COMPANIES
AND
SECURITIES
LAW REVIEW COMMITTEE

NOMINEE DIRECTORS AND ALTERNATE DIRECTORS

REPORT No.8

2 March 1989

CONTENTS

REPORT OF THE
COMPANIES AND SECURITIES LAW REVIEW COMMITTEE
ON
NOMINEE DIRECTORS AND ALTERNATE DIRECTORS

TO: The Ministerial Council for Companies and Securities.

The CSLRC presents to the Ministerial Council its Report on Nominee Directors and Alternate Directors. This is the Eighth report of the Committee, the others being:

* Report on the Takeover Threshold (November 1984)
* Report on Partial Takeover Bids (August 1985)
* Report on Forms of Legal Organisation for Small Business Enterprises (September 1985)
* Report on the Civil Liability of Company Auditors (September 1986)
* Report on the Issue of Shares for Non-Cash Consideration and Treatment of Share Premiums (September 1986)
* Report on a Company's Purchase of its own Shares (September 1987)
Report on Prescribed Interests (May 1988)

Terms of Reference

The Ministerial Council for Companies and Securities referred to the Committee "for inquiry and review the following questions relating to directors and officers of companies:

(a) standards relating to their conduct and performance, and in particular:

...

(ii) what should be the duties and liabilities of nominee directors and alternate directors."

This is a Preliminary Report

Some aspects of the law relating to nominee directors and alternate directors are linked with legal rules as to the duties of directors generally. A thorough inquiry as to the duties of directors generally would require a relatively lengthy time schedule. At the time of preparing this Report the Committee has judged it best to make a separate preliminary report on the duties and liabilities of nominee directors and alternate directors and persons associated with their appointment. The Committee's recommendations are such as to lend themselves to adoption without regard to the wider question of formulation of duties of directors generally.

Discussion Paper

In December 1987 the Committee published Discussion Paper No 7: "Nominee Directors and Alternate Directors". A list of respondents to the Discussion Paper is in the Appendix.

The Committee notes that there was a surprisingly small number of responses to the Discussion Paper. That may suggest that the existing law as to nominee directors and alternate directors is thought to be satisfactory. Alternatively, it may point to a lack of interest on the part of the community in a topic which does not happen to be currently controversial. Another reason may lie in the fact that the subject is an arcane one(1) to be found in case law rather than the more accessible enacted law.

Whatever the reason, the Committee believes that there is uncertainty about some aspects of the duties of nominee directors and alternate directors which calls for limited clarifying legislation.

(1) It has been said that the subject of Alternate Directors is one about which little is known: The Australian Director, Feb/Mar 1985, page 44.

Summary of Recommendations

Recommendations for de-regulatory legislation recognising acceptable business practices not clearly sanctioned by existing legislation.

1. That there be a modification of section 229 of the Companies Act 1981 (Cth) to the effect that a director will not be in breach of section 229 or be otherwise in breach of duty by reason only that his or her main reason or actuating motive for an act or omission was a consideration other than the benefit of the company as a whole provided that:

(a) all the members have jointly or severally given their prior informed consent to the particular exercise of power or performance of duty in that way;

(b) the company is being managed in accordance with an agreement or arrangement to which all members are parties and which authorises the director to take into account the interest of one or more of the members in the particular exercise of power or performance of duty; or

(c) the company is a wholly-owned subsidiary company and the director took into account the interest of a related corporation that is a holding company in relation to it.

For the purposes of that provision an act shall include the communication of information about the company's affairs.

One of the effects of item (b) of this proposed modification will be to meet special needs in a joint-venture company.

In practice, items (a), (b) and (c) will not apply to a listed company.

2. That the legislation should provide that where a director honestly and reasonably believes that he or she has statutory authority for having as a main reason or actuating motive some consideration other than the benefit of the company as a whole, the director shall not be in breach of duty for taking that consideration into account (para [87]).

3. That the legislation should indicate that an exempt proprietary company and a non-commercial company (one that is eligible to be licensed under section 66 of the Companies Act 1981 (Cth)) be at liberty to include in their constituent documents provisions which relieve directors of their normal duty to consider the benefit of the company as a whole, so long as the company is solvent (para [73]).

One member, Mr. Greenwood, dissents from this recommendation insofar as it relates to an exempt proprietary company (para [70]).

4. The legislation referred to in recommendation 1 should not be an exhaustive statement of the circumstances in which it is permissible for a director to take into account a consideration other than the benefit of the company as a whole (para [74]).

5. The legislation referred to in recommendation 1 should be confined to giving authority to a director only while the company is solvent and where the action permitted to the director will not make the company insolvent (para [64]).

6. That section 228(5) of the Companies Act 1981 (Cth) be amended to require a director of a listed company to disclose to the board any arrangement or understanding with another whereby the director expects or is expected to have regard to the interests of another person in respect of:

(a) providing information about the company to a person who is not otherwise entitled to it; or

(b) when exercising powers as a director, taking into account any consideration other than the benefit of the company as a whole (para [81]).

This would not necessarily entail a right to provide a principal with information not available to the members generally: see para [83].

7. That there be a legislative statement that:

* no director may enter into commitments which would prevent the director performing duties imposed on him or her by legislation (para [88]); and

* no director may enter into commitments which would prevent or inhibit the director from performing the duty to take into account the interests of the company's creditors when the company's financial position makes it appropriate that their interests be considered (para [88]).

8. That the legislation should provide that when a company is being administered under a shareholders' agreement there be a statutory obligation to include in the company's records a copy of that agreement and all variations of it (para [85]).

Recommendations for legislation clarifying existing companies legislation

9. That it be stated in the legislation that every company director is under a duty to exercise an active discretion in the exercise of his or her powers and the discharge of the duties of his or her office (para [91]).

10. That there be legislation that where a meeting of directors is required in any company there should be present throughout the period of the meeting at least two directors or such higher number of them as the articles require (para [123]).

Recommendation for legislation about alternative directors:

11. That it be provided that in a listed company a director who will be absent from board meetings should be able to appoint another director in the same company to be a delegate for him or her, the appointor being liable for the acts of the delegate (paras [116] and [118]).

12. That in a listed company it should no longer be possible to appoint an alternate director (para [109]).

13. That one director should be able to be a delegate for more than one director, subject to the multiple presence requirements in the company's articles or in legislation for the constitution of a meeting (see recommendation 10) (para [122]).

14. That where the appointor of a delegate is interested in a contract or proposed contract of the company the appointor should inform the delegate so that the delegate may declare the interest in the manner required by section 228 of the Companies Act 1981 (Cth) (para [125]).

15. That although in an unlisted company it should remain possible for a director to appoint an alternate director:

* an alternate director should by law be treated as a director in his or her own right rather than as agent of an appointor (para [133]);

* an alternate director should have the same rights to attend and speak at meetings of directors not attended by the appointor, and between meetings to be provided with information, to inspect accounts and records and to vote during the period of his or her appointment as are possessed by the director in whose place the alternate director acts (para [135]);

* one person may be an alternate director for more than one director subject to the multiple-presence requirements in the company's articles or in legislation for the constitution of a meeting (see recommendation 10) (para [137]);

* the principle of an age limit as embodied in section 226 of the Companies Act 1981 (Cth) should be applied to an alternate director of an unlisted public company and to an alternate director of a subsidiary of a public company (para [138]);

* a director who has appointed an alternate director and who has reason to believe that a contract or proposed contract of the company in which the appointor is interested will arise for consideration by the alternate director should be under a duty to inform the board of the nature of his or her interest in the manner required by section 228 of the Companies Act 1981 (Cth) (para [140])

Recommendations for legislation facilitating conduct of business affairs:

16. That the legislation authorise for all companies the conduct of meetings of directors by telephone or other communication facilities that allow simultaneous and instantaneous transmission (para [126]).

PART A - NOMINEE DIRECTORS

CHAPTER 1

THE EXISTING LAW

Who are nominee directors?

[1] The aspect of company law reviewed in this report, insofar as it deals with nominee directors, is the application of enacted law and case law to persons who are appointed to the board of directors of a company on terms that they will, as members of the board, have some degree of loyalty to a person other than the company which could affect the performance of their functions as directors of the company.

[2] For the purposes of this report the fact that a person is appointed to the board by some appointor(2) other than the company in general meeting or by the board in filling casual vacancies is not enough to bring the appointee within the expression "nominee director". The report is addressed to the problems that arise when a director, however appointed, has a loyalty beyond the interests of the company as a whole.

[3] The term "nominee director" will be used to refer to persons who, independently of the method of their appointment, but in relation to their office, are expected to act in accordance with some understanding or arrangement which creates an obligation or mutual expectation of loyalty to some person or persons other than the company as a whole. The term "principal" will be used to refer to that other person or persons.

(2) Such as directors nominated or elected to the board as of right by an individual member, a class of members, or some other person or group (for example, a major lender to the company). The Companies Act 1981 (Cth) section 225(1) recognises that a director may be "appointed to represent the interests of a particular class of shareholders or debenture holders". Legislation in other countries also recognises sectional appointments of directors: see Discussion Paper No 7, Page 1.

[4] This report is confined to the situation where directors have a definite loyalty in relation to their office to someone other than the company. It is not concerned with the case where a director has a directorship in several companies. Multiple directorships may entail a competition of loyalties. That possibility is very strong where the director takes directorships in competing companies. The Committee believes it is possible to make recommendations about nominee directors without dealing with the matter of multiple directorships.

The normal legitimate focus of a director's loyalty

[5] The normal legitimate focus of a director's loyalty is taken in this report to be the benefit of the company as a whole. That comes from the language of the decided cases. There is some debate as to what is meant by the phrase "benefit of the company as a whole".

[6] One meaning would require directors to take into consideration the impact of their decision on the interests of different categories of persons who have relations with the corporate entity. They would need to do that because failure to consider those interests could lead to detriment to the corporate entity. For example, under this first meaning directors would have a duty to consider the interests of the company's creditors as well as the interests of members because neglect of creditor's interests could lead to the entity being wound up.

[7] Another meaning would require directors to make their decisions in the light of the interests of the members. If that is the correct meaning of "benefit of the company as a whole", the phrase does not subsume the interests of creditors. There would be a separate additional duty to take into account the interests of creditors once the company is approaching financial difficulty.(3)

(3) Walker v Wimborne (1976) 137 CLR 1 at 6-7; Nicholson v Permakraft (NZ) Ltd. (in liq) [1985] 1 NZLR 242 at 249 and 255, 3 ACLC 453 at 459 and 464 : Kinsela v Russell Kinsela Pty Ltd. (in liq) (1986) 10 ACLR 395, 4 ACLC 215.

[8] Those two meanings are not the only ones considered by commentators.(4) This report does not review the formulation of the duty of loyalty of directors. Whether there is any merit in seeking a more precise statement of that focus and whether any more precise statement should be written into legislation are questions that can be left for another occasion. The Committee believes that it is possible to review the law applicable to nominee directors without attempting to choose between the differing interpretations.

[9] For the purposes of this report it is best to assume that a duty to take into account the interests of a company's creditors is separate from the duty to consider the benefit of the company as a whole. The only reason for making that separation is formal, to ensure that in any recommendations the Committee will make about nominee directors the duty of directors to consider the interests of creditors will not be overlooked.

[10] The statement that the board must act for the benefit of the company as a whole will provide general guidance to a board when it is dealing with issues external to the membership. It will not provide guidance in relation to issues as between the members inter se where a decision that could benefit some members and not benefit others may have to be made. When the board has authority to choose between classes of members the board's duty cannot be stated any more precisely than that the board must be fair as between different classes of members and as between major holders and minor holders.(5)

[11] Hence, the legal model of a company is a company with a board that:

1. in relation to issues external to the company, acts, in general, for the benefit of the company as a whole;

2. in relation to internal issues, acts fairly as between members and different classes of members; and

(4) See the discussion by Heydon in Equity and Commercial Relationships (1987) (ed. Finn) Ch 15.

(5) Mills v Mills (1938) 60 CLR 150 at 164; Howard Smith Ltd. v Ampol Petroleum Ltd. [1974] AC 821 at 835, 3 ALR 448 at 455.

3. considers the interests of creditors when appropriate.

[12] It is clear law that a board of directors is not entitled, without special authority conferred by the articles, to run the company in the interests of a majority shareholder. In Ashburton Oil v Alpha Minerals NL (1971) 123 CLR 614 at 619-620 Barwick CJ pointed out that a board cannot undertake even to a majority shareholder that it will not use powers conferred on it by the articles, unless the interests of the company and of the majority shareholder happen to be identical.(6)

[13] In the legal model of a company a change whereby X, having power as a majority shareholder to determine the composition of the board, is replaced by Y should not, by reason of transfer of that power alone, have any effect on minority shareholders since new directors elected by Y would continue the work of the directors elected by X in administering the affairs of the company for the benefit of the company as a whole. If the administration of the company conforms to the legal model, there should therefore be no premium for sale of effective control on the basis of a transfer of the power to elect directors.

[14] The principle of law that the board should not run the company in the interests of the majority shareholder is not invalidated by the commercial fact of willingness of a buyer of shares to pay a premium for shares the holding of which will enable the buyer to elect new directors. If, and to the extent that, a premium is paid for becoming able (in practice, if not in law) to exert clandestine influence on the board to be partial, the receipt of that premium is a form of unjust enrichment of the seller. The Companies (Acquisition of Shares) Act 1980 (Cth) operates in many cases to prevent that form of unjust enrichment by requiring a bidder for control to make an offer to all shareholders at a uniform price and on uniform terms.

(6) See also Automatic Self Cleansing Filter Syndicate Co Ltd. v Cunninghame [1906] 2 Ch 34 and Howardd Smith Ltd. v Ampol Petroleum Ltd. [1974] AC 821, 3 ALR 448.

Degrees of extraneous commitment by nominee directors

[15] In some cases a nominee director who is beholden to someone other than the company may be obliged to do no more than supply information about the company to the principal. In other cases the nominee director may be obliged to use voting power at board meetings in the interests of the principal. In extreme cases the nominee director may be expected to follow slavishly the directions of the principal. In that last case the nominee director, a mere puppet, is unable to carry out the director's duty of exercising an active discretion on questions that come before the board so as to fulfil statutory obligations. This report does not contain recommendations for change in those statutory obligations or for encouraging appointment of puppet directors.

Is appointment of nominee directors consistent with fiduciary principles?

[16] When a nominee director is appointed and is obliged to a principal a strict view of fiduciary duty would mean that the appointment is invalid simply because the director will not be able to approach questions with an open mind. Statements of a director's fiduciary duties in older cases put a director's fiduciary duty so high that the director was expected to be free from influences which could prevent him or her from considering only the interest of the company. Those statements of principle required a director to have a mind free from loyalty to anyone other than the company when making decisions for the company.(7) In the law of fiduciary obligations that principle has been relaxed by disqualifying the fiduciary only where there is a real sensible possibility of conflict between interest and duty: Boardman v Phipps [1967] 2 AC 46.

[17] In relation to nominee directors there has been further relaxation in that the mere existence of an extraneous loyalty, even though plainly capable of being inconsistent with the interests of the company as a whole, will not disqualify the nominee director. The director is allowed to act

(7) Imperial Mercantile Credit Association v Coleman (1871) 6 Ch App 558 at 567 - 568.

and the director's act will not necessarily be invalid. In Re Broadcasting Station 2GB Pty Ltd. [1964-5] NSWR 1648 Jacobs J said that to require each director to approach each company problem with a completely open mind would be "to ignore the realities of company organization".(8) See Discussion Paper No 7: para [208].

[18] Turning to the question of how a nominee director should use his discretions, how far can a director, in acting in the affairs of the company, consciously have regard to the interests of an outside principal?

[19] What might be regarded as a liberal answer is contained in two expressions of view by Jacobs J (as a Justice of the Supreme Court of New South Wales, as he then was). See Levin v Clark [1962] NSWR 686 and Re Broadcasting Station 2GB Pty Ltd. [1964-5] NSWR 1648. Jacobs J believed that a nominee director could, in some circumstances, go so far as to advance the interests of an outside principal, so long as the director believed in good faith that the principal's interests were consistent with the interests of the company as a whole. That approach is consistent with the views expressed in Mills v Mills (1938) 60 CLR 150 that directors will not be in breach of duty merely because they have regard to their interests as shareholders provided they have a bona fide belief that their decision is for the benefit of the company as a whole. However, if the "main reason" or "actuating motive" for acting was a desire to advance the director's interests or those of an outside principal, the director would

(8) The notion that nominee directors commit no wrong by being nominated in such a way that they ~ act in breach of duty was subsequently supported by the Privy Council in Cumberland Holdings Ltd. v Washington H Soul Pattinson & Co Ltd. (1977) 2 ACLR 307 at 318 and by Bowen CJ in Re News Corporation Ltd. (1987) 70 ALR 419 at 436.

be acting in abuse of power even though he or she believed that the action was consistent with the interests of the company as a whole: Mills v Mills(1938) 60 CLR 150 at 188.(9)

[20] On the other hand, a more conservative test was stated by Street J (as he then was) in Wales (1967) 87 WN Pt 1 (NSW) 307. His Honour's formulation was that "once a group has elected a member he assumes office as a member of the Board and becomes subject to the overriding and predominant duty to serve the interests of the Board, in preference, on every occasion upon which any conflict might arise, to serving the interests of the group which appointed him".

[21] It was suggested in the submission of the Law Society of South Australia that the view of Street J in Bennetts case represents the law and that the views expressed by Jacobs J were strictly obiter.

[22] It appears to the Committee that there is some confusion as to the standard to be observed by a nominee director in making decisions. There is not an abundance of decisions on the matter and the Committee believes that some effort at legislative clarification would be useful.

(9) Recently there has been a suggestion in a dictum of the High Court in Whitehouse v. Carlton Hotel Pty Ltd. (1987) 162 CLR 285 at 294, 70 ALR 251 at 257 with regard to exercise of a power to allot shares that 'As a matter of logic and principle, the preferable view would seem to be that, regardless of whether the impermissible purpose was the dominant one or but one of a number of significantly contributing causes, the allotment will be invalidated if the impermissible purpose was causative in the sense that, but for its presence, "the power would not have been exercised" (per Dixon J, Mills v Mills at 186).' In the adoption of that approach regarding a nominee director the critical question would be whether the nominee director would have made the same decision if he or she had not had an extraneous loyalty.

[23] In any event, it is a clear principle of law that a position as a director is not to be used by an incumbent as an opportunity to serve only some sectional interest merely because that sectional interest elected the director, without regard to the interests of the company as a whole: Bennetts v Board of Fire Commissioners of New South Wales (1967) 87 WN Pt 1 (NSW) 307; Morgan v 45 Flers Avenue Pty Ltd. (1986) 10 ACLR 692 at 705. It sometimes happens that a shareholder who has a significant but not majority holding of shares in a company feels entitled to have the incumbent board invite his nominee to a place on the board. Any such shareholder is entitled to nominate in accordance with the articles a person of his or her choice for consideration by the company in general meeting when it elects directors. But such shareholding does not give the right to require the directors automatically to accede to that request. The board will be in breach of duty by inviting a nominee unless it has reasonable grounds to believe that the nominee would succeed in an election.

[24] The board's power to fill vacancies on the board is, like all the board's other powers, a fiduciary power which is to be used for the benefit of the company as a whole. In considering the interests of the company one of the relevant factors is the likelihood of the nominee being elected if the matter were to go to a general meeting. The directors are entitled to weigh in the balance the consideration that the conduct of a contested election may lead to expense for the company and disruption. But if directors have reason to believe that the nominee of the non-majority shareholder will have as his or her "main reason"(10) or "actuating motive"(10) the advancement of the interests of the principal or will feel obliged to give the principal information obtained as a director without first seeking the authority of the board, the board has a duty to refrain from inviting that nominee to join the board.

[25] In this connection it is to be noted that the Companies Act 1981 (Cth) section 229(3) makes it an offence for an officer or employee of a corporation to make improper use of information acquired by virtue of that position to gain an advantage for himself or herself or any other person or

(10) Mills v Mills (1938) 60 CLR 150 at 188 per Dixon J.

to cause detriment to the corporation. Section 229(4) makes it an offence for an officer or employee of a corporation to make improper use of the position as such an officer or employee to gain, directly or indirectly, an advantage for that officer or employee or for any other person or to cause detriment to the corporation. The maximum penalty for each offence is a fine of $20,000 or imprisonment for 5 years, or both. Other persons, such as financiers or intermediaries, who knowingly procure an individual director to divulge company information without proper authority also commit an offence: See Companies and Securities (Interpretation and Miscellaneous Provisions) Act 1980 (Cth) s.38.

[26] When asked to authorise transmission of information by an individual director to a principal the board is under a duty to consider whether it is in the interests of the company as a whole that the authority should be given. Given the duty of directors to exercise an active discretion on questions affecting the company, it is questionable whether any board should give blanket approval to transmission of information by an individual director to a principal.

Examples of companies in which nominee directors are commercially accepted

Joint Venture Companies:

[27] The essence of a joint venture company lies in the adoption of the corporate form (rather than that of an unincorporated joint venture, partnership or trust) by a small number of incorporators for their joint exploitation of a particular business opportunity. The company will normally be limited by its memorandum and articles or a shareholders' agreement to a single enterprise.

[28] In a joint venture company, instead of the members as a body appointing directors to act in the interests of all the members, each member normally has the right to appoint a number (or specified proportion) of the directors. The articles or a shareholders' agreement may expressly empower each member to remove and replace their own appointees. Each appointee in a joint venture company is an unabashed representative director who acts as a spokesperson for, and exercises powers on the board, in the interests of the appointor rather than the members generally, subject to an overriding duty not to act to the prejudice of the company's creditors.

[29] Each member of a joint venture company agrees, expressly or impliedly, that the appointed directors will not have to consider the interests of all the members collectively. Widespread acceptance in the business community that a joint venture company's constitution can relieve directors of the normal duty to consider the interests of the members as a whole is predicated on a view that there is nothing in the Companies Act to prevent that relaxation. The relevant statutory duty is in section 229(1) which provides:

"An officer of a corporation shall at all times act honestly in the exercise of his powers and the discharge of the duties of his office ..."

[30] The duties referred to in section 229 would be the duties imposed by the Companies Act, other legislation, the company's constitution, the principles of case-law and any terms in the agreement between the co-venturers. Duties imposed by the rules of general law would, as a matter of principle, be capable of being relaxed by provision in the company's constitution or any relevant shareholders' agreement but not so as to prejudice creditors. But there would be limits to the extent to which the duties could be relaxed. It is conceivable that public policy might prevent too wide a relaxation. It has been accepted by the High Court in Whitehouse v Carlton Hotel Pty Ltd. (1987) 162 CLR 285 at 291, 70 ALR 251 at 255 that "the articles of a company may be so framed that they expressly or impliedly authorise the exercise of the power of allotment of unissued shares for what would otherwise be a vitiating purpose." That shows that, at least, that aspect of the fiduciary duty of directors to act honestly which requires that they shall use their powers for a proper purpose can depend on the social contract in the articles.

[31] Given that the commercial desire to use the corporate form in a joint venture as a substitute for an unincorporated joint venture causes no public inconvenience, it would seem inappropriate to adopt a fixed legislative policy of simply applying to every corporation some standard set of fiduciary duties of directors whatever the function of the corporation may be.(11) If a joint venture company is not open to participation by members attracted by an offering to the public, there would seem to be no

(11) Cf Berlei Hestia (NZ) Ltd. v Fernyhough [1980] 2 NZLR 150.

reason why the members should not agree to have articles which relieve the directors of the duty to have regard to the interests of members collectively. It may be that in a joint venture company the emphasis in respect of fiduciary duties so far as the members are concerned will be at the level of relations between members themselves rather than at board level. It may be that, as a matter of principle, even though an enterprise which might otherwise be set up as an unincorporated joint venture is set up as a company, something like the fiduciary relations which exist between unincorporated joint venturers (United Dominions Corporation Limited v Brian Proprietary Limited (1985) 157 CLR 1) will be seen to exist between members of an incorporated joint venture: that the venture is a corporation to the rest of the world but something like a partnership as between the members.

Companies in a Group:

[32] Wholly-owned subsidiaries: Where a company is a wholly-owned subsidiary of another company or is a sibling wholly-owned subsidiary company along with other siblings, the common proprietorship may in commercial eyes appear to justify the board of any one group company having regard to the interests of the group when making decisions for that company without any need to focus on the interests of that company. In the United Kingdom there is some judicial tolerance of directors having regard to group interests where "an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company" : Charterbridge Corporation v Lloyd's Bank [1970] Ch 62 at 74, [1969] 2 All ER 1185 at 1194.

[33] The directors of a wholly-owned subsidiary have a commercial role different from that of directors of an independent company. Consistently with modern practices of group strategic planning and budgeting the decisions for the wholly-owned subsidiaries will often be shaped by the group holding company's board or management.

[34] However, it is settled in Australia that the fact that companies in a group have their own sets of creditors has to be borne in mind by directors of each company. If directors adopt a group policy in total disregard of the interests of their company and its creditors, they will be guilty of misfeasance : Walker v Wimborne (1976) 137 CLR 1 at 7.

[35] A director of a wholly-owned subsidiary will in many cases follow directions given by the management of the parent company. In doing so the director of the subsidiary may appear to be a puppet director but there is nothing wrong in that because the management of the parent company are acting in the interests of the parent shareholder. The director of a wholly-owned subsidiary differs from directors of other companies in being subject to more detailed direction by the owners of the company through their agents than is normally the case.

[36] Partly-owned subsidiary: The presence of a minority shareholding independent of the parent will mean that nominee directors representing the majority shareholder are subject to the duties of directors generally. Their duty is to act in the interests of all the members even though they may have regard to the group's strategic plans and budgets.

[37] However, there are occasions on which the law requires them to communicate information to the parent : for example, the Companies Act 1981 (Cth) section 272(2) requires directors of a subsidiary to supply to the holding company all the information that is required by the directors of the holding company for the preparation of the group accounts, the directors' statement about group accounts and the directors' report.

[38] Associated company: The Committee notes the category of associated company which is significant in regard to accounting and which the Companies Regulations Schedule 7 recognises. There is an accounting theory that a corporate shareholder should include in its annual accounting report to shareholders a share of the profits of another entity over which it exercises a significant degree of influence. The Companies Regulations Schedule 7 clause 34 refers to an associated company as one in which the reporting company has a "material interest".(12)

(12) In the United Kingdom the Department of Trade and Industry has announced changes to the definition of "subsidiary" for the purposes of preparing consolidated accounts but not for other purposes, such as financial assistance given by a company for the purchase of its own shares or loans to directors. Under the new definition for company S to be a subsidiary of company X, X must hold a "participating interest" in S. That means a shareholding or other rights in the capital of S held on a long-term basis by X "for the purpose of securing a contribution to" X's own activities. A shareholding of over 20 percent by X will create a presumption that that purpose exists.

[39] While it may be appropriate for a reporting company to inform its shareholders about the financial operations of the associated company, any suggestion that a director on the board of the associated company is a channel for the exertion of influence in the interests of only one of the shareholders is inconsistent with existing law as to a director's duties.

Director authorized by article to have extraneous loyalty

[40] There has been some judicial acceptance of the proposition that directors may, in certain circumstances, act otherwise than for the benefit of the company as a whole when the articles confer on the board power to act with regard to some extraneous interest. In Levin V Clarke [1962] NSWR 686 articles of a proprietary company contemplated that two directors could act in the interests of a mortgagee of shares in the company after a purchaser of the shares had made default. That modification of the normal duties of the directors was accepted by Jacobs J. See Discussion Paper No 7, para [202]ff. See also Whitehouse v Carlton Hotel Pty Ltd. (1987) 162 CLR 285 at 291, 70 ALR 251 at 255 which indirectly supports the judgment of Jacobs J by confirming that articles may vary the law as to the fiduciary duties of directors when issuing shares.(13)

[41] The question of whether constituent documents should be able to relieve directors of the normal duty to consider the interests of the company as a whole is dealt with later in this report. At this stage the Committee notes that there may be in existence exempt proprietary companies which have articles giving that relief.

(13) See also Imperial Mercantile Credit Association v Coleman (1871) 6 Ch App 558.

What looks like an extraneous loyalty may be inherent in benefit to the company as a whole

[42] In Levin v Clark [1962] NSWR 686 at 700-701 Jacobs J said:

"It is of course correct to state as a general principle that directors must act in the interests of the company ... However, that leaves open the question in each case - what is the interest of the company? It is not uncommon for a director to be appointed to a board of directors in order to represent an interest outside the company - a mortgagee or other trader or a particular shareholder. It may be in the interests of the company that there be upon its board of directors one who will represent these other interests and who will be acting solely in the interests of such a third party and who may in that way be properly regarded as acting in the interest of the company as a whole."

His Honour said that authority for that representation might be found in some agreement between shareholders narrowing the fiduciary duties of directors.

[43] There seems to be no reason in principle why a nominee directorship on behalf of a mortgagee could not be brought within the overall purpose of advancing the company's interests by means other than provision in the articles : a contract made by the directors acting in the interests of the company might require that there be brought onto the board a nominee director.(14)

(14) Compare the principle that directors may bind themselves as to the future exercise of discretionary powers by a contract made in the interests of the company: Thorby v Golgberg (1964) 112 CLR 597. (See, however, the views of Menzies J at 616).

Where the extraneous loyalty transcends the benefit of the company as a whole, can a nominee director have regard to the extraneous loyalty and not be in breach of duty?

[44] Once it is accepted that the mere existence of an extraneous loyalty does not prevent a director acting (see para [17]), the question then becomes one of when a decision of the director will be made in breach of duty. In theory, one possibility could be that the nominee director's act in a given situation will only be proper where it is in fact in the interests of the company as a whole. If that were the position, a nominee director could only act in the interests of the outsider where the interests of the outsider and the interests of the company as a whole were identical. The application of that test would require courts to assess the interests of the company. But the traditional attitude of courts has been to abstain from reviewing the merits of decisions by directors (at least decisions on matters of business) as to what is in the interests of the company so long as the decision is not one that no reasonable board would have made. Hence, there is authority in Australia that in reviewing the acts of nominee directors courts will be satisfied if the nominee director, s had a bona fide belief that the interests of their principals were identical with the interests of the company as a whole : Re Broadcasting Station 2GB Pty Ltd. [1965-5] NSWR 1648. It may be that where a decision of directors has no element of judgment on matters of business but is purely constitutional, the court would declare the decision invalid if it took the view that the decision was not for the benefit of the company as a whole.

[45] In the United Kingdom a strict view appears in the cases. In Boulting v Association of Cinematograph, Television and Allied Technicians [1963] 2 QB 606 [1963] 1 All ER 716 at 723 Lord Denning referred to a nominee director as one "who is nominated by a large shareholder to represent his interests". He said (at 626):

"There is nothing wrong in it. It is done every day. Nothing wrong, that is, so long as the director is left free to exercise his best judgment in the interests of the company that he serves. But if he is put upon terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful."

In Lindgren v L & P Estates Ltd. [1968] Ch 572 at 594, [1968] 1 All ER 917 at 921 Harman LJ took a similar view. He considered it "quite irrelevant" to the liability of a director of a subsidiary company that the director may have been appointed to represent the interests of the holding company.

[46] This matter was addressed by Professor L C B Gower in the Code of Company Law that he prepared for Ghana. He included a provision:

"203(3) In considering whether a particular transaction or course of action is in the best interests of the company as a whole a director ... when appointed by, or as representative of, a special class of members, employees, or creditors may give special, but not exclusive, consideration to the interests of that class."

In his commentary on the provision Professor Gower said:

"There is also the problem of the director who is appointed by a special class of shareholders or by the debentureholders. Is he too expected to think only of the long-term interests of the members as a whole and to ignore the sectional interests of those appointing him? To require that would be to expect directors 'to live in an unreal region of detached altruism and to act in a vague mood of ideal abstraction from obvious facts which must be present to the mind of any honest and intelligent man when he exercises his powers as a director': per Latham CJ in Mills v Mills (1938) 60 CLR 150 at 164."

[47] In the United Kingdom Scottish Co-operative Wholesalers Society Ltd. v Meyer [1959] AC 324 suggests that it is not the nominee director's bona fide perception of identity of interest that is critical but rather the fact of identity. Yet in Charterbridge Corporation Ltd. v Llyod's Bank Ltd. [1970] Ch 62, [1969] 2 All ER 1185 it was the nominee director's bona fide perception that mattered.

[48] The liberal view expressed by Jacobs J that a nominee director will not be in breach of duty for paying regard to the interests of the principal if he has a genuine belief that the principal's interests are identical with those of the company allows the nominee director considerable latitude. However, there is a limitation: a nominee director who is so irrational as to see an identity of interest where no honest and reasonable director would see it, would be in breach of duty if he or she failed to act for the benefit of the company.

Even if a nominee director's regard for an extraneous interest transcending the benefit of the company is not a breach of duty, it may amount to oppressive or unfairly prejudicial conduct of the company's officers.

[49] In Discussion Paper No 7 paras [313]ff reference was made to section 320 of the Companies Act 1981 (Cth) which empowers the Court to give relief to a member of a company where its affairs are being conducted in a manner that is "oppressive" or "unfairly prejudicial" to, or "unfairly discriminatory" against a member or in a manner that is contrary to the interests of the members as a whole : section 320(2)(a). Parallel provisions apply in relation to an act or omission by or on behalf of the company or a resolution of the company: section 320(2)(b). The full implications of this legislation are yet to be spelled out. There has been a view that the section does not require the Court to depart from its traditional stance of refusing to review business management decisions: Re G Jeffery (Men's Store) Pty Ltd. (1984) 9 ACLR 193.

[50] But, subsequently the High Court in Warde v New South Wales Rugby League (1985) 61 ALR 225 appeared to indicate that in determining whether decisions made by a board have an unfair impact on a member the Court may have to review a business decision of a board to see whether it is unfair. This report is concerned with the duties of nominee directors rather than the remedy of oppression. Any directors, not just nominee directors, could be found to have caused oppression or unfair prejudice to the members as a whole within section 320 and yet not be in breach of duty. They may well have performed their duty of acting in what they bona fide considered the interests of the company as a whole and yet they cause oppression or unfair prejudice.

[51] Obviously, it is impossible for legislation to indicate in advance what is oppression or unfair prejudice. Section 320 is probably best seen as an overriding control over the administration of companies which will operate without affecting the standards set for directors. It may well be that the likelihood of attracting section 320 will be higher in cases where nominee directors have been appointed than in other cases.

CHAPTER 2

THE ISSUE AND RECOMMENDATION

Chapter 5 of Discussion Paper No 7 raised issues for review concerning nominee directors. These issues are now considered.

ISSUE 1. Should nominee directors be permitted to depart from the fiduciary standard applicable to directors generally?

[52] Some respondents considered that the existing law provided adequate coverage. One respondent expressed the view that any clarifying legislation may fail to meet all possible commercial situations.

[53] A contrary view is that the existing legislation leaves directors with legislative guidance only in the very broad terms of section 229 of the Companies Act. The legal position of nominee directors needs to be apparent to anyone who is approached to be a nominee director. At present the law is not readily accessible. The law has an aura of uncertainty.

[54] There is evidence that nominee directors are not aware of the responsibilities imposed upon them by case law. According to Loose on The Company Director: his functions, powers and duties, a publication prepared under the authority of the Institute of Directors (1975) (Jordan & Sons Limited, Bristol) para 4-02(d),

"Where a director is a nominee of a parent company, or a shareholder or a creditor, he must bear in mind that there is no such thing as a director in English law. Every director has exactly the same responsibility to the Company as a whole and if he neglects that responsibility in the interests, or on the orders, of his principal he will be guilty of a breach of duty. Thus, he must not starve a subsidiary out of business merely because it suits the parent company to do so Scottish Co-op Wholessalers Society v Meyer [1958] 3 All ER 66), nor must he be guided by the interests of the group as a whole, at least where the subsidiary has separate creditors (Charterbridge Corporation v Lloyd's Bank Ltd. [1969] 2 All ER 1185).

This principle is widely disregarded in practice and nominee directors often see themselves simply as watchdogs for those who put them on the board. They are wrong, and before accepting office they should remember that the law expects them to devote their loyalty to the company as a whole."

[55] That is a statement of the position in the United Kingdom. So far as the Committee can judge there is a similar lack of understanding in Australia of the duties of a nominee director.

[56] It seems to the Committee that the legislation should not ignore the problems facing nominee directors. The Committee believes that section 229(1) is in terms too general to provide guidance to nominee directors. The Committee notes the comments of Loose set out above that the case law principle of loyalty is widely disregarded in practice. The Committee believes that some legislative statement about the position of directors who have justifiable extraneous loyalties is needed if only to alert directors to their duty of loyalty.

[57] Various unimpeachable commercial practices (the use of the corporate form for joint ventures, the practice of organizing one economic enterprise in a group of companies and the use of shareholder agreements to govern administration of some companies) involve a departure from existing legal standards expressed in the fiduciary duties of directors.

[58] If respect for law is to be maintained, a disparity between commercial practice and legal standards should not be allowed to continue even where the commercial practice is not harmful.(15) While it might be possible in time for the doctrines of case law to accommodate commercial practice, it would be better in this instance to proceed by legislation because what little case law exists does not provide clear guidance.

(15) R P Austin, "Directors' Duties and Commercial Expectations - Some Applied Problems" (the Sydney Law Review Conference 1987) The Sydney Law Review (forthcoming).

[59] Accordingly, the Committee recommends that the Companies Act should contain more direct recognition of nominee directorships than is now found indirectly in section 225.

ISSUE 2. If the question in Issue 1 is answered in the affirmative, how should the adjustment be made between the nominee's duties of loyalty to the appointer and to the general body of members?

ISSUE 3. Should any special dispensation for nominee directors require, or be permitted by, formal corporate consent?

[60] In the light of submissions, it is convenient to take these two questions together.

[61] Some respondents favoured a legislative statement similar to section 203(3) of the Ghana Company Law drafted by Professor L C B Gower: see para [46] above. That measure provides that in considering whether a transaction or course of action is in the best interests of the company as a whole a director appointed by, or as a representative of, a special class of persons may "give special, but not exclusive, consideration to the interests of that class." An alternative expanded formulation would allow a nominee director to pay special consideration to the interests of the appointor, provided the nominee director is genuinely convinced that he or she is not acting contrary to the interests of the company. That approach would require a definition of a nominee director.

[62] Another less far-reaching approach, and the one that the Committee recommends, is to have legislation that does not go so far as to state the duties of nominee directors but indicates that action of any directors guided by an extraneous loyalty in certain circumstances will not constitute a breach of their duty. That provision should not purport to be exhaustive but should refer to the circumstances which, in the views that have been expressed by the courts, justify a director having regard to extraneous interests. It would assist the law to come into harmony with what Jacobs J called "the realities of company organization".

Cases where nominee directors are commercially accepted

[63] The legislation should recognise that companies administered under shareholders' agreements (including joint-venture companies) as well as wholly-owned subsidiary companies need special treatment. While doing that, the legislation could also embrace the situation where all the members have given their prior informed consent to particular action by directors which involves an extraneous loyalty.

[64] The legislation should be limited to decisions made by directors while the company is solvent. The restriction of the provision to a solvent company is necessary for the protection of creditors. The qualification about solvency would need to govern the position both before and after the exercise of the director's power or the performance of his or her duty.

[65] The legislation should be along the lines that any director of a solvent company, will not be in breach of duty under section 229 or otherwise by reason only that in the purported exercise of the director's powers or the purported performance of duties the director took into account as his or her main reason or actuating motive a consideration(16) other than the benefit of the company as a whole where:

(a) all the members have jointly or severally given their prior informed consent to the particular exercise of power or performance of duty in that way;

(b) the company is being managed in accordance with an agreement or arrangement to which all members are parties which authorises the director to take into account the interest of one or more of the members in the particular exercise of power or performance of duty; or

(c) the company is a wholly-owned subsidiary company and the director took into account the interest of a related corporation that is a holding company in relation to it.

(16) Compare the language in Administrative Decisions (Judicial Review) Act 1977 (Cth) s 5(2).

[66] The legislation recommended in para [65] would authorise a director in the exceptional cases in items (a), (b) or (c) to make a wide range of decisions and should be wide enough to authorise a decision to divulge information to a principal without the authority of the board where items (a), (b) or (c) apply. However, to make the position clear, the legislation should indicate that the provision extends to the communication of information about the company's affairs.

[67] The three cases in items (a), (b) and (c) provide for the situation where the only persons interested in the company are at one on the giving of authority to directors to be anything but loyal only to the company as a whole. In practice items (a), (b) and (c) will not extend to listed companies.

[68] Item (c) does not in terms refer to the interest of a related corporation that is a subsidiary of a common parent. The controlling factor under item (c) is the interest of the parent. There will be cases where as a result of taking the parent's interest into account, the directors, in effect, advance the interest of that other related corporation. But that will only be an incidental effect of taking into account the interest of the parent.

Authority from constituent documents

[69] The Committee considered whether there should be a further item under which the company's constituent documents could authorise or require directors while the company is solvent to take into account extraneous considerations. The Committee decided that to include such an item to be available for all commercial companies could lead to widespread dilution of the directors' duty of loyalty where dilution was not warranted. There would be the possibility of a majority altering the focus of the directors' duty of loyalty to the prejudice of a minority. Although there must be occasions when the majority are to be allowed to prevail, the Committee does not believe that in commercial companies, other than exempt proprietary companies, relaxation of so central a facet of directors' fiduciary administration as the duty to act only in the interests of the company as a whole, is one of them. So far as exempt proprietary companies are concerned, a majority of the Committee believes that because they can be used for a wide range of purposes the framers of articles of such companies should continue to be free to relieve directors of the normal duty to consider the interest of the company as a whole, so long as it is solvent.

[70] One member of the Committee, Mr. Greenwood, considers that there are good reasons for the general law of fiduciary duty to the company as a whole to apply to directors of exempt proprietary companies except to the extent that relaxation is proposed elsewhere in this Report, and for that law to override contrary provisions in the articles. Exempt proprietary companies are frequently the vehicle for family or other small group enterprises, in which one member of the group exercises a dominant influence. That influence typically reduces "board" decisions to a formality. For the law to authorise articles of association of exempt proprietary companies to provide that the company may be managed in the interests of that dominant person opens the way for a wide variety of oppressive conduct (especially when family disagreements or dissolutions occur) for which section 320 would not be an adequate remedy. A purpose extraneous to the interests of the members as a whole may be sufficiently secured by articles dealing with voting and dividends, or within trusts which the exempt proprietary company administers.

[71] In non-commercial companies (mostly companies limited by guarantee) the members are usually conscious that the company is an association and not just a vehicle for investment. In the case of a non-commercial company (for example, a charitable or community service organisation) there is not the same objection to a provision in the constituent documents allowing directors to decide by reference to extraneous considerations where the constituent documents require or authorise it. For example, a church appointed member of an incorporated school may be authorised to act in accordance with the interests of the appointing church notwithstanding that those interests may be inconsistent with the interests of the school viewed as a continuing educational entity.

[72] The distinguishing mark of a non-commercial company that could be used in the legislation could be the same as that which marks off companies which may be eligible to obtain a licence to dispense with the word "Limited" as part of their names.

[73] Accordingly, the recommendation of the Committee (subject to the dissent of Mr. Greenwood in relation to exempt proprietary companies) is that in item (b) the reference to an agreement or arrangement should not include the constituent documents of the company unless the company is an exempt proprietary company or a non-commercial company.

Non-exhaustive legislation

[74] The Committee believes that the proposed exculpatory legislation should not be exhaustive. There will be cases, other than those in items (a), (b) or (c) in para [65] which will be acceptable on a case by case basis. An example is a particular decision of the board or of an individual director which appears at first sight not to be in the interests of the company but which can be seen to be a direct consequence of an earlier decision of the board that was made in the interests of the company. That could be the case where a lender has been permitted by the board to have a representative on the board. See Levin v Clark [1962] NSWR 686 at 700-701 referred to above. It should be made clear that the constituent documents of a company, other than an exempt proprietary company or a non-commercial company, cannot relax the duty. The Committee has in mind a provision to the following effect;

"This section is not an exhaustive statement of the circumstances in which a director's consideration of something other than the benefit of the company as a whole will not be a breach of the director's duty but a director of any company, other than an exempt proprietary company or a non-commercial company, shall not be so excused merely because the company's constituent documents purport to authorise directors to take into account considerations other than the benefit of the company as a whole."

ISSUE 4. Should there be a statutory definition of a "nominee director"?

[75] The Committee believes that the issues raised in connection with nominee directors can be dealt with by legislation without the need for a definition of "nominee director".

ISSUE 5. Should there be a register of nominee directors?

Knowledge of a competing loyalty

[76] The Committee is of the view that members of a company and the Commission should have the means of knowing whether any of the directors of a company have a loyalty to anybody other than the members as a whole.

[77] The idea of registration in the records of the company (but not in the records of the Commission) of the fact that a director is a nominee director was supported by several respondents.

[78] The Committee sees merit in directors of listed companies having an occasion when directors should declare whether they have extraneous loyalties.

[79] Nominee directors, whether their only extraneous loyalty requires them to provide company information to some person not otherwise entitled to it or to do more, are persons with dual loyalties. As such, they are in the same category as the persons who have to make disclosure under section 228. Section 228 is currently confined to dual loyalties arising from:

(i) a contract or proposed contract with the company : section 228(1), (2), (3), (4);

(ii) an extraneous office held by the director : section 228(5); and

(iii)property owned by the director : section 228(5).

[80] As suggested by one respondent, the matter of disclosure that a director is a nominee could be dealt with by amending section 228(5).

[81] The Committee agrees with that and recommends legislation to extend section 228(5) to require a director of a listed company to make disclosure where the director has an arrangement or understanding with another person whereby he or she expects or is expected to have regard to the interests of another person in regard to:

(a) providing information about the company to a person who is not otherwise entitled to it; or

(b) when exercising powers as a director, taking into account any consideration other than the benefit of the company as a whole.

The disclosure should identify the principal to whom the nominee director is answerable and provide a statement of the nature and extent of the arrangement or understanding.

[82] For listed companies the requirement of that disclosure would complement section 225(1) which recognizes that special interests may be represented.

No automatic entitlement to disclose information

[83] The disclosure under section 228 now proposed will not necessarily entail entitlement to act in accordance with the arrangement or understanding. That entitlement may arise under case law or the legislation proposed in para [65]. So far as communication of information is concerned, there will be no entitlement to provide information (not available to members generally) to the principal unless the board has given authority or the matter falls within a case referred to in the legislation recommended in para [65] or communication is necessary for ensuring compliance with legislation.

Notification to the Commission by return

[84] The Committee considered whether the legislation should require that the return of Directors, Principal Executive Officer and Secretaries under section 238 indicate whether or not each director is under any obligation to consider the interests of any person or persons other than the members as a whole and, where appropriate, the interests of creditors. The Committee decided against making any recommendation to that effect in the belief that disclosure under section 228 would be adequate as is the case with other disclosures under that section.

Shareholders' Agreement

[85] There should be a statutory obligation where a company is being administered under a shareholders' agreement to include in the company's obligatory records a copy of the agreement and all variations of it. In this connection the Committee notes section 251(1)(b) which seems to be confined to agreements binding a class of shareholders.

ISSUE 6. What commitments should nominee directors be permitted to make to their principals?

[86] It is not possible to define in advance the matters on which a nominee director should be able to make commitments. There can only be a broad formula. The legislation should allow the director to make commitments to

consider interests other than those of the company as a whole that are consistent with the particular warrant for consideration of extraneous interests. For example, where the director is the representative of a special class of shareholders the nature and extent of the directors' commitment would be limited by the special interests of that class. Where, in another example, the director is the representative of a lender the nature and extent of the directors' commitment would be limited by the nature and terms of the lending. Thus, it would be in order for a representative of a lender to take into account the lender's interests when the board is considering a possible expansion of the company's business: the expansion might put in jeopardy the prospect of repayment of the loan. But it would not be in order for the representative of that lender to rely on that representative role when deciding a question unrelated to protection of the interests of the lender as such.

[87] There will obviously be marginal situations where a representative director may be unsure as to whether the matter under consideration falls within the scope of the director's commitment. This could be met by the legislation providing that where a director honestly and reasonably believes that there is a statutory authority for having as his or her main or actuating reason for deciding some consideration other than the interests of the company as a whole, the director will not be in breach of duty. The Committee recommends a provision to that effect.

[88] The Committee recommends that the legislation should be so framed that no director should be able to make commitments that prevent the director:

(a) from performing the specific duties imposed by the legislation, for example, duties in connection with a company's financial statements, responding to requisitions for meetings etc; and

(b) from performing the duty to take into account the interests of creditors when the company's financial position makes it appropriate that their interests be considered.

ISSUE 7. The personal liability of the nominee director for breach of duty.

[89] Attribution of principal's knowledge to the nominee: In Discussion Paper No 7 para [515] the question was raised as to whether for the purpose

of determining a nominee director's liability for breach of duty the knowledge of company affairs and transactions that the appointor possesses should be attributed to the nominee director.

[90] The Law Council of Australia, in its submission, said that a distinction should be drawn between a director who properly considers a question that comes before the board and a director who is a mere puppet, one who puts himself or herself "blindly at the disposal of a stranger": Selangor United Rubber Estates v Cradock (No 3) [1968] 1 WLR 1555, [1968] 2 All ER 1073. The former should be judged in the light of the director's own knowledge and the knowledge of the appointor should not be attributed to the director. The latter should have imputed to him or her the knowledge of the appointor.

[91] Whether or not there is legislation as the Committee recommends (see para [65]) indicating when a director may properly take into consideration something other than the benefit of the company as a whole, it would be appropriate to add to section 229(1) a provision spelling out an aspect of section 229(1). That elucidation should be to the effect that in the administration of the affairs of a company a director, whether acting as a member of the board or individually, has a duty to exercise an active discretion. It may be that in some of the cases where directors could properly take into account considerations other than the benefit of the company as a whole (such as joint venture companies, wholly-owned subsidiaries and companies administered under a shareholders' agreement) the director may have little discretion left to him or her by the principal. The provision now suggested would need to be expressed to be subject to any legislation of the kind suggested in para [65]. But the fact that a director must always consider whether the company has reached the point when the board must take into account the interests of creditors is enough to make it necessary to require that all directors are under a duty to exercise an active discretion and so there should never be any recognition of puppet directors.

[92] The principle about imputing the knowledge of the principal to the nominee should depend on the extent of the freedom to make decisions that the appointor has allowed to the nominee. The Committee believes that this is a matter best left to case law.

ISSUE 8. Liability of principal for nominee's acts or ommissions.

[93] Given that a nominee director may have to follow the dictates of a principal, should the legislation make any statement about the liability of the principal for the director's acts?

[94] The Law Council of Australia made the point that the legislation already catches and makes liable a shadow director who falls within the extended statutory definition of "director" in the Companies Act section 5(1). That definition extends to "any person in accordance with whose directions or instructions the directors of the corporation are accustomed to act".(17) The wording does not make it quite clear whether the definition refers to a person who has power to influence the board or power to influence an individual director.(18) Probably, the correct interpretation is that the definition refers to customary compliance by the board rather than any individual director. That view rests on an assumption that the legislature means only to catch a person who can have some real effect on the conduct of the company's affairs, that is to say, one who is able to influence an organ of the company, the board. Compare section 8(4)(c) referring to the "body corporate" ... "or its directors" being accustomed to act in accordance with the directions of another person.

[95] Liability of shadow director. So far as the Committee can see, one reason for including a shadow director in the definition is to make him or her liable in the same way that an individual director properly appointed or a shadow director is liable. If that is so, then influence over an individual director, short of influence over the board, should be enough to attract liability.

[96] The Committee notes that at present it is not clear as to which references to a "director" in substantive provisions throughout the Companies Act

(17) A similar provision appears in the definitions of "director" in section 4 of the Securities Industry Act 1980 and section 4 of the Futures Industry Act 1986 (both Cth).

(18) For example, the question could be important in a joint venture company. The Committee notes, in passing, that although section 219(2) makes a corporation incapable of being appointed as a director, it does not follow that a corporation is incapable of being a "director" by force of section 5(1).

the Companies (Acquisition of Shares) Act, the Securities Industry Act and the Futures Industry Act attract the definition's extension to shadow directors. The answer to that question depends on the presence or absence of a contrary intention in each substantive provision. It is not always easy to determine whether a contrary intention is evinced. The United Kingdom legislation in the Companies Act 1985 meets the problem by having a separate definition of "shadow director" in section 741 and by including in each particular substantive provision that is intended to apply to a shadow director an express provision to that effect.

[97] The Committee believes that because many of the provisions in question impose a statutory duty every effort should be made to indicate upon whom the duty is cast. The matter goes beyond the subject of nominee directors and the Committee makes no recommendation on it in this report.

ISSUE 9. Nominee directors and the oppression remedy.

[98] Discussion Paper No 7 in para [313] - [320] referred to the range of judicial orders that can be made at the suit of an individual member under the "oppression or unfair prejudice" remedy provided for by section 320. Action by a nominee director in furtherance of the interests of someone other than the company as a whole might amount to "oppressive or unfairly prejudicial" conduct of the affairs of the company when seen from the viewpoint of persons other than the principals of the nominee director.

[99] If the legislation recommended in para [65] above is enacted, it will be in order for a nominee director to take into account considerations other than the benefit of the company as a whole.

[100] As explained in para [50] there is the possibility of a company's affairs being conducted in a way that attracts section 320 even though the directors are not acting in breach of duty. Sections 364(1)(f), 364(1)(fa) or 364(1)(fb) could also be attracted.

[101] It seems to the Committee that the reform needed is a clarification of the duties of nominee directors so that they will not be in breach of duty where they take into account a sectional interest in the situations referred to in para [65]. It is not necessary to make any recommendation

in relation to sections 320, 364(1)(f), 364(1)(fa) or 364(1)(fb) because those provisions are designed to deal with oppression and unfair conduct regardless of whether directors are in breach of duty. Doubtless in cases that may arise under those sections the fact that the legislation recommended in para [65] applies in the particular case will be one of the circumstances to be considered in determining whether the conduct complained of is oppressive or unfair.

ISSUE 10. Nominee directors representing a parent company.

[102] The issues raised under this heading in Discussion Paper No 7 in paras [518] to [519] are covered by earlier parts of this report.

ISSUE 11. Reporting back to the appointer

[103] Consistently with the Committee's view that a nominee director should have to exercise an active discretion in his or her own right, a nominee director should be entitled to as much information about the company's affairs as any other director. It is to be assumed, unless the contrary is proved, that the director is acting in the affairs of the board and not in conflict with them: Moloby v Whitehead (1985) 63 ALR 282; Morgan v 45 Flers Avenue Pty Ltd. (1986) 10 ACLR 692 at 705.

[104] Like other directors a nominee director would be subject to restrictions as to the use that can be made of the information. If the legislation recommended in para [65] were enacted there would be some cases in which a nominee director would be free to divulge information to a principal.

ISSUE 12. Statutory corporations

[105] Statutory corporations call for consideration in the present context only because of a possibility that a statutory corporation with sectional nominee directors might be 'privatised' and converted into a company. The Committee believes that any such company should be governed by the legislation recommended earlier.

PART B - ALTERNATE DIRECTORS

CHAPTER 3

ISSUES AND RECOMMENDATIONS

Existing law about alternate directors

[106] In Discussion Paper No 7 paras [601]ff the existing law about alternate directors was described and the reasons and the occasions for appointing alternate directors were discussed.

[107] In Chapter 7 of the Discussion Paper several issues were stated as arising out of the earlier discussion. This report will deal with those issues.

ISSUE 1. Should constraints be introduced on the capacity to appoint alternate directors?

[108] Among respondents there was a variety of opinion on this issue. The Law Council of Australia thought that the existing law is adequate. It pointed to the fact that an appointment of an unsuitable alternate could be a breach of duty by an appointor. The Committee believes that there is in the business community sufficient uncertainty as to the extent to which alternate directors are to be treated as ordinary directors to justify it recommending clarification of the existing law. Another respondent thought that "it was valid to query whether or not in the case of listed public companies the ability to appoint an alternate director is indeed appropriate."

[109] The Committee is of the view that the law as to appointment of alternate directors should not be the same for listed companies as for others. Listed companies attract investment from the investing public. The administration of listed companies (and their subsidiaries) should be, and should be seen to be, under the ultimate control of persons who have a continuous role in the administration of the company and who have been

elected to the board of the company (or in the case of a group, the ultimate holding company) by shareholders. There should be only two qualifications of that principle; where a casual vacancy occurs on a board or there is scope for appointing an additional director. In those two cases the existing practice is for the remaining members of the board to fill the vacancy, the appointee holding office only until the next annual general meeting and being eligible for election at that meeting. In filling a vacancy the directors are subject to the usual fiduciary obligations; see para [24]. The Committee recommends that in a listed company it should no longer be possible to appoint an alternate director.

[110] The Committee is of the view that the existing law as to alternate directors in its application to unlisted companies calls for only minor amendments which are detailed later. The category of unlisted companies covers a wide range of companies:

* public companies which have made offerings to the public but have not been listed on a securities market;

* public companies which are really private in the sense that they have not made a public offering (including some joint-venture companies);

* non-profit companies; and

* proprietary companies.

[111] Unlisted companies should be left free to give power in their articles to their directors to appoint alternates or to authorise in their articles any other lawful means of meeting the problem that directors (whether elected or otherwise) may have to absent themselves from board meetings. The reason for that view in respect of companies which have not approached the public will be obvious. In relation to companies which have raised funds from the public but which have never been listed it may be thought that they should be treated like listed companies for present purposes. The difficulty is that it is not practicable to make the operation of the law now under consideration turn on whether a company is a public or a proprietary company; there are private joint-venture companies and wholly-owned subsidiaries which are formed as public companies and there are nonprofit companies limited by guarantee all of which should be left free of

restrictions appropriate to listed companies. This means that the principle of not allowing an appointment of non-directors to act for an absent director in companies to which the public has subscribed funds cannot be fully implemented. However, investor-protection legislation cannot guard against all folly of investors. Sensible investors do not invest in unlisted companies without making special enquiries about the company. A limitation of the operation of the principle favoured by the Committee so that it applies only to listed companies should be seen as helping to fulfil the expectation of a sensible investor that the law will set appropriate standards of administration for those companies to which sensible investors may be expected to confide their money. Restriction to listed companies of operation of standards as to delegation by directors is also explicable as part of the government function of setting minimum standards for the operation of securities markets.

[112] Listed Companies: The Committee considered various possible provisions to meet occasional absences of individual directors from board meetings.

[113] To require a listed company to elect enough directors to ensure that the normal incidence of absenteeism would not prejudice the functioning of the board might be thought to be a solution. But that would be wasteful and cumbersome.

[114] The Committee considered whether it would be a solution to require that in a listed company a panel of potential alternate directors be elected at each annual general meeting so that the persons elected would be available for appointment as alternate directors as the need arose. However, the Committee rejected that because:

* a person having the capacities needed to be a good alternate director would not want to be seen to be playing a second class role while waiting to be appointed as alternate director and to be devoting attention to an appointment which may not eventuate; and

* a listed company's affairs are usually complex enough to require attention by directors who are continuously informed about those affairs and there could be difficulty in ensuring that members of the panel were kept so informed.

[115] Delegation only another director: Given the need in a listed company for its board members to have the endorsement of its shareholders and to have complete knowledge of the company's affairs, the Committee recommends that it should not be possible for a director in a listed company to delegate his board functions to anyone else than another director. Of course, the board would continue to be capable of having authority in the articles to delegate to non-directors activities in the conduct of the company's business.

[116] Delegation by appointment as delegate: The Committee believes that the need for a director to have another director act for him at a meeting which he cannot attend can best be met by amending the legislation to enable a director who proposes to be absent from a meeting of directors to appoint another director as his delegate to vote on his behalf. The Committee recommends accordingly.

[117] Appointer's liability for delegate's breach of duty: The intention is that the delegate should be a representative of the appointor. Any breach of duty by the appointee when purporting to act for the appointor should be deemed to be a breach of duty by the appointor. The risk of the delegate acting in breach of duty should rest on the appointor; it should not be possible for a director to avoid responsibility by appointing a delegate.

[118] The Committee recommends appropriate legislation to make Jt clear that a director is liable for the acts of his delegate. Attribution of liability to the appointor should not reduce any liability of the delegate.

[119] Mode of appointment and revocation of appointment: The Committee recommends that the appointment of a director's delegate should be required to be in writing (including facsimile) signed by the appointor so that it can be produced at a meeting of directors at which the delegate acts on behalf of the appointor. The appointment should be capable of being made for a particular meeting or all directors' meetings held in a period specified in the form of appointment. The fact that a director has voted as a delegate should be required to be minuted. The appointment should be revocable by written notice (including facsimile) to the appointee and to the company. If after making an appointment the appointor

attends a directors' meeting covered by the appointment, the delegate should not be able to vote on matters arising while the appointor is present but that attendance of the appointor should not, of itself, revoke an appointment made for a period.

[120] Company' right to assume delegate's authority: It should be open to the appointor to give the delegate as wide or as narrow an authority as the appointor chooses. There is scope for disputation as between the appointor and the delegate as to whether the delegate in any particular meeting has followed the directions of the appointor.

[121] The Committee recommends that the company should be at liberty to accept the delegate's conduct in relation to voting or not voting on a matter at the meeting as the equivalent of the appointor's conduct where the appointor is not present at the meeting where the matter is voted upon and where no director at the meeting other than the delegate has actual knowledge that the appointment has been revoked or that the delegate is not acting properly.

[122] One director as delegate for several directors: The Committee recommends that it should be permissible for a single director to be a delegate for more than one director. This should be subject to the requirements of multiple physical presence’s to satisfy whatever provisions there may be in the articles about a quorum and to satisfy the need for a physical presence of more than one person to constitute a meeting in this context.

[123] On that last point the Committee recommends legislation making it clear that a meeting of directors in any company must be constituted by the presence of at least two directors in person, notwithstanding any provision in the articles.

[124] Disqualification for interest: It should not be possible for an appointor who has an interest in a contract or proposed contract to vote through a delegate. See ASX Listing Rule 3 L(6) providing that "A director (including an alternate director) shall not vote at a meeting of directors in regard to any contract or proposed contract or arrangement in which he has directly or indirectly a material interest." That rule appears to look to the interest of the person actually voting and not to extend to an interested appointor who does not vote. There is judicial authority that an

alternate director who has been appointed in such a way that the director will be a director in his or her own right rather than an agent of the appointor, is not personally disqualified from voting because the absent director is disqualified for interest: Anaray Pty Ltd. v Sydney Futures Exchange Ltd. (1982) 6 ACLC 271. Under the Committee's proposals the delegate will be a representative of another director and it is appropriate that the vote he or she has as delegate should not be used where, to the delegate's knowledge, the appointor is interested.

[125] The Committee recommends that where an appointor is aware that a particular matter in which he or she is interested is likely to be dealt with at a meeting for which the appointor has appointed a delegate, the appointor should be under a duty to inform the delegate of that interest and the delegate should then be under a duty to declare the interest at the meeting, to abstain from voting and to observe any other requirements that may be in force, whether in the articles or otherwise, in relation to the appointor being interested. The consequences for failure to comply should be similar to those for a contravention of section 228.

[126] Meetings by telephone: To reduce the number of occasions upon which it may be necessary to appoint a delegate or an alternate director the Committee recommends that the Companies Act should contain a provision allowing meetings of directors of companies generally to be held by means of telephone or other communication facilities that allow simultaneous and instantaneous transmission. At present it is open to any company to adopt as part of its articles a provision to that effect and some companies have already done so. The provision suggested should be expressed to operate unless the articles otherwise provide.

[127] The Committee has in mind a provision similar to section 126(13) of the Business Corporations Act of Ontario:

"Unless the by-laws otherwise provide, if all the directors present or participating in the meeting consent, a meeting of directors may be held by means of such telephonic, electronic or other communication facilities as permit all persons participating in the meeting to communicate with each other simultaneously and instantaneously, and a director participating in such a meeting by such means is deemed for the purposes of this Act to be present at that meeting."

[128] The Ontario Act has a related provision in section 126(14) under which, if a majority of the directors participating in a meeting held under sub-section (13) are then in Canada, the meeting shall be deemed to have been held in Canada. The Committee does not see any need for any provision comparable with section 126(14) to be enacted here.

[129] Unlisted Companies: The Committee does not see any need to recommend restraints on the appointment of alternate directors in companies other than listed companies.

ISSUE 2. Should the Companies Act make specific provision for the appointment, duties and liabilities of alternate directors?

[130] In an earlier part of this report the Committee has recommended that it should not be possible for an appointment of an alternate director to be made in a listed company. What follows is confined to companies other than listed companies.

[131] Appointment of alternate directors: At present the power to appoint an alternate director can be conferred on a director by a provision in the articles. The power can be wide enough to enable appointment of a person who is neither a director nor a member. See Table A reg 72(1).

[132] The Committee sees no reason to recommend any provision which would prevent an individual director making an appointment. It would be inappropriate to limit the power to the board; there may be factions and a nominee director properly appointed, as such, may need to choose an alternate. Nor does the Committee see any need to require that the appointee should be drawn from other directors or from members. However, there is a need for legislative guidance as to voting rights where a director is appointed to be an alternate director. Unless the articles otherwise provide the alternate director should have both original voting rights and the voting rights of the director in whose place he or she acts as a director unless that director is present at the meeting.

[133] Alternate directors should be a director in his or her own right rather than an agent for the appointer: The Committee thinks that it is no longer justifiable to have an appointment of an alternate director on terms that he or she is to be the agent of the appointor where it is possible for someone other than another director, to be appointed. The Committee is of the view that any alternate director must be appointed to be a director in his or her own right. It is now accepted that directors are under a duty to consider whether the company has reached the point where it is required that they should take into account the interests of the company's creditors and, if so, to take their interests into account. That requires that any director be a person acting in his or her own right rather than as an agent. In para [91] the Committee has recommended an amendment to the Companies Act which would state the duty of each director to exercise an active discretion in the affairs of the company. That provision should apply as well to alternate directors as to others. Section 234(2) in saving an appointment of an alternate director from the prohibition on assigning an office of director uses language that suggests that an alternate director acts as an agent for the appointor. So also does Table A reg 72(3). Insofar as those provisions suggest that an alternate director can be appointed to be an agent for the appointor it seems that they should be amended and the Committee recommends to that effect.

[134] Consistently with the principle that alternate directors act in their own right, they should be counted as part of any quorum that is required for meetings of directors whenever the appointing director, would be counted unless the appointing director whose place has to be taken attends the meeting.

[135] Rights of alternate directors: If, as the Committee recommends, alternate directors are to be directors in their own right and liable as such, there are certain rights which the legislation should confer on them. During the period for which an alternate director is appointed he or she should have the same rights to attend and speak at meetings of directors at which the appointor is not present, to be provided with information, to inspect accounts and records and to vote as are possessed by the director in whose place he or she acts. The Committee recommends accordingly.

[136] Share Qualification: Whether an alternate director should be required to have a share qualification should be up to individual companies. Under Table A reg 72(4) an alternate director is not required to have a share qualification.

[137] One person as alternate for more than one director: The Committee sees no reason why one person should not be an alternate director for more than one director, provided the articles give authority to that effect. This should be subject to whatever requirements of multiple presence's may be in the articles and subject to the multiple presence's required by the concept of a meeting as used in this context. See para [123].

[138] Age limit for alternate directors: Section 226 embodies the principle that a person who has attained 72 years of age should not be appointed or, subject to exceptions, act as a director of a public company (or a subsidiary of a public company) unless the members of the company (or of the holding company) approve by a prescribed resolution. The Committee is of the view that the principle of section 226 should apply to an alternate director of an unlisted public company and to an alternate director of a subsidiary of a public company. This will require companies to give thought in advance as to the persons who, apart from directors, may need to be appointed as alternate directors and, if need be, obtain the approval of the members of the unlisted public company or the parent (as the case may be). In the working out of this principle in relation to a subsidiary of a public company, if a person is to be appointed as an alternate director on the board of the subsidiary and is 72 or more, there should be a mandate from the members of the parent company in general meeting. In this connection it is noted that the wording of section 226(7)(b)(i) may need revision. Its reference to "a candidate for election" may not be apt for the case of the director who is to be appointed, but not elected, to the board of a subsidiary company.

[139] Disqualification for interests: Existing judicial authority indicates that an alternate director appointed to act in his or her own right in the place of a particular director is not disqualified from voting because the absent director is disqualified for interest: Anaray Pty Ltd. v Sydney Futures Exchange Ltd. (1982) 6 ACLC 271. The Committee's view that an alternate director should be a director in his or her own right accords with that approach.

[140] However, an appointing director who has reason to believe that matters which arise for decision by the alternate will include a contract or proposed contract in which he or she has an interest of the kind declarable under section 228(1) should be under a duty to inform the board under section 228. Failure to comply should lead to the same consequences as follow a contravention of section 228. The Committee recommends accordingly.

ISSUE 3. Should the Companies Act be amended to make it clear that alternate directors are included in the provisions affecting directors.

[141] The extended definition of "director" in section 5(1) of the Companies Act in its application to de facto directors would extend to an alternate director. The definition includes "any person occupying or acting in the position of director of the corporation, by whatever name called and whether or not validly appointed to occupy or duly authorized to act in the position:".

[142] Given that definition, the Committee believes that legislation to make it clear that alternate directors are included in the provisions affecting directors is not needed.

ISSUE 5. Should specific statutory provision be made to extend to alternate directors the general law principles of fiduciary liability applying to directors generally.

[143] In dealing with Issue 3 the Committee relied upon the existing extended definition of "director" in section 5(1) of the Companies Act as making alternate directors liable to the statutory duties in the Companies Act. The general fiduciary duties are subsumed under the statutory duty in section 229(1) to act honestly. Accordingly, the Committee does not recommend special provisions to extend to alternate directors the general principles of fiduciary liability applying to directors generally.

[144] The Committee notes that ASX Listing Rule 3L(6) dealing with listed companies embodies the same principle. It provides:

"A director (including an alternate director) shall not vote at a meeting of directors in regard to any contract or proposed contract or arrangement in which he has directly or indirectly a material interest".

The Committee reads this as referring to a principal director who has an interest of his or her own and an alternate director who has an interest of his or her own. As so interpreted, the rule is consonant with the principle that an alternate director should be looked upon as a director in that director's own right.

ISSUE 6. Should the Companies Act or Table A (or both) be amended to provide for the liability (if any) of the appointer for the acts of the alternate director?

[145] It is consistent with the principle favoured by the Committee that all alternate directors of any company should be considered to be in the same position as principal directors that an appointor should not be liable for the acts and omissions of the alternate director merely by reason of having been the appointor. A similar view seems to have been taken by Joske J in Re Associated Tool Industries Ltd. (1963) 5 FLR 55 at 68 where His Honour ruled that it was "quite impossible as a matter of law to impute" the knowledge of an alternate director to the appointor or to make the appointor liable for the alternate's actions.

[146] An appointor might incur liability for breach of the duties of care and diligence by making an unsuitable appointment.

[147] The Committee does not recommend any legislation on this matter. Alternate directors would be covered by the amendment to section 229 recommended earlier (see para [91]) under which all directors would be under a duty to exercise an active discretion.

(NOTE : Issue 4 of the Discussion Paper, "Should alternate directors have equivalent powers to their appointors?", has been dealt with in other parts of this Report, particularly paragraphs [133] - [135].)

H A J FORD (Chairman)

G W Charlton

D A Crawford

A B Greenwood

D R Magarey

2 March 1989

APPENDIX

LIST OF RESPONDENTS

1. Australian Bankers' Association

2. M.I.M. Holdings Limited

3. Baker & McKenzie

4. Allen, Allen & Hemsley

5. Law Council of Australia

6. The Law Society of South Australia

7. Mr. Ian Renard of Arthur Robinson & Hedderwicks