over shareholders' interests 	Scheme members
Outgoing RE (RE capacity)	<ul style="list-style-type: none"> • Act in best interests of members and prefer over shareholders' interests 	Scheme members
Incoming RE (personal)	<ul style="list-style-type: none"> • AFSL holder duties, RE duties from appointment 	Scheme members
Incoming RE Director: <ul style="list-style-type: none"> • Generally • Of public co (as director) 	<ul style="list-style-type: none"> • Act in best interests and avoid conflicts • Disclose material personal interests, don't vote 	Shareholders Statutory

Step Three – Identify Decision-Makers and Decisions

Decision-Maker	Decisions
Outgoing RE Board	<p>Substantive - best interests of members to:</p> <ul style="list-style-type: none"> • Retire (DD - impact on Fund (eg change of control, tax, transfer of assets)) • In favour of Incoming RE (DD - appropriate) • On terms in DORA • Conflict matters - Board composition / IBC? <p>Process / Facilitative</p> <ul style="list-style-type: none"> • Advice (tax, regulatory and legal) and DD • Apply for relief • Negotiate and enter into DORA • Give notice to members
Incoming RE Board	Accept appointment (DD - commercially advantageous and legal liability limited) and on what terms
Fund members	To call for postal vote

Step Four – Identify Interests of Stakeholders

Party/Stakeholder	Direct Interest	Indirect Interest
Outgoing RE directors: Executive	Nil? (assume no LTIP)	Employment status and influence of Bidder? MPI?
Non-executive	Viability of NED role with Outgoing RE?	
Outgoing RE	Loss of fees and FUM	Self-interest of Bidder
Incoming RE directors: Executive	Nil? (assume no LTIP)	Employment status and influence of Bidder? MPI? Improve viability of NED role
Non-executive	Nil?	
Incoming RE	Gain fees and FUM	Self interest of Bidder
Bidder	Loss / gains of subs offsetting and neutral	Synergies (savings) and strategy

Step Five – Identify Conflicts

Party	Duty	Conflicting Interest	Potential Conflict
Outgoing RE	Best interests of members	Interests of Bidder	Possibility that retaining Outgoing RE better option than Incoming RE
Outgoing RE Directors*	Best interests of members	Interests of Bidder Self-interest of Outgoing RE Directors	As above Interest in retaining FUM and role as director
Incoming RE	AFSL – efficient Best interests of shareholders		
Incoming RE Directors*	Best interests of shareholders		

Advantages v Disadvantages of Change of RE

From the POV of members:

- Advantages / benefits in changing RE
- Potential disadvantages / benefits in changing RE
 - Taxes and stamp duty – opinion that no adverse impacts
 - Transfer of assets – exiting custodian?
 - Costs of transaction and implementing
 - Change of control triggers and pre-emptive rights?
 - Decrease in efficiency
 - Loss of familiarity

Step Six – Consider RPT Provisions

Outgoing RE:

- Providing financial benefit (DORA) as RE to a related party?
- On arm's length terms?

Incoming RE:

- Providing financial benefit (DORA) to a related party?
- Once becomes RE?

Determine the Process

- Outgoing RE drive process – obtain written legal advice on conflicts and steps plan
- Two management deal teams for Incoming RE v Outgoing RE – Adopting transaction specific conflict management protocols:
 - Separate legal representation
 - DD on a reliance basis
- Outgoing RE – IBC of NEDs?
- Management paper outlining benefits for members – from Incoming RE
- Preparation and verification of notice to members

Manage Process

- Consider if steering committee needed with representatives from Incoming RE and Outgoing RE
- ASIC relief
- Member engagement

Example Two: Fund Merger and IBCs

- Much more involved process than change of RE
- More heavily reliant on tax advice and structuring (more fun for advisers) – trust scheme, wind up and in specie distribution of units in new fund, buy-back offer with scrip consideration or stapling
- Member approval very likely
- PDS-like disclosure very likely
- Potential for requirement for independent expert report
- Disclosure, member approval and independent expert will assist in addressing conflict issues
- Valuation and recommendation issues will need to be considered

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Recap

Recap

- Know the rules: disclosure and prohibitions
- Identify duties and conflicts
- Determine process – the key is early identification of issues, establishing proper processes and appropriate form of management
- Then actually manage the process!

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