

CONFLICTS OF INTEREST

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THE CONFLICTS RULES THAT APPLY TO CROWN ENTITIES

According to the Auditor-General's good practice guide *Managing conflicts of interest: Guidance for public entities*¹ a conflict of interest arises where:

A member's or official's duties or responsibilities to a public entity could be affected by some other interest or duty that the member or official may have.

The Guidance notes that the other interest might exist because of:

- The member's or official's own financial affairs;
- A relationship or other role that the member or official has; or
- something the member or official has said or done.

So far as Crown entities are concerned, a Crown entity's status as part of the executive, means that the entity and its members and employees are subject to legal rules that may impact on its decision making where a conflict of interest has arisen under both the Crown Entities Act 2004 and the common law. In short, the outcome of the Act and the common law, is that in some cases where a decision of a Crown entity is tainted by a conflict of interest, the associated transaction entered into by the entity may be found to be invalid.²

Short of this, even if a transaction is not invalid there may be adverse publicity where an action of the entity is tainted by a conflict.

This paper considers the mix of statutory and common law rules which apply to Crown entities in relation to a conflict. While it is generally restricted to a discussion of the statutory provisions relating to statutory Crown entities, in general the principles are of wider application.

CROWN ENTITIES ACT PROVISIONS

(a) Identifying conflicts

The conflicts provisions in the Crown Entities Act apply only to board members of statutory entities, and do not impact on employees. Board members have a fiduciary relationship with the statutory entity of which they are members and the conflicts provisions in the Act are consistent with the rule of the law of equity that a person in a fiduciary position is not allowed to put himself or herself in a position where his or her interest and duty conflict.³

Initial disclosure

The duties of a potential board member in fact start before appointment, with a requirement in section 31 of the Act to disclose to the responsible Minister of the statutory entity the nature and extent (including monetary value, if quantifiable) of all interests that the person has at that time, or is likely to have, in matters relating to the entity. However, in recognition of how difficult such disclosure may be in relation to some statutory entities, the Act does not make disqualification for failure to comply with this requirement automatic. Rather, the board must notify the responsible Minister of a failure to comply with section 31(1) as soon as practicable after becoming aware of the

¹ Controller and Auditor General, Wellington, June 2007, 5.

² This was dramatically illustrated in the original High Court decision in *Diagnostic Medlab Ltd v Auckland District Health Board* [2007] 2 NZLR 832 where Asher J ruled that a multi-million dollar contract entered into by the Auckland District Health Boards was invalid.

³ *Bray v Ford* [1896] AC 44.

failure.⁴ The Minister may then remove the member if the breach meets the requisite standard for the type of entity, and the Minister considers such removal appropriate.

Meaning of "interested"

The pre-appointment disclosure regime in section 31 does not explicitly tap into the other conflicts provisions in the Crown Entities Act, but is likely to be interpreted by reference to them. In this regard, the definition of a "conflict of interest" in the Crown Entities Act is rather more prescriptive than the broad description in the 3 bullet points in the Auditor-General's Guidance (as set out in the first paragraph of this paper), but the result is similar to the first 2 bullet points. Section 62(2) of the Crown Entities Act provides that a person is "interested" in a matter for the purposes of the Act if he or she:

- (a) may derive a financial benefit from the matter; or
- (b) is the spouse, civil union partner, de facto partner, child, or parent of a person who may derive a financial benefit from the matter; or
- (c) may have a financial interest in a person to whom the matter relates; or
- (d) is a partner, director, officer, board member, or trustee of a person who may have a financial interest in a person to whom the matter relates; or
- (e) may be interested in the matter because the entity's Act so provides; or
- (f) is otherwise directly or indirectly interested in the matter.

A "matter" is defined in section 62(1) as meaning –

- (a) a statutory entity's performance of its functions or exercise of its powers; or
- (b) an arrangement, agreement, or contract made or entered into, or proposed to be entered into, by the entity.

However, under section 62(3), a member is not interested in a matter–

- (a) only because he or she is a member or an officer of a wholly-owned subsidiary of the entity or of a subsidiary that is owned by the entity together with another parent Crown entity or entities; or
- (b) because he or she received an indemnity, insurance cover, remuneration, or other benefits authorised under the Crown Entities Act or another Act; or
- (c) if his or her interest is so remote or insignificant that it cannot reasonably be regarded as likely to influence him or her in carrying out his or her responsibilities under this Act or another Act; or
- (d) if the entity's Act provides that he or she is not interested, despite this section.

Paragraphs (a) to (e) of the definition of "interested" in section 62(2) are self explanatory. Paragraph (f) is designed as a catch-all for pecuniary interests that may not fall within the relationships in paragraphs (a) to (d) and for non-pecuniary interests which could be seen to influence a member's

⁴ Section 31(2) Crown Entities Act

exercise of his or her duties. In that regard paragraph (f) would catch at least matters where a member had a close relationship or involvement with an organisation that is interested in the matter.

The breadth of the definitions of “matter” and “interested” means that, if interpreted widely, board members, many of whom are appointed because of explicit knowledge or experience in a Crown entity’s sector of operation, could be permanently in a position of conflict. However, it is now clear that this is not the case.

The equivalent definition of a “transaction” in section 6 of the New Zealand Public Health and Disability Act 2000 was recently considered by the Court of Appeal in *Lab Tests Auckland Ltd v Auckland District Health Board and Others*⁵ In that case, the Court clarified that, despite the breadth of the test of a “transaction” in that legislation,⁶ whether a conflict exists is essentially a factual question which must be looked at a point in time. Thus the Court of Appeal found the High Court was incorrect to have taken the view that Dr Bierre, a member of the Auckland District Health Board, had a conflict in relation to all the Board’s dealings with community laboratory testing just because he may have had a conflict at two points in time in relation to specific matters to do with community laboratory testing. The question was, when the “actual” conflict arose, was it dealt with correctly in terms of the legislation?

(b) Consequences of being interested

Disclosure

The Auditor General’s Guidance on Conflicts notes the need to have policies and procedures for the identification and disclosure of conflicts of interests. So far as board members of statutory Crown entities are concerned, sections 63 and 64 of the Crown Entities Act require conflicts of interests to be disclosed in an interests register and to the chairperson, (or in default of the chairperson to the deputy chairperson, or in default of both the chairperson and deputy chairperson, to the responsible Minister). When a conflict of interest arises the Act requires the following matters to be disclosed in an interests register-

- (a) the nature of the interest and the monetary value of the interest (if the monetary value can be quantified); and
- (b) the nature and extent of the interest (if the monetary value cannot be quantified).

Although section 63(2) provides for pre-disclosure via a “general notice of an interest in a matter”, it is worth noting that such notice is unlikely to be sufficient to constitute disclosure if an actual conflict arises. Section 63(2) and (3) provide:

- (2) A general notice of an interest in a matter relating to the statutory entity, or in a matter that may in future relate to the entity, that is disclosed in accordance with section 64 is a standing disclosure of that interest for the purposes of this section.
- (3) A standing disclosure ceases to have effect if the nature of the interest materially alters or the extent of the interest materially increases.

This makes it clear that a general disclosure does not satisfy the test for disclosure where circumstances change.

⁵ [2009] 1 NZLR 776 (CA). Consequent to this judgment, Diagnostic Medlab Ltd applied unsuccessfully for leave to appeal to the Supreme Court. The Supreme Court declined the application on the basis that the Court of Appeal’s decision ultimately turned on its own facts and there was no arguable question of public or general importance raised that was likely to be determinative of the proposed appeal, [2009] NZSC 10.

⁶ Which like the Crown Entities Act definition of “matter” includes “the exercise or performance of a function, duty, or power of the DHB” as well as “an arrangement, agreement, or contract to which the DHB is a party” or “a proposal that the DHB enter into an arrangement, agreement, or contract.”

On the relationship between “general” and “specific” disclosure, the Auditor General’s Guidance goes so far as to say that:

An interests register can help public entities identify when a conflict of interest might arise so that steps can be taken to manage it. However, such a register is no more than a tool to help members, officials, and public entities in their efforts to identify and manage conflicts of interest before they create problems. An interests register is not a substitute for disclosing and dealing with specific conflicts of interest as and where they arise. Public entities need to ensure that members and officials understand their ongoing obligation.

Thus, in the *Lab Tests* case, the Court of Appeal found that Dr Bierre’s pre-election disclosure that he was a pathologist who might have cause to contract with the District Health Board “because all pathologists working in the area are either employed by the ADHB or have a contractual relationship with the ADHB” was possibly sufficient, although it would have been preferable if he had disclosed at that point that he was sounding out the DHB about establishing a boutique laboratory for which he intended seeking funding from the DHB of which he was a member.

However, the disclosure was insufficient “once he had decided to undertake the steps necessary to enable him to put such a proposal to the ADHB”. The Court went on to say that by that point, even if the ADHB had not previously been considering community laboratory services, Dr Bierre was “interested in a transaction” and the more explicit disclosure required by the Act should have been made. This was despite the fact that Dr Bierre was relatively open about the fact he had a conflict. The Court said at para 185:

So the criticism of Dr Bierre at this point is not that he did not disclose that he had an “interest in a transaction”, but that he did not do so soon enough and was, in any event, not sufficiently explicit about the nature of his interest. The criticism of the board is, first, that they (or some of them) did not find out from Dr Bierre exactly what his conflict of interest was and second, that even though Dr Bierre had declared a conflict of interest, the board did not follow the process set out in cl 36. Rather, the board simply allowed Dr Bierre to participate in their deliberations.

Management

Section 66 of the Act Crown Entities Act deals with the situation where a conflict has arisen. It provides that a board member of a statutory entity who is “interested” in a matter involving a statutory entity—

- (a) must not vote or take part in any discussion or decision of the board or any committee relating to the matter, or otherwise participate in any activity of the entity that relates to the matter; and
- (b) must not sign any document relating to the entry into a transaction or the initiation of the matter; and
- (c) is to be disregarded for the purpose of forming a quorum for that part of a meeting of the board or committee during which discussion or decision relating to the matter occurs or is made.

The provision appears to leave open the possibility that board members may attend a board meeting at which a matter in which they are interested is being considered. Nor is it clear that an interested member is not entitled to receive information from the entity about the matter in which he or she is interested. However, nevertheless, the Auditor General’s Guidance suggests that in some circumstances it may be that members will choose not to exercise these rights and to absent themselves completely from the Board’s consideration of a matter in which they are interested.

Permissions to act

The conflicts of interest provisions in the Crown Entities Act mean that it is possible that in some cases a board may be left without a quorum. However, section 68 of the Act provides that a chairperson, deputy chairperson, or in the last instance the Minister, may give permission for a board member to act if "satisfied that it is in the public interest to do so".⁷

Thus, in a situation where a quorum cannot be formed, the relevant person could give a permission under section 68 to allow the conflicted member to vote on a motion to delegate the matter to a committee or other authorised person. This provision may be particularly important for a Crown entity that is a corporation sole, which if they are interested in a matter before them could otherwise be powerless to act.

Consequences of failure to comply with the Act's conflicts provisions

Avoidance

The consequences of breach of the conflicts provisions of the Crown Entities Act are set out in section 67. Section 67(1) requires the Board to disclose the breach to the responsible Minister as soon as practicable after it becomes aware of it, while section 62(2) provides that a failure to comply with the obligation to disclose an interest under section 63, or an act of a member in breach of section 66, does not affect the validity of an act or matter under the Act.

However, while the act in breach of the conflicts provision may not automatically lead to invalidity of an action under the Crown Entities Act, sections 69 to 72 of the Act go on to say that where the act was a natural person act⁸ it may be avoided by the entity within 3 months of the affected act being disclosed to the responsible Minister, if the entity did not receive fair value. The entity is presumed to receive fair value in respect of an act that was done by the entity in the ordinary course of business (s70(1)). There is a protection in s72 for a bona fide purchaser for value, that is, a person who has acquired title from a person other than the entity without knowledge of the circumstances which tainted the original matter.

Section 67(3) provides that subsection (2) does not limit the right of a person to apply for judicial review.

Judicial review

The *Lab Tests* case was such an action for judicial review. There, counsel for Diagnostic Medlab Ltd argued that the decision of the Auckland Regional District Health Boards on a tender should be invalidated by the court, among other things because the DHBs had failed to properly deal with Dr Bierre's conflict of interest. Asher J in the High Court agreed, finding compliance with the Crown Entities Act provisions relating to conflicts and use of insider information, would have been insufficient to meet the requirements of administrative law. However, the Court of Appeal allowed Lab Tests' appeal. That court, having found the conflicts provisions in the NZPHD Act to have been breached, went on to consider how the failure to properly disclose an interest and formally follow the procedures in the NZPHD Act had affected meetings of the Board that had been attended by Dr Bierre, and found that in fact the breach did not impact on the final tender result which was challenged by Diagnostic Medlab Ltd.

According to the Court of Appeal, a separate conflict of interest arose when Dr Bierre decided that he would attempt to put together a consortium to respond to the ARDHB's request for tender and shortly after this Dr Bierre took leave of absence from the Board and did not participate further in any

⁷ Note, there may also be other situations when it may be in the "public interest" for a member to be permitted to act. The commentary in the Controller and Auditor-General's *Guidance for members of local authorities about the law on conflicts of interest* on the approach the Auditor-General takes to permitting members to act under section 6(4) of the Local Authorities (Members' Interests) Act may be useful in determining other matters that might be considered to be in the public interest (Controller and Auditor General, Wellington, June 2007).

⁸ The definition of "natural person act" appears in section 24.

discussions or decisions relating to the tender. It is apparent from the Court's judgment that this was an acceptable course of conduct and met the Board's and Dr Bierre's duties in relation to that conflict.

In essence, the Court of Appeal's view, even in regard to Dr Bierre's earlier conflict in relation to his proposed boutique laboratory, was that compliance with the statutory conflicts provisions in the NZPHD Act would have been sufficient to meet the Board's procedural requirements.

COMMON LAW RULES ON BIAS

Bias

There is some overlap between the Crown Entities Act conflicts provisions and the administrative law rules against predetermination and bias. These rules potentially apply to anyone making a decision on behalf of a Crown entity. While their application was originally limited to judicial proceedings, it has now been extended generally to decision makers who exercise public powers that affect the rights of others. However the strictness with which the principle is applied will depend on the context.⁹

Bias has been described as the possibility that a decision-maker "might unfairly regard, with favour or disfavour, the case of a party to the issue under consideration."¹⁰ At common law bias is divided into presumptive bias and apparent bias. Presumptive bias usually arises where a person involved in a decision has a direct pecuniary interest in the matter being decided (subject to a de minimus rule). Under New Zealand law at present, such an interest automatically disqualifies a decision maker from taking part in a decision, (although in some circumstances a waiver may still be possible).¹¹

Apparent bias arises from non-pecuniary interests, where circumstances are established that might lead a fair-minded lay-observer to reasonably apprehend that the decision-maker might not bring an impartial mind to the resolution of the case.¹² Apart from the situation of predetermination, which is discussed below, the Auditor-General's *Guidance for members of local authorities about the law on conflicts of interest*¹³ notes the most common risk of non-pecuniary bias is where a person has a close relationship or involvement with an individual or organisation affected by a matter.:¹⁴

Apparent bias does not generally extend to an interest that is in common with the public – for example, it would not disqualify a person from making a decision on road user charges just because they owned a diesel vehicle, or a person dealing with "anti-smacking" legislation just because they had children.

Under the common law, where there is apparent bias a decision maker must stand aside unless the parties waive their right to object in clear and unequivocal terms and in full knowledge of the facts.¹⁵ However, it is noted that in some specific circumstances a statutory context may override the common law rules around disqualification for bias. In *NZI Financial Corp Ltd v NZ Kiwifruit*

⁹ For example, in *Pratt Contractors Ltd v Transit New Zealand* [2005] 2 NZLR 433 (PC), the Privy Council found that in making a commercial decision on a tender Transit was not required to act judicially, nor was it bound by the rules against bias that would apply to those acting judicially.

¹⁰ *Riverside Casino v Moxon* [2001] 2 NZLR 78(CA)

¹¹ *Auckland Casino Ltd v Casino Control Authority* [1995] 1 NZLR 142, 148 (CA), confirmed in *Muir v CIR* [2007] 3 NZLR 495, 505, para 43 (CA).

¹² *Auckland Casino Ltd v Casino Control Authority* [1995] 1 NZLR 142, 148 (CA), confirmed in *Muir v CIR* [2007] 3 NZLR 495, 505, para 43 (CA).

¹³ Controller and Auditor-General, June 2007.

¹⁴ Above n 7, para 5.10.

¹⁵ However, despite the ability to obtain a waiver under the common law, it is noted that the effect of section 66 of the Crown Entities Act may be that a member cannot act even where a waiver is given. To do so would not affect the validity of the act (per section 67), but would be a breach of the member's duty to comply with the Crown Entities Act.

*Authority*¹⁶ the Court held that because the authority was a specialised industry tribunal whose membership was drawn from persons engaged in the industry, the regulations constituting the authority must be read as excluding disqualification by reason of presumptive bias because of the members' financial interest in export licences.

The Auditor General's Guidance for local authorities provides good practical advice in regard to the treatment of non-pecuniary interests that may be useful to Crown entities. The Guidance notes also that in deciding whether a conflict of interest arises the Courts will take into account the type of function being exercised and that: 17

[t]hey are likely to take a strict approach with decisions that directly affect the legal rights, interests, and obligations of an individual or small group of individuals (as opposed to decisions with a large policy or political element).

A decision of a Crown entity where a member is found to be biased, could be invalidated in an action for judicial review.

Predetermination

The recent decision of the High Court in *New Era Inc v Electricity Commission*¹⁸, provides a good précis of the law of predetermination, which Wild J argues in the case should now be considered separately from presumptive and apparent bias. He notes at para 71 that what amounts to predetermination in any given administrative decision varies with the circumstances of the decision and the decision made, but the general test remains that in *CREEDNZ v Governor General*¹⁹

Before the decision can be set aside on the ground of disqualifying bias [i.e. predetermination] it must be established on the balance of probabilities that in fact the minds of those concerned were not open to persuasion and so, if they did address themselves to the particular criteria under the section, they simply went through the motions.

Wild J went on to say at para 73 that:

...decision-makers cannot approach their decisions with "fixed views" or "closed minds": they must give due consideration to the merits of the options before them. A blank mind is not required. Decisions-makers are not expected to be completely uninfluenced by previous consideration of the matters involved; they are simply required genuinely to apply themselves to the decision at hand: *New Zealand Fishing Industry Association Inc v Minister of Agriculture and Fisheries* [1988] 1 NZLR 544.

In *New Era*, allegations were made that the Electricity Commission had surrendered its discretion to government Ministers who told it what to do. The Court found on the facts that this had not occurred.

WIDER RULES AROUND CONFLICTS

As is noted in the Auditor-General's Guidance, managing conflicts of interest is a fundamental part of good public sector administration, and the rules for Crown entities go further than legal rules and stray into protocol. The Guidance notes that:²⁰

Regardless of whether any relevant legal rules apply, ethical considerations should always be taken into account when seeking to identify and manage a conflict of interest in the public sector.

¹⁶ [1986] 1 NZLR 159(HC).

¹⁷ Above n7, para 5.7.

¹⁸ (Wild J, HC Wgn, 4 May 2009, CIV 2007-485-2774).

¹⁹ [1982] 2 NZLR 172, 194

²⁰ Auditor-General's Guidance, 15, para 2.15

For these reasons most Crown entities will operate an interests register that is wider than just Board members and which requires at least senior employees to also disclose interests. (As noted earlier, this is not to do with a “conflict” per se, but is intended to encourage people to think about conflicts that may arise in the course of their work).

The Guidance (para 3.10) notes that organisations should have policies and procedures in place which -

- state principles or values that emphasise the entity's commitment to addressing conflicts of interest, and the importance of people within the entity being alert for such situations;
- establish rules for the most important and obvious actions that people must or must not take (see paragraph 3.6);
- establish a mechanism (such as an interests register) for recording those types of ongoing interests that can commonly give rise to a conflict of interest, and a procedure for putting this into effect and updating it on a regular basis (see paragraphs 3.7-3.9);
- set out a process for identifying and disclosing instances of conflicts of interest as and when they arise (including a clear explanation of how a member or official should disclose a conflict of interest, and to whom);
- set out a process for managing conflicts of interest that arise (including who makes decisions, and perhaps detailing the principles, criteria, or options that will be considered);
- provide avenues for training and advice;
- provide a mechanism for handling complaints or breaches of the policy; and
- specify the potential consequences of non-compliance.

However the Guidance notes that policies and procedures are not enough in themselves, and individual judgment needs to be made in relation to every conflict or potential conflict of interest that arises. In this wider sense it is not just legal risk which is an issue, but the risk of adverse public perception if someone with a perceived conflict of interest participates in a decision or project in respect of which the conflict has arisen. In such situation it may be prudent for the member or official to withdraw or be excluded from being involved in the workstream for the particular matter, whether or not an actual conflict has arisen. As the Guidance notes:

In the interests of openness and fairness (and to minimize the risk of the public entity having to defend itself against an allegation of impropriety), it is always safer to err on the side of caution.

It is also prudent to record how the conflict was dealt with in writing.

These wider rules are also pertinent for board members and employees in the context of board member and employee duties. In addition to their individual duty act in accordance with the Act (s53 Crown Entities Act), Board members must act with honesty and integrity (s54) and comply with the duty to act in good faith, which explicitly deals with conflicts by stating (s55):

A member of a statutory entity must, when acting as a member, act in good faith and not pursue his or her own interests at the expense of the entity's interests.

The first limb of this duty – the duty to act in good faith is an essential element of the common law fiduciary duty of a director. A good faith requirement is essentially one of proper motive.

The second limb of the duty amends the common law duty of a director to act in what the director believes to be the best interests of the company. The Crown Entities Act does not require a board member to act in the best interests of the entity; but only that he or she does not place his or her own interests above the entity's interest. This no doubt reflects the fact that the board as a whole has public duties under sections 49 to 52. Complying with a duty to act in the entity's best interests, might at times otherwise put board members in a situation of conflict with their collective duties.

Employees also have a duty to their employer to act in good faith.