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23 July 2013

Acting Chief Executive
Hawke's Bay Regional Council
Private Bag 6006
NAPIER

Attention: Liz Lambert

By email: liz@hbrc.govt.nz

Dear Liz

HAWKE'S BAY REGIONAL INVESTMENT COMPANY LIMITED: CONFLICT OF INTEREST ISSUES

- 1 You have asked us to provide you with an opinion in response to a Paper on Governance Issues and Options which has been presented by the Chairman of Hawke's Bay Regional Investment Company Limited ("HBRIC") and the Chairman of that company's Audit and Risk Committee.

Summary of Advice

- 2 For the reasons set out in this opinion, it is our view that any conflict of interest issues, whether real or perceived, can be adequately managed within the existing governance structure without the need for significant change.

Issue

- 3 The issue is whether there is a conflict of interest (either real or perceived) in having Hawke's Bay Regional Council ("HBRC") councillors sit and determine issues around the HBRIC board table (in their role as "Councillor directors") that might attract criticism when it comes to their participation as councillors of HBRIC making decisions in and around Ruataniwha Water Storage Scheme ("RWS Project").
- 4 The issues are set out in the relevant (undated) Additional Item Paper as follows:
 - 1 Conflict of interest for councillors who are councillor directors of HBRIC Limited when decisions are being made in 2014 by Council on an RWS investment recommendation from HBRIC Limited;
 - 2 Predetermination by councillors who are councillor directors of HBRIC Limited when decisions are being made in 2014 by Council on RWS investment recommendation from HBRIC Limited;
 - 3 Conflict of interest for Council's CEO in advising Council in 2014 on a RWS investment recommendation from HBRIC Limited.

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- 5 As noted in the Paper the last issue has been dealt with through the secondment of Andrew Newman to the full-time role as Managing Director of HBRIC Limited.
- 6 The remaining issues of conflict of interest and pre-determination are the matters to which this opinion responds.

Discussion

7 The main concern is that the decision of Council whether to proceed or not with the RWS project may well be challenged by way of judicial review with the consequent expenditure of money and time delays that result from that.

8 It is our view that the appointment of Councillor directors to the board who are charged with administering and overseeing the management of the water storage scheme, is likely to result in the most experienced and appropriate individuals for the position and the best placed to make quality decisions and bring about enduring solutions.

9 We note that one of the specific exceptions to participation in decision making under the Local Authority (Members' Interests) Act 1968¹ relates to councillors who have been elected by, or are appointed to represent, any activity, industry, business, organisation or group of persons and their pecuniary interest is not different in kind from the interests of others in the activity, industry, business, organisation or group by which the councillor is elected, or in respect of which they are appointed.

10 That point is reinforced in the OAG's Report on governance issues involving subsidiary companies:²

207 Although councillor directors face potential conflicts of interest, they may also provide a useful service by:

- being a council voice;
- providing a local community perspective; and
- ensuring that the objectives of the board are aligned with those of the local authority.

208 The presence of councillor directors also enables the board to explore the likely response of the shareholding local authority to board proposals.
...

229 We recommend, as in our 1994 report, that the boards of holding companies include councillor directors... While the holding company is the legal owner of operating subsidiaries, the local authority is ultimately accountable to the community for the performance of the subsidiaries. Councillor directors on the holding company are a means of ensuring that commercial decisions have appropriate regard to the wider interests of the local authority shareholder.

230 In determining the balance of councillor and external directors on the board of the holding company, the local authority should consider:

- the desired mix of skills and experience for the holding company's role as the local authority's professional investment manager;
- the nature of the local authority's investment portfolio; and

¹ Section 6(1A)

² See *Local Authority Governance of Subsidiary Entities* (Office of the Auditor-General, 23 March 2001).

- the relationship between the holding company and the local authority.
- Council Representatives on Boards of Local Authority-owned Companies...

766 In our 1994 report we commented on the roles of councillor directors on the boards of commercial enterprises. In this study we heard a variety of arguments for and against such appointments.

767 The benefits of appointing councillor directors include:

- providing a local authority voice on the board; and
- making the company more sensitive and responsive to community views.

768 Concerns about such appointments include:

- councillor directors may face difficulties in reconciling their dual roles as councillor and company director; and
- local authority representatives may be expected to pass information from the company to the shareholding local authority outside established communication channels, which is inappropriate behaviour.

769 Some local authorities have a policy of appointing councillors to the boards of their commercial trading companies. Of the ten companies we reviewed, only three boards did not include a councillor representative.

770 Councillor directors need to have the commercial skills, background and experience to make a fully informed contribution to board discussions. A formal process for selecting directors is an effective way to meet this requirement.

771 One holding company periodically sought expressions of interest from councillors wishing to be appointed to the boards of local authority owned companies. The skills and experience of those interested can then be assessed against the competencies for appointment to a board. This preserves the transparency of director appointments. It also ensures that all councillor appointees have the necessary competencies to fill director positions and participate fully in governance of the company.

11 The issue here is one involving a non-pecuniary interest. There is very little guidance on this issue from the OAG except for some general comments appearing in a Report prepared by that office in 2004:³

Non-pecuniary conflicts of interest: The rule against bias

1.21 If a person challenges a local authority's decision by way of judicial review proceedings, the courts could invalidate the decision because of bias on the part of a member of the decision-making body. The question you need to consider, drawn from case law, is:

Is there a real danger of bias on the part of a member of the decision-making body, in the sense that he or she might unfairly regard with favour (or disfavour) the case of a party to the issue under consideration?

1.22 It is the appearance of bias, not proof of actual bias, that is important.

1.23 The law about bias does not put you at risk of personal liability. Instead, the validity of the authority's decision could be at risk.

12 We have looked for New Zealand case law on the point but the issue does not appear to have been raised except in the context of pecuniary interests. In 1992⁴ the High Court

³ See *Guidance for members of local authorities about the law on conflicts of interest* (Office of the Auditor-General, 1 June 2007)

⁴ *Calvert & Co v Dunedin City Council* [1993] 2 NZLR 460

was asked to set aside a series of resolutions made by the Dunedin City Council when setting directors fees for Councillor directors on various Council-owned or controlled bodies. Some of those Councillor directors deliberated and voted on those resolutions. Prior to the matter coming before the Court, Dunedin City Council changed its policy and made it clear that Councillor directors were only entitled to meeting fees based on the usual tariff in accordance with their public office. The directors fees were refunded to Council. On that occasion the plaintiffs wanted to pursue a declaration that the Councillor directors had breached natural justice because they were biased in their approach to setting the fees in the first instance. The High Court declined to grant relief. It held that the powers of the Court on judicial review were discretionary and that nothing would be gained, in the face of a change in policy and refund in fees, by having the Court grant relief to the plaintiffs. An attempt to appeal that decision failed for lack of jurisdiction.

- 13 We also observe in the OAG's advice to HBRIC⁵ that Mark Maloney is of the opinion that there is no conflict in Councillor directors making decisions about HBRC's investments.
- 14 We believe there is a strong case for retaining the current governance structure and managing any conflict of interest that might arise.
- 15 That then only leaves the matter of "perception" of a conflict of interest. That is not a legal matter but one of politics and appearance.
- 16 The options for avoiding perceptions of conflict of interest have been set out in the Additional Item Paper.⁶ They include:
 - 16.1 Temporary removal of Councillor directors;
 - 16.2 Delegation of decision-making to a subsidiary entity;
 - 16.3 Appointment of alternate directors.
- 17 A further option might have been to limit the involvement of the Councillor directors at either HBRC council meetings or HBRIC board meetings by regulating their right to attend, right to participate in the deliberation and the right to vote at properly constituted meetings.
- 18 Currently they are able to exercise all three but it is possible for each entity to allow attendance, deliberation but not voting; or allow attendance but not deliberation or voting or not allow attendance, deliberation or voting. All of this would be characterised as management of the conflict or potential conflict.
- 19 Our view is that these options are extreme and likely unnecessary because they each take away from the process the very thing that leads the OAG to encourage councils to appoint councillors to council controlled entities.



⁵ Additional Item Paper, page 1.

⁶ At page 2.

20 In 2000, the Court of Appeal in the Hamilton Sky Casino case approved of the words adopted by the High Court Judge at first instance:⁷

Subject to contrary indications in the statute or other empowering document, little or no predisposition or extraneous influence will usually be tolerated where the decision-maker is a court, tribunal or similar body operating in a formal adversarial setting, the determination requires the application of a legally dictated result once facts are found, the decision impacts upon specific individuals rather than the community at large, and the impact upon those individuals is serious, particularly if involving human and civil rights and freedoms.

The reverse will usually be true where the decision-maker is a democratically elected body, the decision-maker is intended to form its own policies, particularly where on-going, the challenged aspect of the decision did not involve the application of closely controlled legal consequences to facts once found, eligibility for appointment, and hearing methodology, suggest that its members were intended to draw upon their own views, experience and expertise, and the opportunity to be heard is limited or informal. In such cases intervention will usually be justified only where the decision-maker entered upon the hearing with a closed mind, that is to say one which was not amenable to proper argument, or was unwilling to consider the case on its individual merits. [Emphasis added]

21 It is perhaps patronising to suggest that Councillor directors are unable to view the issues from two separate viewpoints: their role as a director of HBRIC voting in the best interests of the company (on the one hand) and a councillor voting in the best interests of the region.

22 In some cases those two positions may appear incompatible, but there is the very real prospect that a responsible Councillor director might approve the scheme in his or her capacity as director of HBRIC but vote against it as a Councillor voting around the Council table on the grounds of cost contribution or for some other reason. To some that may appear nonsensical but in our view that situation is completely logical and sustainable and shows a clear delineation between the interests of the two groups.

23 For these reasons, the appointment of Councillor directors is not only acceptable, it is positively encouraged by the OAG as a means of producing a better informed decision in the interests of Council.

24 The way in which conflicts are identified and managed does not require going to the lengths suggested in the options put up in the Additional Item Paper.

25 The perception by the public of potential conflict or predetermination is a political issue upon which we are not qualified to comment. The cost involved in a legal challenge (including delay) is a matter to be carefully considered but our advice is that, properly managed, the status quo can be maintained without taking the artificial and extreme steps suggested in the three options presented in the Additional Item Paper or the conflict management suggestion in paragraph 17.

⁷ *Riverside Casino Ltd v Casino Control Authority & Others*, CA 113/00; 19.12.00 at paragraph [13].

26 We would be happy to clarify or expand on any aspect of this advice.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Stuart Webster', written over a circular stamp or seal.

Stuart Webster
Partner

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