

THE SLIPPERY WORLD OF CORPORATE CONFLICTS

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“Corporate ethics”. Some believe this term has become an oxymoron. With recent corporate scandals costing investors billions of dollars, there is understandable mistrust of corporate managers.

This is a gross over-generalization, of course, and unfair to almost all men and women who participate in the business world. Even for businesses that do not have billions of dollars of capitalization, however, the effects of Enron, Worldcom and others have created a new world of corporate governance.

In many cases, those governance issues involve conflicts of interest, particularly on the part of company directors. Everyone seems to agree that conflicts of interest are to be avoided. So why does this issue keep cropping up?

First of all, a conflict of interest is not necessarily illegal, or even a bad thing. While this might seem odd, it arises because there is no standard definition of “conflict of interest”.

The phrase invokes images of a person being tugged in more than one direction and making a decision that unfairly acts to somebody’s detriment. That word “detriment” might be the most important one of all. If nobody is hurt, directly or indirectly, a conflict of interest can actually be useful.

For example, directors are often asked to sit on boards because they have certain experience or knowledge from other ventures. Anyone running a technology company would find it invaluable to enjoy the expertise of a director who has participated in the same industry, and has learned through the school of hard knocks. This is a classic case of a beneficial conflict of interest. Sure, the other board member might sometimes be competing for similar customers, but at least it is in the open.

This brings in the second important part of conflicts of interest: disclosure. Our culture frowns upon people using secret information for their own personal advantage. In fact, some of our institutions are built around avoiding profits from such information. The insider trading rules in our securities laws are a good example of this.

Our legal system does not prohibit conflicts of interest so much as it prohibits *undisclosed* conflicts. The rationale is that we cannot stop all conflicts, nor would we want to. In fact, we cannot even define in advance all possible conflicts. Consider the never-ending debates among lawmakers over political codes of ethics. No matter how carefully drawn the code is, someone will accidentally or intentionally fall into a loophole. Conflicts are similar.

Disclosure allows a self monitoring system that will deal with conflicts in the most practical manner possible. There are many ways to do it, but a common method is to have a director declare they have a conflict, and then excuse him or herself from the discussion and/or vote.

This is by no means a perfect system. The ambiguity of human relationships still applies. A conflicted director, for instance, might “bully” the others into submission. The other directors also have to be constantly on the watch for conflicts, and deal with them firmly when they arise. Too often, people will dodge the issue to avoid creating a scene.

Some conflicts of interest are too serious for disclosure alone. The issue might be highly sensitive, or it might be doubly important to avoid not only a conflict, but the *appearance* of a conflict. In such cases, complete avoidance may be the only remedy.

Conflicts of interest are a perfect example of how laws and rules can only do so much. Many organizations have the most comprehensive rules possible, but if they are not enforced, they might as well not exist. Conversely, many businesses are steeped with such a high degree of trust and good faith that specific rules are never drafted. No matter where a particular business fits, though, it should always be on the lookout for conflicts, and should regularly review its practices to ensure that they are working for the benefit of all.

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