COMPANIES
AND
SECURITIES
LAW REVIEW COMMITTEE

NOMINEE DIRECTORS AND ALTERNATE DIRECTORS

DISCUSSION PAPER No. 7

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COMPANIES AND SECURITIES LAW REVIEW COMMITTEE

DISCUSSION PAPER NO. 7

THE DUTIES AND LIABILITIES OF NOMINEE DIRECTORS AND ALTERNATE DIRECTORS

Preface

Function and Membership

The Companies and Securities Law Review Committee was established late in 1983 by the Ministerial Council for Companies and Securities pursuant to the inter-governmental agreement between the Commonwealth and the States of 22nd December, 1978.

The Committee's function is to assist the Ministerial Council by carrying out research into and advising on law reform in relation to legislation concerning companies and the regulation of the securities industry.

The Committee consists of five part-time members, namely:

Mr. Donald R. Magarey
Mr. Geoffrey W. Charlton
Mr. David A. Crawford
Professor Harold A.J. Ford (Chairman)
Mr. Anthony B. Greenwood.

The full-time Research Director for the Committee is

Mr. John B. Kluver.

The Committee's office is at Level 24, M.L.C. Centre, 19-29 Martin Place, Sydney, New South Wales, 2000.

General Aims of the Committee

To develop improvements of substance and form in such parts of companies and securities law as are referred to the Committee by the Ministerial Council and for that purpose to develop proposals for laws:

* which are practical in the field of company law and securities regulation;

* which facilitate, consistently with the public interest, the activities of persons who operate companies, invest in companies or deal with companies and of persons who have dealings in securities; and

* which do not increase regulation beyond the level needed for the proper protection of persons who have dealings with companies or in relation to securities.

In the identification of defects and the development of proposals to have regard to the need for appropriate consultation with interested persons, organisations and governments.

The Reference from the Ministerial Council

The Ministerial Council for Companies and Securities has 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."

Aims of the Discussion Paper

Nominee directors and alternate directors lie outside the mainstream of company law doctrine and scholarship. There is only a slight body of case law applying specifically to them and little by way of text-book analysis and scholarly examination. They are not subject to specific statutory regulation. This formal disregard belies the apparent importance of the offices which are widely employed in Australian business and the issues of legal policy which each peculiarly raises. This paper seeks to identify these issues and to canvass the various regulatory responses which might be made to them. The Committee hopes that it will thereby attract a range of opinion as to the merits of the competing approaches that might be taken to these issues.

Issues concerning nominee directors are posed for consideration by interested persons in Chapter 5 of this paper. Issues touching alternate directors are set out in Chapter 7. Other chapters of the paper provide background discussion relevant to consideration of these issues.

Invitations for Responses

The Committee invites written submissions on the matters dealt with in this Paper.

The Committee will assume that it is free to publish any submission, in whole or in part, unless the respondent indicates that the submission is confidential. All respondents will, in any event, be listed in any report made by the Committee to the Ministerial Council.

Submissions should be sent to:

The Research Director,
Companies and Securities Law Review Committee,
Level 24,
MLC Centre,
19-29 Martin Place,
SYDNEY. 2000.

By 31st March, 1988.

Acknowledgment

In preparing this Discussion Paper, the Committee appointed as its consultant Paul Redmond, Senior Lecturer in Law, University of New South Wales. The Committee expresses its appreciation for his valued and substantial contribution, both in research and the identification of issues for review.

PART A

NOMINEE DIRECTORS

CHAPTER 1

Nominee Directors and General Fiduciary Duties

The term 'Nominee Director'

[101] This term is not defined, indeed, it is not even employed in company statutes. Nor have the courts adopted any single clear definition. In commercial practice persons may be nominated or elected to the Board of Directors as of right by an individual shareholder, a class of shareholders, or some other groups (e.g. a major lender to the company or the employees of the company), rather than by the general body of shareholders. Sectional appointment of directors is recognised in Australia[1] and overseas[2]. However "nominated directors"

1. Companies Code s225(1): "A public company may, by resolution, remove a director before the expiration of his period of office but where any director so removed was appointed to represent the interests of a particular class of shareholders or debenture holders, the resolution to remove him does not take effect until his successor has been appointed."

2. In the USA, the Revised Model Business Corporation Act (1984) s8.04 s8.08(b) and 8.10(b) provides that the company articles may authorise the election and removal of a specific number of directors by one or more classes of shareholders. These shareholders may fill a casual vacancy where the retiring director was originally elected by that group of shareholders.

New York State law provides that a corporation may confer the right to vote for directors on holders of the corporation's bonds and the articles may authorize election of one or more directors by those bond holders, voting as a class. These sectional interests are also recognized in provisions regulating the removal of directors and the filling of casual vacancies.

West German law requires a mandatory two tier board system for stock corporations, a management board and a supervisory board. Depending upon the size of the stock corporation, either one third or a half of the supervisory board is elected by the employees of the enterprise: Journal of Comparative Business and Capital Market Law Vol. 8 No. 4 December 1986 p403.

may not necessarily be "nominee directors". The term "nominee directors" will be employed in this Discussion Paper to identify persons who, independent of the method of their appointment, but in the performance of their office, act in accordance with some understanding, arrangement or status which gives rise to an obligation (in the wide sense) to the appointor. This understanding etc. may take a variety of forms, from provisions in the Articles or Shareholder agreements outside the Articles, formally appointing a director as nominee of another, to tacit understandings or mere expectations that a nominee will represent interests on the board. This arrangement or understanding may be reinforced by the appointor having the right or power to remove and replace the nominee director. The term "nominee director" shall not be applied to "nominated directors" who carry no on-going commitment to the nominator.

[102] In practice there seem to be various categories of nominee directors. The first may be described as 'representative nominee directors'. They act as advocates of the nominator's stance or protector of the nominator's interests, this often being pre-determined or agreed with the nominator before the board meeting. They normally include employees, (e.g. the Chief Executive of a corporate nominator) external advisers engaged for the purpose (e.g. solicitors) or representatives of lenders or special interest groups (e.g. an employee representative). Each can be regarded as the spokesperson for, and the protector of the interests of, the nominator.

[103] A second category may be termed 'independent nominee directors'. They are expected to keep the particular interests of their nominator in mind when acting as a director and to keep the nominator informed either generally, or on issues of particular interest to the nominator. They differ, often in

degree only, from the first group of nominee directors by the reduced level of consultation with or commitment to their nominators. The common feature is that such persons act with a fair degree of independence from the nominator but the links with or loyalty to the nominator are such that such directors are not truly independent.

[104] Nominee directors may fall between the two categories according to the degree of independence they have from the nominator. However, for the purpose of discussion, it may be useful to maintain the distinction between 'representative' and 'independent' nominee directors.

[105] The incidence of 'independent' and 'representative' nominee directors often depends on the nature of the company of which they are directors:

1. Listed Public Companies

[106] With such companies, the nominator will often be a significant shareholder. The right of appointment may arise from the mere agreement of the board in recognition of that shareholding or it may be contractually based or, in exceptional circumstances, be provided for in the articles. The nominee director will usually be a representative nominee director although any additional nominee director may well be an independent nominee director to satisfy sensitivities.

2. Listed Subsidiary and Associated Companies

[107] In these companies, there will usually be representative nominee directors, independent nominee directors, directors who are senior managers of the company, and independent directors representing the minorities. Even the representative directors in such cases may exercise a degree of independence because of consciousness of responsibilities to minority shareholders.

3. Wholly Owned Subsidiaries

[108] Boards of such companies will mostly be comprised of representative directors, but not entirely. Non-executive independent nominee directors are often appointed to wholly owned subsidiary boards to provide an external perspective to the business of the company, particularly for Australian wholly owned subsidiaries of overseas corporations.

4. Joint Venture Companies

[109] A joint venture company is essentially the adoption of the corporate form (rather than an incorporated joint venture, a trust or partnership) for the pursuit by a small number of parties (usually 2 or 3) of a common business enterprise. The company will normally be constrained by its Memorandum and Articles or shareholders agreement to a single enterprise or purpose.

[110] Appointment of directors by each participating party will normally be the means by which that party protects its own interests. As such, such appointees are (unabashed) representative directors who act as spokespersons for, and carry out their duties, solely in the interests of the appointor. The articles may expressly empower the participating parties to remove and replace their appointees on the board.

[111] The foregoing illustrates the various shades of nominee directors which exist in commercial practice. Of course, it is impossible to identify with any precision the incidence of nominee directors and the particular interests which they are appointed to represent. There is no obligation to register such appointments or to notify such understandings except as applies under general provisions of the Companies Code requiring disclosure of interests which a director has in contracts with his company or of offices or property which raise the possibility of conflict with his duties as a director (s.228). Company articles may impose similar obligations of

disclosure but neither body of provisions is addressed specifically to the nominee director and will in most cases not apply to compel disclosure of the fact or terms of the nominee's understanding with his appointor.

The derivation of directors' duties

[112] In considering the office of nominee director, it is necessary to first outline the duties of company directors generally. These duties fall into two broad categories -fiduciary obligations of good faith towards the company and duties to bring to the discharge of their office proper levels of care, diligence and skill. The issues peculiarly raised by the appointment of nominee directors are concerned with the scope of their fiduciary obligations. Accordingly, it is with that element of directors' duties that we shall be exclusively concerned in this chapter.

The duty of good faith

[113] Our legal system imposes various obligations of good faith upon company directors. These doctrines were largely fashioned by English courts in the second half of the nineteenth century after legislation in the middle of the century had granted trading companies the right to incorporate with limited liability for their members. This legislation had, however, left to the courts the task of devising standards of conduct proper for those directing the affairs of these new registered companies. In shaping these standards the courts initially adopted as their model the established legal office of the trustee. The trustee, who holds property or rights for the benefit of another, has long been burdened with strict duties of honourable and self denying conduct towards the trust beneficiaries. Over time the position of the director was differentiated from that of the trustee and the rigour of the trustee standard tempered in its application to directors. In the end, courts have come to treat directors as "fiduciaries" towards their company, one of several such categories of office

or occupation fixed with more or less rigorous obligations of good faith and disinterested conduct towards another person or persons.

The director's duty to act bona fide for the benefit of the company as a whole

[114] One fiduciary obligation imposed upon directors is the duty to act bona fide for the benefit of the company as a whole. This duty is sometimes called the duty of good faith. The duty obliges directors to exercise their powers and perform their functions by reference to their perception of the interests of the company as a whole. How does the law interpret the "interests of the company" to which directors must have regard? One formulation of these interests which has been widely cited by Australian courts is that expressed by the English Court of Appeal in Greenhalgh v Arderne Cinemas Ltd.[3] where Evershed M.R. said:

"In the first place, I think it is now plain that 'bona fide for the benefit of the company as a whole' means not two things but one thing. It means that the [director] must proceed upon what, in his honest opinion, is for the benefit of the company as a whole. The second thing is that the phrase, 'the company as a whole' does not ... mean the company as a commercial entity, distinct from the corporators: it means the corporators as a general body. That is to say, the case may be taken of an individual hypothetical member and it may be asked whether what is proposed is, in the honest opinion of those who voted in its favour, for that person's benefit."[4]

[115] The duty of good faith, therefore, requires directors to consult the interests of the shareholders as a general body, and not merely those of a particular section of the membership, an individual shareholder or an outsider. Accordingly, where directors act solely for the benefit of a single shareholder (even one who holds a majority of the capital or voting rights in the company) they will breach their duties of good faith.[5] In short, the director's their duties of good faith.[5] In short, the director's

3. [1951] Ch 286.

4. At 291.

5. See, e.g., Ngurli Ltd. v McCann (1953) 90 CLR 425.

allegiance is to the collective interests of members and he is obliged to act impartially in interpreting and advancing those interests.

[116] In some recent cases judges have interpreted the duty of good faith as requiring the director to have regard to the interests of the company's creditors. For example, in the decision of the High Court of Australia in Walker v Wimborne[6] Mason J. (now the Chief Justice of the Court) said:

"[I]t should be emphasized that the directors of a company in discharging their duty to the company must take account of the interest of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them. The creditor of a company must look to that company for payment. His interests may be prejudiced by the movement of funds between companies in the event that the companies become insolvent."[7]

The claims of creditors upon directors' consideration will be more urgent where the company is insolvent, of doubtful solvency or if a contemplated payment or transaction would jeopardize that solvency.[8]

The duty to avoid the possibility of conflict between duty and interest

[117] A second element of the director's fiduciary obligation is the duty to shun engagements which create the real possibility of conflict between his personal interest (or another interest which he is bound to protect) and his duty of

5. See, e.g., Ngurli Ltd. v McCann (1953) 90 CLR 425.

6. (1976)137 CLR I at 7.

7. See also Kinsela v Russell Kinsela Pt Ltd. (in liq.)(1986) 4 ACLC 215; Grove v Flayel (1986) 4 ACLC 654; in New Zealand see Nicholson v Permakraft NZ Ltd. (1985) 3 ACLC 453; in England, see Winkworth v Edward Baron Development Go. Ltd. [1987] 1 WLR 1512 at 1516.

8. Nicholson v Permakraft NZ Ltd. (in liq.) (1985) 3 ACLC 453 at 457-460.

loyalty to the company. This "conflict avoidance" obligation is not discharged merely by the director preferring the claims of duty to those of self-interest. Rather, the obligation requires the director to avoid commitments or situations which raise the possibility of conflict itself. The obligation has been called prophylactic in that it requires directors to shun the occasion of temptation and not merely to resist its thrall.

[118] The conflict avoidance obligation rests upon the judgment that it is "neither wise nor practicable" for the law to look for a criterion of liability beyond the fact that duty has been opposed to self interest: "the consequences of such a conflict are not discoverable. Both justice and policy are against their investigations."[9] Over a century ago a judge concluded that the "safety of mankind" would be put at risk by a rule which made a fiduciary liable only for preferring interest to duty.[10] A modern judge has said that "in a nuclear age [this risk assessment] may perhaps seem something of an exaggeration, but, nonetheless it is eloquent of the strictness with which throughout the last century and indeed in the present century, courts of the highest authority have always applied this rule".[11]

[119] The conflict avoidance obligation embodies the ancient wisdom that it is impossible to honour dual loyalties. The judgment is by no means peculiar to our legal system. It is perhaps best expressed by the evangelist Luke: "No servant can be the slave of two masters: he will either hate the first and love the second or treat the first with respect and the second with scorn" (Luke 16:13; cf. Matthew 6:24).

9. Furs Ltd. v Tomkies (1936) 54 CLR 583 at 592 per Rich, Dixon and Evatt JJ.

10. Parker v McKenna (1874) 10 Ch App 96 at 124 per James L.J.

11. Industrial Development Consultants Ltd. v Cooley [1972] 1 WLR 443 at 452 per Roskill J.

[120] The conflict avoidance obligation has a number of specific applications in relation to company directors. Thus, in the absence of express authorisation, a director may not contract with his company since his scrutiny of the proposed contract in his capacity as director would necessarily be compromised by his conflicting interest in deriving personal benefits under it. Similarly, a director is precluded from exploiting for his own benefit valuable information or opportunities acquired by reason and in the course of his office as director. The pursuit of such an opportunity would itself raise an opposition between the director's duty to exploit the opportunity to best corporate advantage and the director's personal interest in its private exploitation. In both instances, directors may be released from their duty by the company in general meeting and, within limits, by appropriate provision in the company's articles of association. Indeed, articles of association almost invariably make provision enabling the director to have an interest in contracts with his company subject to particular safeguards such as disclosure of the nature of that interest and exclusion from voting on the contract.

The core problem raised by nominee director

[121] Nominee directors occupy a most delicate position. Under Australian and English company law the board of directors is conceived as a collegiate group of persons each bearing allegiance to the general body of shareholders, and not a collection of individuals each representing a particular sectional interest. Further, at first sight the nominee director appears to offend the duties of loyalty and conflict avoidance. As to the former, is not the nominee appointed for the very purpose of acting partially, either by subordinating the interests of the general body of members to those of his appointor or by indentifying company interests with those of the appointor? Equally, it would seem that the nominee's agreement or understanding with his appointor may

create either a personal stake or a duty to the appointor in possible conflict with the nominee's duty to advance the interests of the general body of shareholders. There is a provision in the Companies Code which provides that the removal of a director appointed to represent the interests of a particular class of shareholders or debenture holders does not take effect until his successor has been appointed (s.225(1)). This implies that the appointment of a nominee director is not in itself unlawful but the Code is silent as to the adjustment of conflicting loyalties. How that adjustment should be made is the central concern of this Part of the Paper.

CHAPTER 2

The distinctive Australian case law on the nominee director's duty of good faith

[201] In the 1960s a distinguished judge sitting in the Supreme Court of New South Wales (and who later became a member of the High Court) delivered two judgments which lent legitimacy to the practice of appointing nominee directors and relaxed the duties of good faith applying to them. These judgments are a natural starting point for a reappraisal of the practice and of the nominee director's duties. This paper looks at each decision in some detail, treating each in the nature of a "case study". There are several reasons for doing so. First, these are the only cases in Australian and English law which pay detailed attention to the duties of nominee directors. Secondly, the facts of these cases themselves raise many of the important issues which arise in a thoughtful reappraisal of the nominee director's position. Thirdly, the two cases illustrate different but recurrent instances in which nominee directors are employed.

Nominee directors representing an unpaid vendor of shares in a prove company - Levin v Clark

[202] The first case was Levin v Clark[1], decided in 1962. The plaintiff Levin purchased the majority shareholding in a proprietary company and simultaneously mortgaged the shares to the vendor to secure the future payment of the purchase price. Prior to the sale the company's articles of association had named Clark and Rappaport as governing directors and conferred extensive powers upon them. Under the sale agreement the articles were to be amended to make the powers of Clark and Rappaport exercisable only in the event of Levin's default

1. [1962] NSWR 686.

under the mortgage agreement. The articles were accordingly altered. The articles and the sale and mortgage agreements did not expressly identify Clark and Rappaport as nominees of the mortgagee/vendor and did not specify any special duties or loyalties for them (apart, of course, from their suspended offices as governing directors). However, it was evident that they retained those offices to protect the interests of the mortgagee in the event of Levin's default under the mortgage.

[203] The mortgagee subsequently gave notice of Levin's default and Clark and Rappaport proceeded to exercise their powers as governing directors. Levin challenged their assumption of power upon the ground that, as governing directors, their primary allegiance was to the mortgagee and not the company as a whole. Levin also argued that certain resolutions which Clark and Rappaport had purported to pass as governing directors were invalid because they were acting solely in the interests of the mortgagee and not in the interests of the company.

[204] In the Supreme Court of New South Wales, Jacobs J. made the following findings of fact and conclusions as to their significance (at 700-701):

"I consider that Clark and Rappaport did act primarily in the interests of the mortgagee once they resumed the exercise of their powers as governing directors. However, I consider that it was permissible for them so to act. 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. To argue that a director particularly appointed for the purpose of representing the interests of a third party cannot lawfully act solely in the interests of that third party, is in my view to apply the broad principle governing the fiduciary duty of directors, to a particular situation, where the breadth of the fiduciary duty has been narrowed, by agreement amongst

the body of the shareholders. The fiduciary duties of directors spring from the general principles, developed in courts of equity, governing the duties of all fiduciaries - agents, trustees, directors, liquidators and others - and it must be always borne in mind that in such situations the extent and degree of the fiduciary duty depends not only on the particular relationships, but also on the particular circumstances. Among the most important of these circumstances are the terms of the instrument governing the exercise by the fiduciary of his powers and duties and the wishes, expressed directly or indirectly, by direction, request, assent or waiver, of all those to whom the fiduciary duty is owed.

"In the present case, the sole shareholders are the plaintiff and Clark and Rappaport. By agreement with the plaintiff, Clark and Rappaport remain in the company so that upon default arising under the security agreement they can immediately commence to act in the affairs of the company in order to protect the interests of the mortgagee of the shares. It does not follow, in my opinion, that by acting in the interests of the mortgagee, and solely in the interests of the mortgagee, those directors necessarily cease to act in the interests of the company. Certainly they may cease to act in the interests of the plaintiff, and admittedly the plaintiff is the registered holder of the shares, but it would be quite artificial to ignore the interests of the mortgagee in these circumstances."

[205] In summary, Jacobs J referred to "particular circumstances" conditioning the "extent and degree of fiduciary duty". Among the "most important" of these circumstances were the "terms of instrument governing the exercise by the fiduciary of his powers". Here, that instrument was the company's articles of association which named Clark and Rappaport as governing directors but with powers arising only upon the plaintiff's default. While the articles did not make explicit their role as representatives or nominees of the mortgagee, it was not difficult to infer that their primary duty was to protect the mortgagee's interests in the event of default.

[206] The judgment indicates that a company's constituent documents may, directly or indirectly, modify the duties of nominee directors such that promotion of the interests of their nominators may, on a broad perspective, be in the interests of the company as a whole.

[207] What principles apply where the articles do not effect some accommodation of the general fiduciary duty to particular

circumstances? Such a situation came before the same judge two years later.

Nominee directors in a partly owned subsidiary - Re Broadcasting Station 2GB Pty Ltd.

[208] The decision in Re Broadcasting Station 2GB Pty Ltd.[2] arose out of control of the operator of Sydney broadcasting station 2GB in 1964. For some years the issued capital of Broadcasting Station 2GB Pty Ltd. (hereafter "2GB") had been held as to 45% by Broadcasting Associates Pty Ltd., as to 14% by the John Fairfax group of companies and the balance by various minority shareholders. The articles of 2GB contained a provision entitling the Fairfax group to be represented upon the 2GB board by one director. Of the other six 2GB directors, four were nominees of Broadcasting Associates (or its holding company) and one regarded himself as representing the minority shareholders. The remaining director, the managing director, did not occupy any particular representative capacity.

[209] From 1958 the capital of Broadcasting Associates had been held by A.T.V. (Australia) Pty Ltd., the Australian subsidiary of an English company Associated Television Ltd. In June 1964 the Fairfax companies purchased the Australian investments of Associated Television including its shares in Broadcasting Associates. Under the terms of 2GB's broadcasting licence Ministerial consent was required for the transfer of interests in Broadcasting Associates if the station's licence was not to be put into jeopardy.

[210] In July, just prior to the completion of the transfer, Fairfax gave notice that it required the resignation of all directors of A.T.V. (Australia) and of all directors of other subsidiary companies where they were nominees or appointees of A.T.V. This direction specifically included the four directors

2. [1964-5] NSWR 1648.

of 2GB who had been nominees of Broadcasting Associates. Two of these four directors indicated their willingness to comply with this directive but two refused (the appointor in this case did not have an express power to remove and replace nominee directors). One of the latter explained his position thus:

"I hold shares in 2GB and my appointment is by the shareholders. I recognize no difference in my responsibility to the minority shareholders as well as to the major holding involved in the pending transaction, the welfare of the company and its shareholders generally being the paramount consideration."

[211] In the light of this unexpected development, i.e., that two directors no longer regarded themselves as nominees of Broadcasting Associates but as representatives of the general body of shareholders, the Fairfax companies devised a procedure whereby a majority of the board could be expected to heed their wishes. At board meetings in early August two senior Fairfax employees were appointed by the board as additional directors under a power contained in the articles. Shortly afterwards the two 2GB directors who had earlier agreed to resign did so and the board appointed two further Fairfax nominees to fill the casual vacancies. These appointments were opposed by the two directors who had earlier resisted the Fairfax direction to resign and by the director who had long regarded himself as representing minority shareholders. These three directors sought information as to the security of the 2GB licence and assurances concerning the future position of minority shareholders, but received no response from other members of the board or the Fairfax companies.

[212] One of the three directors petitioned the Supreme Court of New South Wales seeking orders that the affairs of 2GB were being conducted in an oppressive manner. (This provision, now contained in the Companies Code s320, empowers the Supreme Court to make a wide range of orders to relieve against the oppressive conduct of company affairs.) The alleged oppression lay in (1) the steps taken to secure the appointment of a majority of Fairfax directors on the board, being steps taken

solely in the interests of the Fairfax companies and (2) the withholding by the Fairfax interests of information concerning the negotiations with the Commonwealth Government to preserve the 2GB licence consequent upon the change in control of Broadcasting Associates, the principal shareholder in the licensee company.

[213] In the Supreme Court of New South Wales Jacobs J. examined a number of cases dealing with the oppression remedy. He said (at 1661-1662):

"My conclusion from these cases is that it is my duty to look at the whole course of events in the company in the period complained of and see whether [they disclose] a 'visible departure from the standards of fair dealing' or conduct which is 'burdensome, harsh and wrongful' or which suggests a lack of probity... However, in applying these tests, the further question arises of determining what conduct falls within the ambit of the word or words used, whether it be the word 'oppressive' as used in the section itself or the words used in the synonyms suggested in the cases to which I have referred. What is the 'fair dealing' which the member is entitled to expect? When is the conduct 'wrongful' or 'lacking in probity'? Clearly the section does not refer to all conduct in the affairs of a company which merits these descriptions. It refers only to such conduct when it is oppressive to a member and the question still remains - when is such conduct oppressive?"

[214] The judge concluded that this question should be resolved by reference to the legal doctrines defining the duties of directors and majority shareholders. He said (at 1662-1664):

"It seems to me that it is necessary, in the circumstances of the present case, to have recourse to the principles which have been developed in the cases dealing with the duties of a director in his conduct of the affairs of a company, and the duties of a majority shareholder towards the minority. Each of them in his own way must govern his acts by his appreciation of the interests of the company as a whole. Ordinarily the interests of the company can be identified with the interests of the majority of its shareholders. In a company the majority rule, unless the articles of association are so drawn as to provide otherwise. The system of election of directors is intended to achieve this result of majority rule. However, all directors must act in the interests of the company as a whole, as also must the majority shareholders who appoint them. The difficulty lies in reconciling this duty in all the shareholders with their right, generally speaking, to vote in their own interests. The reconciliation is to be found in the necessity that the shareholder should have a genuine belief that the proposed action, however much it

may benefit him, is in the interests of the company as a whole, including the minority shareholders. If he does not or reasonably could not hold such a belief, and if the proposed act is to the pecuniary disadvantage of the minority shareholders then they can complain that the conduct is oppressive...

"When I consider the course of events in the present case I commence at a point of time when the Fairfax companies controlled at least 60 per cent of the voting power of the company. I conclude that they thought, at the time of the purchase of the A.T.V. shares, that they could reconstitute the board of directors in a manner which would practically ensure that their wishes were carried out. When it was found that this could not be done as simply as was originally thought, a procedure was adopted which would achieve the same result. Now, although these could be the preliminary steps in a course of behaviour which might lead to oppression, they are not in themselves oppressive, provided the legal requirements of the articles of association are observed. Under the articles two additional directors were, to all intents and purposes, the nominees of the Fairfax companies who would be likely to act and who would be expected by the Fairfax interests to act in accordance with the latter's wishes. At this point I feel that a crucial stage in the analysis is reached. It is my view that conduct of the kind which I have related is not reprehensible unless it can also be inferred that the directors, so nominated, would so act even if they were of the view that their acts were not in the best interests of the company. This is not a conclusion which can lightly be reached and I see no evidence in the case upon which I can reach that conclusion. It may well be, and I am inclined to regard it as the fact, that the newly appointed directors were prepared to accept the position that they would follow the wishes of the Fairfax interests without a close personal analysis of the issues. I think that at the board meetings of early August that is what they did, but I see no evidence of a lack in them of a bona fide belief that the interests of the Fairfax company were identical with the interests of the company as a whole. I realize that, upon this approach, I deny any right in the company as a whole to have each director approach each company problem with a completely open mind, but I think that to require this of each director of a company is to ignore the realities of company organization. Also, such a requirement would, in effect, make the position of a nominee or representative director an impossibility.

"I think that it follows from what I have said that I am not particularly impressed by the individual reasons given by each director why he voted on any occasion in any particular way. I think the bare truth of the situation can be summed up by saying that the Fairfax companies were determined, by any legal means available, to obtain control of the direction of the company, or

rather to retain such control despite the contemplated changes in the board. I think that the various moves were made for that purpose and that the various actors ... played their parts accordingly.

"The view which I take of the conduct of the directors does not in my approach to this matter amount to oppression of any shareholder nor to improper conduct so long as they bona fide believed that the Fairfax companies would act in the interests of the company as a whole. They were prepared to leave it to the Fairfax companies to conduct the

negotiations with the Postmaster-General. There is, in my view, no evidence which would support a conclusion that this course was not one which was in the best interest of the company to adopt. However, this attitude which was adopted by the majority of the directors has a very important result, namely, that if it could be shown that the Fairfax companies were acting in their own interests, either contrary to the interests of the company, or without any regard to the interests of the company, then no one, director or shareholder, could rely on the acts of the directors, or the failure of the directors to act, upon the ground that they acted or failed to act in a bona fide belief that the Fairfax companies would act in the interests of the company.

"In the circumstances revealed in this case I think that it is proper to shift attention from the acts of the directors to the acts of the Fairfax companies, because the directors have, in effect, left the matter to the Fairfax companies. If it were to appear that the latter were acting contrary, or without regard to the interests of the company, to the detriment of any of the minority shareholders, then I think that a case of oppression would be made out. The Fairfax companies, which, if they had left the board of the company as an independent board, could have proceeded in their negotiations with the Minister practically independently, cannot so long as they, in effect, act for the company and so long as their decisions are, in effect, the decisions of the board, be free of the obligation to act in what they believe to be directly in the best interests of the company as a whole. I do not think that there is any evidence that they have acted otherwise than in what they believe to be the best interests of the company. I do not think that it is sufficient that they have put themselves in a position where their interest and the duty which they have taken directly upon themselves may conflict. It would only be in the event that, on a conflict arising, they preferred their own interest that a situation of oppression could arise."

[215] In summary then the memorandum and articles of the broadcasting company did not make any provision for the appointment of the additional nominee directors or for the adjustment of their loyalties. Further, Jacobs J. found that these directors were "to all intents and purposes" nominees of the Fairfax companies who would be likely to act in accordance with the wishes of the Fairfax group which would expect them to do. Jacobs J. considered that such conduct would not be reprehensible "unless it can also be inferred that the directors, so nominated, would so act even if they were of the view that their acts were not in the best interests of the company" (at 1663). There was no evidence from which such an inference might be drawn. The nominees did, however, follow the wishes of the group "without a close personal analysis of

the issues". However, such compliance would not be objectionable as long as they had a bona fide belief that the group's interests were identical with the interests of the company as a whole. It seems, therefore, on this analysis that nominee directors will breach their duty to the company only if they knowingly sacrifice company interests for those of their appointor. To require a higher standard of nominee loyalty would be "to ignore the realities of company organization [and] ... make the position of a nominee or representative director an impossibility" (at 1663).

Statutory corporations: a special case?

[216] Three years later substantially similar issues arose in another New South Wales case, but now dealing with a statutory board and not a registered company. The decision is significant for its statement of the undivided loyalties of persons appointed to the governing boards of statutory bodies, including those appointed to represent a particular sectional interest upon the board. No reference was made in the decision to the (then) recent decisions of the same court concerning nominee directors of business corporations. The litigation is reported as Bennetts v Board of Fire Commissioners of New South Wales[3].

[217] The Board of Fire Commissioners of New South Wales was established by legislation with the duty of taking all practicable measures to prevent and extinguish fires and to protect life and property in the event of a fire (Fire Brigades Act 1909 (NSW), s19). The Board was constituted as a statutory corporation with membership comprising persons elected by interested groups - the municipal and shire councils, insurance companies, volunteer firemen and permanent firemen who are members of the Fire Brigade Employees' Union (s9).

3. (1967) 87 WN (NSW) 307

[218] In June 1967 the Industrial Commission, on the application of the Fire Brigade Employees' Union, made an award determination affecting the permanent firemen employed by the Board. After obtaining a barrister's opinion on the prospects of an appeal, the finance committee recommended to the Board that an appeal be instituted. When the Board met to receive and consider this recommendation Bennetts, who had been elected by the permanent firemen, sought a copy of counsel's advice which the chairman agreed to supply, but only upon Bennetts' undertaking not to disclose its contents to his union. He refused to give this undertaking. The Board voted, notwithstanding Bennetts' opposition, to adopt the finance committee's recommendation. Bennetts then commenced proceedings to gain unconditional access to counsel's advice and to restrain the lodging of appeal.

[219] The presiding judge, Street J. (now Chief Justice of the NSW Supreme Court) took the opportunity to explain the principles governing the responsibilities and duties of members of statutory boards and commissions. Often these boards will comprise persons nominated or chosen by groups with a direct interest in the public undertaking controlled by the board. In such situations, Street J. said (at 310-311):

"[e]ach of the persons on such a board owes his membership to a particular interested group; but a member will be derelict in his duty if he uses his membership as a means to promote the particular interests of the group which chose him.

"The consideration which must in board affairs govern each individual member is the advancement of the public purpose for which parliament has set up the board. A member must never lose sight of this governing consideration. His position as a board member is not to be used as a mere opportunity to serve the group which elected him. In accepting election by a group to membership of the board he accepts the burdens and obligations of serving the community through the board. This demands constant vigilance on his part to ensure that he does not in the smallest degree compromise or surrender the integrity and independence that he must bring to bear in board affairs.

"Undoubtedly there will be differences of opinion between board members... But the predominating element which each individual must constantly bear in mind is the promotion of the interest of the board itself. In particular, a board member must not allow himself to be compromised by looking to the interests of the group which appointed him rather than to the interest for which the board exists. He is most certainly not a mere channel of communication or listening post on behalf of the group which elected him. There is cast upon him the ordinary obligation of respecting the confidential nature of board affairs where the interests of the board itself so require...

"[A view] is apparently held that, because a board member is appointed or elected by a particular group, he owes some overriding obligation or duty to the group which has conferred upon him his status as a member. The error inherent in this view must be exposed and, for purposes of emphasis, I repeat what I have earlier said. It is entirely foreign to the purpose for which this or any other board exists to contemplate a member of the board being representative of a particular group or a particular body. 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. With this basic proposition there can be no room for compromise."

[220] Street J. acknowledged the bona fides of Bennetts' perception that he was subject to conflicting loyalties and that he owed the higher duty to his electors. These bona fides notwithstanding, Street J. concluded (at 313) that "the principle governing the manner in which that conflict should be resolved is that the overriding duty is the duty to the board, and that that duty must not be compromised in any degree whatever." As noted above, Street J. did not make any reference to the recent decisions of Jacobs J. imposing quite different standards of loyalty upon nominee directors of trading companies.

[221] There have been a number of subsequent Australian cases that impinge on the rights and duties of nominee directors. These will be discussed at appropriate points in the following chapters. The issues posed by the foregoing discussion appear in Chapter 5.

CHAPTER 3

Some Related Legal Issues

[301] The principal question raised by the reference on nominee directors concerns their fiduciary duties to the company. There are, however, subsidiary issues touching on the nominee's duties and liabilities. This chapter outlines the legal doctrine applying to each.

Commitments by a nominee director to his appointor

[302] It is a basic rule of company law that directors should maintain, and bring to bear, an independent judgment in the exercise of their powers. The rule is a further application to companies of the general equitable obligation upon fiduciaries to avoid the possibility of conflict between duty and interest (see [117]-[120]). Thus, in the absense of an empowering provision in the articles, directors may not delegate their discretionary powers to another group or individual.[1] Similarly, directors may not impair their independent judgment by binding themselves as to the future exercise of discretionary powers. Although there is little authority directly in point, the rule undoubtedly prohibits directors from binding themselves, by agreement with each other or with outsiders, as to how they shall vote as directors. Thus, in Boulting v Association of Cinematograph, Television and Allied Technicians Lord Denning M.R. said:[2]

"It seems to me that no one, who has duties of a fiduciary nature to discharge, can be allowed to enter into an engagement by which he binds

1. Re Leed's Banking Co. Howard's Case (1866) LR 1 Ch App 561

2. [1963] 2 QB 606 at 626.

himself to disregard those duties or to act inconsistently with them. No stipulation is lawful by which he agrees to carry out his duties in accordance with the instructions of another rather than on his own conscientious judgment or in which he agrees to subordinate the interests of those whom he must protect to the interests of someone else. Suppose a Member of Parliament should be in the pay of some outside body, in return for which he binds himself to vote as he is directed to do. The agreement would clearly be void as against public policy."

[303] Any such agreement by directors would be invalid if the directors thereby assumed obligations to act "in a specified manner to be decided by considerations other than [their] own conscientious judgment at the time as to what is best in the interests of [their company]".[3] Thus, in Clark v Workman[4] directors were empowered by the articles to approve the transfer of a controlling interest in the company. Several had promised a potential purchaser to use their best endeavours to get the controlling interest into his hands. The board decision honouring this promise was set aside. These directors had, by this fetter upon their judgment, disqualified themselves from acting bona fide in the company's interests.

[304] However, in practice it may often be assumed that the nominee will retain his position as director only for so long as he acts in accordance with the wishes of those whom he represents. Indeed the constituent documents of a company may provide an appointor with the right to remove and replace nominee directors. In these circumstances, the boundaries of this lettering rule are uncertain and its application to understandings between nominee and appointor which fall short of a strict legal commitment is far from clear.

3. Osborne v Amalgamated Society of Railway Servants [1909] 1 Ch 163 at 187 per Fletcher Moulton L.J.

4. [1920] 1 IrR 107.

Attributing the appointor's knowledge to the nominee director

[305] Company directors will be personally liable if they breach their duties to the company. The question whether they have breached their duty will often turn upon the state of knowledge of the individual director. If an appointor uses a nominee director in the manner of a puppet, i.e., to do the appointor's bidding but with little appreciation of the significance of the acts he is performing, how is the nominee director's understanding of the transaction to be assessed? Should the nominee's state of knowledge be determined by reference to that of his appointor or by that of the nominee himself?

[306] The English decision in Selangor United Rubber Estates Ltd. v Cradock (No. 3)[5] illustrates the problem. Cradock had made a take-over offer for stock in a company whose sole assets were funds standing in its bank account. Cradock's offer was accepted by holders of 79% of the stock. He procured the appointment of two persons to be directors of the company. These directors executed Cradock's scheme by which company funds were applied, through a loan to an intermediary, to fund the acquisition of the company stock for which Cradock had acceptances. Such an application of company funds to assist the acquisition of its own stock was illegal (cf Companies Code s129).

[307] The directors were sued for misapplication of company funds. Directors who misapply company assets in their hands or under their control will be personally liable as though they had been trustees of that property or funds.[6] The directors, however, denied any knowledge that the company funds

5. [1968] I WLR 1555.

6. He Lands Allotment Co. [1894] 1 Ch 616 at 631, 637-639.

lent to the intermediary were to be on-lent to Cradock to fund his stock acquisition. Should Cradock's knowledge of the scheme be attributed to them?

[308] The judge held that where a director acts in a transaction on the direction of a third party (who may be, as here, a controlling shareholder) he is fixed with the third party's state of knowledge of the nature of that transaction, and may not rely upon his own limited appreciation. He found that the directors had acted under the direction of Cradock. Indeed, they were "puppets which had no movement apart from the … strings manipulated by Cradock".[7] They were accordingly liable to replace the misapplied funds.

The appointor's liability for acts of the nominee director

[309] In the Selangor United Rubber Estates case the "puppet master" Cradock was insolvent when the company sought replacement of the funds misapplied by his nominees. The litigation, therefore, principally concerned the liability of the banks who had received and paid the cheques drawn in the circular transaction. If Cradock had been solvent, however, would he have been liable for his nominees' default and upon what basis?

[310] The liability of the appointor for acts of a nominee director appears not to have been directly addressed in the case law. There are, however, several potential bases of liability. First, depending upon circumstances, liability may arise under either limb of the rule in Barnes v Addx[8]. Under the first limb of the rule, if the appointor receives company property from his nominee he will hold it not for his benefit but as trustee for the company, at least where the appointor receives the property where he knows or the

7. [1068] 1 WLR 1555 at 1614.

8. (1874) 9 Ch App 244.

circumstances are such that he ought to know that the nominee is acting in breach of duty. In the Selangor United Rubber Estates case the appointor Cradock was liable upon this basis.

[311] The second limb of the rule may apply where the appointor does not himself receive company property but nonetheless participates in his nominee's misapplication. The appointor will be liable where he knowingly assists his nominees in a dishonest design on their part to misappropriate assets or funds of the company. This limb has potentially wide application where the nominees have acted as mere ciphers for the appointor in the disposition of corporate assets. The limb may also apply where the nominees have acted independently and not as passive instruments of their appointor's will but where the latter has some apprehension of their fraudulent application of corporate assets. The degree of apprehension which will attract liability for the appointor was described thus by Gibbs J. (as he then was) in Consul Development Pty. Ltd. v D.P.C. Estates Pty. Ltd.:[9]

"It may be that it is going too far to say that a stranger [such as the appointor] will be liable if the circumstances would have put an honest and reasonable man on inquiry, when the stranger's failure to inquire has been innocent and he has not wilfully shut his eyes to the obvious. On the other hand, it does not seem to me to be necessary to prove that a stranger who participated in a breach of trust or fiduciary duty with knowledge of all the circumstances did so actually knowing that what he was doing was improper. It would not be just that a person who had full knowledge of all the facts could escape liability because of his own moral obtuseness prevented him from recognizing an impropriety that would have been apparent to an ordinary man."

In the same case Stephen J. (with whom Barwick C.J. agreed) said that if the stranger "knows of facts which themselves would, to a reasonable man, tell of fraud or breach of trust, he may be liable under the second limb as he would be if he had consciously refrained from enquiry for fear lest he learn of fraud."[10]

9. (1975) 132 CLR 373 at 398.

10. Ibid. at 412.

[312] A second basis of liability for the appointor may arise under the extended definition of "director" in Companies Code s5(1). The definition applies in the Code, subject to a contrary intention appearing, to include "any person in accordance with whose directions or instructions the directors of the corporation are accustomed to act". Whether the definition has the effect of extending the Code's provisions on directors to a nominee's appointor has yet to be decided[11].

In particular, it is not clear that the statutory definition would apply if only a minority of the board were nominees. If the statutory definition does apply to a nominee director and his appointor it would seem to apply only for the purposes of the Code and not extend to an appointor such judge-made principles of fiduciary liability as had not been enacted.

The oppression remedy

[313] Since 1947 in the United Kingdom (and later in Australia) there has been a statutory remedy for shareholders who complain that the affairs of their company are being conducted in a manner oppressive to them. The courts have been empowered to make a wide range of orders with a view to bringing the oppression to an end. Early cases on the oppression remedy in both the United Kingdom and Australia concerned the conduct of nominee directors. In 1959 the House of Lords in Scottish Co-Operative Wholesale Society v Meyer[12] found that the behaviour of nominee directors in preferring the interests of their appointor was oppressive conduct within the scope of s210 Of the Companies Act, 1948 (U.K.) (see now Companies Act 1985 (U.K.), ss459-461). This decision is examined below at [404]-[405].

11. Theoretically a corporate appointor could fall within this definition notwithstanding the terms of the Companies Code s219(2) which provides that: "A person is incapable of being appointed ms a director of a company unless he is a natural person." That sub-section applies to the formal appointment of directors and does not deal with de-facto directors.

12. [1959] AC 324.

[314] On the other hand, in Re Broadcasting Station 2GB Pty Ltd. (as we have seen) Jacobs J. found that the behaviour of the nominees in giving effect to their appointors' wishes did not amount to oppression under Companies Act, 1961 (N.S.W.) s186 (see [208]-[215]). The judge found "no evidence of a lack" in the nominee directors of a bona fide belief of identity between the company's interests and those of the appointor, although he was in any event prepared to absolve them from a "close personal analysis of the issues" (see [214]). Since the directors had left the conduct of the particular negotiations to their appointors, the focus in the oppression suit shifted onto their conduct of those negotiations and whether they had preferred their own interests to those of shareholders generally. Had the company been constituted with an independent board, the shareholders would have been insulated from such an inquiry. In the circumstances, however, their conduct was held not to amount to oppression under the Uniform Companies Act provision.

[315] In Re Broadcasting Station 2GB Pty Ltd. Jacobs J. adopted the definition of "oppressive" conduct applied in earlier case law, viz., conduct which is "burdensome, harsh and wrongful" (see [213]). In 1983, Companies Code s320 was amended to provide for wider grounds of relief. The Supreme Court, on the application of a member, may now make remedial orders if it is of the opinion that the affairs of a company are being conducted in a manner that is "oppressive" or "unfairly prejudicial" to, or "unfairly discriminatory against a member (whether in that or in any other capacity) or in a manner that is contrary to the interests of the members as a whole (s320(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 (s320(2)(b)). The orders that may be made under the section are cast in the widest terms and include orders that the company be wound up and that a member's shares be purchased by another member or by the company itself.

[316] The decision in Re Broadcasting Station 2GB Pty Ltd. and the consequences of nominee directors having an understanding with their appointors will need to be reconsidered in the light of the modified terms of s320. A judge of the Supreme Court of Victoria has said that "the newly introduced expressions 'unfairly prejudicial to' and 'unfairly discriminatory against' clearly contemplate conduct of greater amplitude that is understood by the term 'oppressive'. The new sub-section has made the task of the applicant shareholder less onerous in respect of the conduct about which he is entitled to complain".[13]

[317] Proceedings under s320 often require the court to examine the policy of a course of action pursued by those in control of a company to determine its fairness or unfairness in the particular circumstances of the company. The New Zealand Court of Appeal in Thomas v H.W. Thomas Ltd.[14] has described this fairness determination under the section in the following terms:

"Fairness cannot be assessed in a vacuum or simply from one member's point of view. It will often depend on weighing conflicting interests of different groups within the company. It is a matter of balancing all the interests involved in terms of the policies underlying the companies legislation in general and [s320] in particular: thus to have regard to the principles governing the duties of a director in the conduct of the affairs of a company and the rights and duties of a majority shareholder in relation to the minority; but to recognise that [s320] is a remedial provision designed to allow the Court to intervene where there is a visible departure from the standards of fair dealing; and in the light of the history and structure of the particular company and the reasonable expectations of the members to determine whether the detriment occasioned to the complaining member's interests arising from the acts or conduct of the company in that way is justifiable".

13. Re G. Jeffrey (Mens Store) Pty Ltd. (1984) 9 ACLR 193 at 198 per Crockett J.

14. (1984) 2 ACLC 610 at 618 per Richardson J.; see also Wayde v New South Wales Ruby League Ltd. (1985) 10 ACLR 87 at 91-92.

[318] The decision in Re Weedmans Ltd.[15] illustrates the potential application to nominee directors of the recast remedy under s320. The case was decided in 1974 upon s222(1)(f) of the Uniform Companies Act which enabled the Supreme Court of a State or Territory to order the winding up of a company whose directors have acted (inter alia) in "any ... manner whatsoever which appears to be unfair or unjust to other members" (see now Companies Code $364(1)(f)). Sportscraft secured voting control of Weedmans and appointed its nominees to constitute a majority of the Weedmans board. The controlling nominees then issued a substantial block of shares to a Sportscraft subsidiary in abuse of their fiduciary powers. They subsequently took steps to facilitate a takeover bid for the outstanding equity in Weedmans. Notwithstanding that the bid price was "grossly less than a true or fair price", the nominee directors recommended that shareholders accept the offer. Further, they announced that they intended to do so for their shares which they held, however, merely as nominees for Sportscraft. They misinformed and misled the minority shareholders in other material respects. The Court apparently accepted that the recommendation for acceptance of the bid, even at a gross undervalue, did not, of itself, involve breach of the nominees' duty. However, the deceitful and misleading statements made to shareholders by the nominee directors as to their own shareholdings and other matters were held to offend standards of commercial morality and to react unfairly and unjustly against other members. A winding up order was made.

[319] A recent decision of the New South Wales Supreme Court has, however, highlighted significant obstacles that remain in challenging the conduct of nominee directors under $320. In Morgan v 45 Flers Avenue Pty Ltd.[16], the plaintiff, who was a shareholder of the defendant appointor company, sought a s320 remedy against that company. He claimed that the nominee director appointed by the defendant company to the board of

15 [1974] Qd R 377.

16. (1987) 5 ACLC 222.

another company (MR) had, as a director of MR, acted in a manner which was oppressive and unfair to the plaintiff. Young J. denied relief, ruling that the complaint related to the conduct of the nominee director on the MR Board and it did not go to the conduct of the affairs of the defendant appointor company. A nominee director taking part in a Board Meeting is not acting in the "affairs" of the appointor company within the meaning of s320:

"It is of course true that a person who is what might be called a nominee director, may legitimately exercise his votes on a board in the interests of the person who appointed him without being in breach of a fiduciary duty to the company on whose board he sits. However, I do not consider that this state of affairs is sufficient for one to conclude that when so taking part in a board meeting of a company one is acting in the affairs of the appointor company".[17]

[320] A further limitation on the s320 remedy has also been suggested. A shareholder of the company on the board of which the nominee directors are serving will be able to complain only if the activities of the nominee directors amount to conducting the affairs of the company or involve acts or omissions "by or on behalf of the company": s320(1) (a) (ii). Where the nominee directors are in control of the company, the statutory wording would seem to be satisfied[18]. Where, however, the nominee directors whose conduct is objected to are in a minority or deadlock position, it may be difficult to establish that their conduct amounts to conducting the affairs of the company or acting by or on behalf of the company. The consequence is that the activities of nominee directors who are not in a controlling position may well be beyond review under s320 (and also s364)[19]

17. ibid at 234.

18. e.g. Re Weedmans Ltd. [1974] Qd R 377.

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

Nominee directors representing a parent company

[321] A particular instance of nominee appointments, perhaps the principal instance in view of the proliferation of company groups, is of persons appointed by a holding company to the board of a subsidiary.[20] The question of nominee loyalty arising from such appointments is closely linked with the general definition of group and individual company interests within such structures and, in particular, with the extent to which directors of the subsidiary may take account of the interests of the group as a whole, of the holding company or another subsidiary.

[322] The case law establishes that directors of a company within a corporate group must act by reference to their perception of the interests of that company, and not those of another company in the group or of the group as a whole.[21] Since creditors of a company may look only to that company for discharge of their debts and, absent fraud or other wrongdoing, not to its parent or other related company[22], directors owe a duty to their company to consider the interests of its creditors (see [116]). However, where the company is a wholly owned subsidiary, its interests may be safely identified with those of its holding company[23]. Its directors may then properly act by reference to the parent's interests and in accordance with its wishes, with due solicitude of course for the interests of the subsidiary's creditors. Where, however, there is an independent minority shareholding in the subsidiary, the obligations of the subsidiary's directors will be little different from those of nominee directors generally.

20. See, e.g., Re Broadcasting Station 2GB Pty Ltd. (above at [206]-[210]), Scottish Co-operative Wholesale Society Ltd. v Meyer (below at [404]) and Berlei Hestia (N.Z.) Ltd. v Fernyhough (below at [408]).

21. See Walker v Wireborne (1976) 137 CLR 1; Lindgren v L. & P. Estates Ltd. [1968] Ch 572.

22. See Re Southard & Co. Ltd. [1979] 1 WLR 1198; Re Sarfax Ltd. [1979] 2 WLR 202.

23. cf Charterbridge Cot oration Ltd. v Lloyds Bank [1970] Ch 62.

Reporting back to the appointor

[323] Although the understanding will vary with the particular relationship, a nominee director will often be expected to report back to his appointor as to the state of the company affairs[24]. Indeed, in many cases the "reporting back" function may be the primary motive for the nominee's appointment[25]. Two questions arise. First, are the nominee director's rights of access to corporate information qualified by reason of his nominee status? Secondly, are there any limits upon the right of the nominee director to disclose to his appointor information acquired as a director?

[324] The general common law principle is that directors are prima facie entitled to inspect all corporate documents. The leading Australian authority is Edman v Ross[26] where Street CJ stated that

"The right to inspect, and, if necessary to take copies of [corporate documents] is essential to the proper performance of a director's duties, and, though I am not prepared to say that the court might not restrain him in the exercise of this right if satisfied affirmatively that his intention was to abuse the confidence reposed in him and materially to injure the company, it is true nevertheless that its exercise is, generally speaking, not a matter of discretion with the court and that he cannot be called upon to furnish his reasons before being allowed to exercise it. In the absence of clear proof to the contrary the court must assume that he will exercise it for the benefit of the company".

This right is reinforced by the statutory entitlement of directors to inspect the company's accounting records[27]. It

24. It is doubtful whether a nominee director could be directed to provide information to his nominator: cf Lonrho Ltd. v Shell Petroleum Ltd. [1980] 1 WLR 627 at 634-35. However appointors may have the power to dismiss and replace their nominee directors thereby exercising effective control over them.

25. In NCSC v Industrial Equity Ltd. (1982) 1 ACLC 35 at 39 Needham J referred, without comment, to the practice of potential bidders obtaining a sufficient shareholding to negotiate a place on the target board and "thereafter information is available to it [the appointor] which will allow a decision to be made whether the target company has such potential that a full takeover offer is appropriate".

26. (1922) 22 NSWR 351.

27. Companies Code s267(9) as interpreted in Berlei Hestia (NZ) Limited v Fernyhough [1980] 2 NZLR 150 at 163. Note also s267(8).

is less certain whether directors are entitled to papers of board sub-committees of which they are not members, except by demonstrating their "need to know" the relevant information[28].

[325] In the context of nominee directors, the case law supports the right of access. In Bennetts' case (see [216]-[220]), the representative director, with striking candour, admitted that it was his intention to communicate the terms of the advice obtained by the board to his Union to be used to best advantage in its dispute with the board. The court ruled that the director had misconstrued his duties as a director and had failed in his overriding duty to the board. The court therefore exercised its discretion under the Edman v Ross formulation to refuse inspection.

[326] The ruling in Bennetts' case may be exceptional, given the unusual admission by the nominee director. It will ordinarily be assumed, unless the contrary is demonstrated, that a director appointed to a statutory body to represent a sectional interest will nevertheless act in the interests of that body. It seems that a similar rule applies to companies incorporated under the Companies Code. In Berlei Hestia (N.Z.) Limited v Fernyhough, nominee directors were granted access to corporate books, notwithstanding that the nominator company and the defendant company were in direct competition. Mahon J believed that the right of inspection was further strengthened where the company articles made specific provision for nominee directors.

[327] These principles were applied in Molomby v Whitehead[29] The managing director of the Australian Broadcasting Corporation had denied a staff elected director

28. Birmingham City District Council v O [1983] AC 578 at 594; Molomby v Whitehead (1985) 63 ALR 282 at 292.

29. (1985) 63 ALR 282.

access to documents which he had sought concerning the management of the Corporation. No suggestion was made that the staff director was seeking the documents for an ulterior purpose and not in discharge of his fiduciary responsibilities. In the Federal Court of Australia, Beaumont J. made it clear that "no initial burden of proof rests upon [the director] to show any particular reason for, or utility in, the grant of access. This will ordinarily be assumed."[30] The managing director's decision to withhold inspection was, therefore, in breach of the staff director's rights of access to corporate information.

[328] The director's obligation to avoid conflicts of interest prevents him from exploiting, without the consent of his company, information acquired in the course of his office (see [120]). Companies Code s229 (3) & (4) strengthen this rule with a prohibition upon a director's improper use of his position or of information acquired by virtue of his position to gain an advantage for himself or for any other person or to cause detriment to the company. But what use of information will be "improper"? May a nominee director merely report back to his appointor information gained by reason of his office where the director does not gain any personal profit from the disclosure?

[329] These questions have yet to be judicially considered in respect of nominee-appointor communications. It would appear, however, that the boundaries of "proper" disclosure will be determined by the equitable duty of confidence which prevents fiduciaries such as company directors from making improper use of confidential information acquired by virtue of their position.[31] This formulation of the limits of proper disclosure is undoubtedly tautologous but, it is suggested, inevitably so.

30. At 293.

31. See P.D. Finn, Fiducia Obligations (1971), p. 142.

[330] The Institute of Directors (U.K.) has adopted another formulation of the nominee directors entitlement to share information with his appointor. The Institute expresses the rule thus:

"The first principle here must be that information which is received in confidence must be treated in confidence. Information is part of the company's property, which directors must not misapply. The duty of confidence is plainly not absolute; many matters are discussed at board meetings which it is a director's right, and indeed often his duty, to disclose to third parties. The simple criterion is whether the disclosure is bona fide in the interests of the company. It is for the director concerned to prove that any disclosure is indeed bona fide. A director cannot be acting bona fide in the interests of his company if he fetters his discretion as to how he is to act. Thus if a nominee director agreed always to pass on to his nominator the management accounts of the company of which he is a director, that action alone would be a breach of his duty to act in good faith towards that company".[32]

Under this "simple criterion" the nominee's right to disclose corporate information to his appointor depends upon "whether the disclosure is bona fide in the interests of the company". It seems, therefore, that the scope of the nominee's disclosure rights under this formulation depends upon the answer to the fundamental question posed in the previous chapter: within what limits may the nominee director identify the interests of the company with those of his appointor?

32. Institute of Directors, Nominee Directors (Guide to Boardroom Practice No. 8, 1985), para. 17.

CHAPTER 4

The experience .of other jurisdictions

[401] The Australian case law touching on the duties of nominee directors discloses a body of doctrine which is relatively underdeveloped. The decisions impose rather relaxed obligations of allegiance by the nominee to general shareholder interests. The Australian case law also indicates an apparent cleavage between the rules applicable to companies incorporated under the Companies Code and statutory corporations (exercising non-profit functions).

[402] What is the position of nominee directors in other countries with comparable legal systems? In briefest summary, the two Australian decisions generally stand alone. They have been followed in a New Zealand decision but do not appear to have been considered in any reported judicial decision in the United Kingdom or Canada. Further, they run counter to the grain of the general fiduciary principle applicable to company directors in those jurisdictions and in the United States whose corporation law does not recognize any special doctrine applicable to nominee directors. In this chapter we shall examine the treatment of nominee directors in the United Kingdom and in the New Zealand decision referred to.

(a) United Kingdom

[403] The United Kingdom case law reflects a more traditional view of the obligations of the nominee director. Thus, in Boulting v Association of Cinematography, Television and Allied Technicians[1] Lord Denning M.R. referred to a nominee

1. [1963] 2 QB 606.

director, "that is, a director of a company who is nominated by a large shareholder to represent his interests". He said:

"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."[2]

Similarly, in Lindgren v L. & P. Estates Ltd.[3] Harman L.J. 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.

[404] The United Kingdom case law recognizes a second constraint upon the appointment of nominees to a company board. Where the appointor is in commercial competition with the company or in other respects the interests of the company and the appointor are in conflict, the nominee's appointment may raise such a conflict as to inevitably place the director in breach of his duty. In Scottish Co-operative Wholesale Society Ltd. v Meyer[4] the articles of a company empowered its holding company to nominate three out of five directors to act "as nominees" of the parent. It nominated three of its own directors. Lord Denning M.R. said of their appointment:

"So long as the interests of all concerned were in harmony, there was no difficulty. The nominee directors could do their duty to both companies without embarrassment. But, so soon as the interests of the two companies were in conflict, the nominee directors were placed in an impossible position ... It is plain that, in the circumstances, these three gentlemen could not do their duty by both companies, and they did not do so."[5]

2. At 626. These comments appear directed more to 'representative nominee directors' than either 'independent nominee directors' or 'nominated directors' without on-going commitments to the nominator: see [102]-[104].

3. [1968] Ch 572 at 594.

4. [1959] AC 324.

5. At 366.

An order was made against the parent company for its oppressive conduct in the subsidiary's affairs under s210 of the Companies Act, 1948 (U.K.) (repealed) (cf. Companies Code s320).

[405] In the Scottish Co-operative Wholesale Society case, Lord Denning M.R. identified the conflicts as arising (i) when the realignment in shareholdings in the subsidiary company, among the parent company and the minority directors, was raised for discussion at the subsidiary's board and (ii) when the parent company set up its own department to compete with the business of the subsidiary. Clearly, such conflicts are by no means peculiar to nominee appointments to the boards of subsidiaries. Equally, such appointments to subsidiaries may never give rise to such conflict. The scope of such conflict which will make the appointment, or continuing office, of a nominee director "impossible" have not been directly considered in other reported litigation on directorships of competing companies[6]. The identification of situations in which nominees will necessarily infringe the no-conflict rule will be determined by the principles discussed above in [117]-[120]. In many instances the rule may exclude from nominee appointment many of those (e.g., the directors, solicitor, accountant etc. of the appointor) whose representation is likely to be of the greatest advantage to the appointor.

[406] Assuming the validity of the nominee's appointment and of his understanding with his appointor, to what extent may the director identify the interests of the company, which he is bound to advance, with those of his appointor? Is the director's obligation to act bona fide in the interests of the company as a whole qualified in its application to nominee directors to enable them to honour their understandings with appointors? Statements in several United Kingdom cases suggest that the fiduciary obligation is in no way compromised in this

6. London & Mashonaland Exploration Co. Ltd. v New Mashonaland Exploration Ltd. [1891] WN 165; Bell v Lever Bros. Ltd. [1932] AC 161; Movitex Ltd. v Bulfield (1986) 2 British Company Law Cases 99,403.

situation and that nominee directors owe the same duty of loyalty to their company as their fellow directors. Thus, they will breach their duty to the company if they subordinate its interests to those of their patron, even if this subordination merely takes the form of passive inactivity in the face of improper conduct by their patron.[7]

[407] A further indication of the United Kingdom thinking on the dangers of nominee appointments to company boards may be derived from the Guide to Boardroom Practice prepared by the Institute of Directors (U.K.) on the subject of nominee directors.[8] The Guide draws the following conclusions:

"General Principles

A director owes his duties of diligence and honesty to the company of which he is a director and he is under an obligation to act bona fide in that company's interest. If a director owes a duty to more than one company considerable conflicts of interest can arise and it is for this reason that the Institute of Directors deprecates the appointment of nominee directors if the primary motive of the nominator is simply to ensure that his own interests are preferred above others.

This is not to say that the Institute does not believe that investors should pay close attention to the composition of boards of a company in which they invest. It considers, however, that this is best accomplished by the investor exerting his influence to ensure that the members of the company as a whole appoint appropriate directors, including an adequate number of properly qualified non-executive directors formally independent of both the existing management and existing financial interests. If appropriate, a major investor might put the names of such candidates forward after consultation with the company's chairman...

The Consequences for the Nominee

... A nominee can by no means always be certain that in resolutely pursuing his nominator's interest he is in fact acting bona fide in the interests of the company as a whole. Take for instance a director nominated by the holder of a substantial minority interest in the shares of a quoted company which has been bought as a prelude to possible outright acquisition. The nominator's interest lies in being able to acquire the rest of the shares at as low a price as possible. The interest of the company as a whole must surely be to ensure that he pays as much as possible.

7. See Boulting v Association of Cinematography, Television and Allied Technicians [1966] 2 QB 606 at 627; Scottish Co-operative Wholesale Society Ltd. v Meyer [1959] AC 324 at 367.

8. Institute of Directors, Nominee Directors (Guide to Boardroom Practice No. 8, 1985).

The consequences to the individual arise from a director's primary duty being owed to the company of which he is a director. This may cause problems if he is a director of more than one company, or if he has some other fiduciary capacity (e.g. as a trustee) which may conflict with this duty. He is also under a duty not to misapply a company's property (which includes knowledge of a company's affairs) and he has a duty not to use information given to him in confidence, so that he can discharge the functions of his office, for any purpose which is not bona fide in the interests of the company giving it. A director acts as a representative of all shareholders, not as a delegate of all shareholders, and still less as a delegate or a representative of some shareholders or debenture holders." [9]

(b) New Zealand

[408] In Berlei Hestia Pty Ltd. v Fernyhough[10] a single judge of the Supreme Court of New Zealand considered the Australian dicta on nominee directors in light of the traditional notion of undivided fiduciary loyalty. The capital of a New Zealand company was held, as to 40%, by an Australian company and as to the balance by a group of New Zealand shareholders. The articles of the company provided for equal representation upon the board for the Australian and New Zealand shareholders. In the result, the Australian company and the New Zealand shareholders each nominated three directors to represent their interests. No provision was made for a casting vote. When the New Zealand company began to export its product to Australia it came into commercial competition with the Australian company. Subsequently, the Australian directors claimed they had been effectively ousted from management control of the company and denied information as to its affairs. An interlocutory injunction was granted to restrain their exclusion from management participation.

[409] In the course of his judgment Mahon J. considered the position of the Australian nominee directors. He said (at 165-166).

"It was strongly contended by [counsel for the New Zealand company] that the interests of the Australian company as a minority shareholder

9. At paras. 1, 2, 8, 9 & 10.

10. [1980] 2 NZLR 150.

could be adequately preserved by disclosure to that company of the general financial position and trading results of the New Zealand company. But I am afraid I cannot agree. Notwithstanding that the Australian directors are the nominees of the Australian company, they nevertheless have responsibilities to the whole body of shareholders. That principle seems to be settled in England by Scottish Co-operative Wholesale Society Ltd. v Meyer and by Boulting v Association of Cinematography, Television and Applied Technicians. But despite the width of that proposition, there have been attempts to bring this theoretical doctrine of undivided responsibility into harmony with commercial reality, upon the basis that when Articles are agreed upon whereby a specified shareholder or group of shareholders is empowered to nominate its own directors, then there may be grounds for saying that in addition to the responsibility which such directors have to all shareholders as represented by the corporate entity, they may have a special responsibility to those who nominated them. Such a view proceeds on the basis that the Articles were so constructed with the intent and belief that the institution of such a special responsibility towards one class of shareholders was conducive to the interests of the company as a whole. For an illustration of this line of thinking I refer to the dicta of Jacobs J. in Levin v Clark and in Re Broadcasting Station 2GB Pty. Ltd. In the present case this business undertaking, stripped of its corporate shell, is a trading partnership between two organisations operating in different countries. They agreed, when the company was incorporated, that each partner nominate three directors, and they impliedly agreed, as the Articles show, that one class of directors was at liberty to bring the Board's functions to a stand-still when a disagreement arose, and that disagreement would almost certainly have its origin in a dispute between the two sets of shareholders. These consequences were all well known to the corporators when the Articles were drawn. As a matter of legal theory, as opposed to judicial precedent, it seems not unreasonable for all the corporators to be able to agree upon an adjusted form of fiduciary liability, limited to circumstances where the rights of third parties vis-a-vis the company will not be prejudiced. The stage has already been reached, according to some commentators, where nominee directors will be absolved from a suggested breach of duty to the company merely because they act in furtherance of the interests of their appointors, provided that their conduct accords with a bona fide belief that the interests of the corporate entity are likewise being advanced, cf P.D. Finn, Fiduciary Obligations (1977), para. 114."

CHAPTER 5

The issues for review concerning nominee directors

[501] From the preceding discussion it is possible to identify several issues which need to be addressed in a review of the law relating to nominee directors. These issues, and some options with respect to them, are canvassed in this chapter.

Issue #1: Should nominee directors be permitted to depart from the fiduciary standard applicable to directors generally?

[502] Should the law permit nominee directors a licence to depart from the obligations applying to directors generally, viz., to consult the interests of the shareholders as a general body and not to identify company interests with those of an individual shareholder, a group of shareholders or other appointor? Would the "realities of company organisation"[1] be wholly confounded by holding nominees to the general standard of conduct? It has been said that the general legal formulations of company interests are themselves "miserably indeterminate and that their application turns excessively upon the dictionary of the individual director's conscience.[2] Should the class of nominees be allowed an even lower, or more subjective, standard?

1. See Jacobs J. in Re Broadcasting Station 2GB Pty Ltd. [1964-5] NSWR 1648 at 1663, quoted above in [208].

2. See R.W. Parsons, "The Director's Duty of Good Faith" (1967) 5 Melbourne University Law Review 395 at 396, 418.

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 his appointor and the general body of members?

[503] To what extent should nominee directors be permitted to identify the interests of the company with those of their appointor? Should the nominee director be permitted to place the interests of his appointor before those of the general body of present shareholders, of future shareholders or the company as a commercial entity?

[504] In Re Broadcasting Station 2GB Pty Ltd. Jacobs J. held that nominee directors might act in accordance with the wishes of their appointor and will breach their duty to the company only if they knowingly sacrifice its interests (i.e., those of the general body of shareholders) for those of their appointor (see [214]-[215]). Does this doctrine reflect a sound adjustment of the interest of the appointor and the company generally? If some compromise of the standard of fiduciary loyalty is to be permitted to nominees, that attenuation need not necessarily extend as far as that proposed by Jacobs J. in Re Broadcasting Station 2GB Pty Ltd. There are a number of intermediate formulations between this standard and that applying to directors generally. For example, the Companies Code (1963) of Ghana, which implements reforms proposed by Professor L.C.B. Gower as Royal Commissioner, empowers representative directors to give "special, but not exclusive, consideration" to the interests of their appointor (s203(3)). Would a formulation such as this provide a more secure, and desirable, protection to the interests of the general membership?

Issue #3: Should a special dispensation for nominee directors require, or be permitted, by formal corporate consent?

[505] Should any latitude extended to nominee directors to have special regard for the interests of their appointors depend upon or, alternatively, be influenced by, whether the

articles of association make special provisions for the appointment of the nominee directors or for the attenuation of their duties to the company? Alternatively, if the articles make no such provision, should any attenuation of duty depend upon some other expression of the company's consent to the nominee's special position, such as through a resolution of shareholders in general meeting or through a shareholder agreement? If attenuation by resolution or agreement is sought, what requirements, if any, for public notice should there be, and for whose benefit should they be designed? Should any mandatory notice requirement apply uniformly to all companies? Further should shareholders be entitled to provide a dispensation to nominee directors only prospectively, or may they also confirm or ratify the modification of duties retrospectively?

[506] The Australian case law suggests that the presence of some provision in the articles for the appointment of representative directors will assist, but need not compel, the court to compromise the directors' duty of loyalty to the general body of shareholders. Thus, the articles in Levin v Clark and Berlei Hestia (N.Z.) Ltd. v Fernyhough, while they may have made provision for appointment of the nominee directors, did not expressly state their representative functions or modify the duties applicable to them. Both cases, nonetheless, placed considerable weight upon the appointment provisions as pointing towards the creation of special responsibilities towards the appointors. In Re Broadcasting Station 2GB Pty Ltd., however, the appointment of the majority of the nominee directors was made dehors the articles and the attenuation of their duty to the company was in no way attributable to any special provision in the articles.

[507] The significance of the articles in articulating the legitimate parameters of nominee directors' behaviour is

reinforced by the High Court in Whitehouse v Carlton Hotel Pty. Ltd.[3] where Mason CJ, Deane and Dawson JJ, in dicta, stated that:

"the articles of a company may be so framed as to expressly or impliedly authorize the exercise of the power of allotment of unissued shares for what would otherwise be a vitiating purpose."[3]

This implies that a company could draft its articles as to substantially modify or attenuate the common law fiduciary duties of nominee directors to use powers for proper purposes.[4]

[508] A number of subsidiary questions arise. First, if any special dispensation extended to nominee directors is to be conditional upon, or arise from, special provision in the articles, the effect of Companies Code s237(1) will need to be considered. This section declares void any provision in company articles which exempts an officer from, or indemnifies him against, liability in respect of any negligence, default, breach of duty or breach of trust. The English provision from which s237(1) is derived was introduced in the Companies Act 1928 (U.K.)[5]. The provision was inserted in response to the recommendation of a company law review committee (The Greene Committee) in 1926 which criticised the practice early in this century of company articles granting generous indemnity rights to directors. The Committee said:

"The decision in [a recent] case has directed public attention to the common article which exempts directors from liability for loss except when it is due to their 'wilful' neglect or default'. Another form of article which has become common in recent years goes even further and exempts directors in every case except that of actual dishonesty. We consider that this type of article gives a quite unjustifiable protection to directors. Under it a director may be guilty of the

3. (1087) 5 ACLC 421.

4. At 425

5. See now UK Companies Act 1985 s310.

grossest negligence provided that he does not consciously do anything which he recognises to be improper ... The position is one which in our opinion calls for an alteration of the law. To attempt by statute to define the duties of directors would be a hopeless task and the proper course in our view is to prohibit articles and contracts directed to relieving directors and other officers of a company from their liability under the general law for negligence, breach of duty or breach of trust".[6]

[509] Is this policy sound in its application to nominee directors? Need, and should, an amendment be made to s237 to permit company articles to provide a relaxed standard of loyalty for those of its directors who are nominees. Alternatively should the application of s237 to nominee directors be clarified, given the uncertainty as to the circumstances in which the section applies where companies seek in their articles to reduce the common law duties on directors, rather than relieve them from liability for breach of duty[7]. Second, if an amendment to s237 is called for, should a distinction be drawn for this purpose between different corporate structures whereby, for instance, private companies and joint venture vehicles would enjoy greater freedom than say, public companies in fashioning their articles (or other documents) that define the role of the nominee directors. If it is thought that protection of the interests of "public" investors overrides the considerations supporting relaxation, how should the "private" company (or, conversely, the "public" company) be defined? Are the Companies Code classifications of "exempt/non-exempt proprietary company" or "public company" suitable to distinguish companies which should be permitted or, alternatively, excluded from relaxing, through the articles, the duties of their nominee directors?

6. Report of the Company Law Amendment Committee 1925-1926 (Cmd 2657), para. 46.

7. see (1982) Law Quarterly Review 413; 548. In Movierex Ltd. v Bolfield (1986) 2 British Company Law Cases 99,403 at 99,429 Vinelott J ruled that any attempted modification through the articles of a director's fiduciary duty of care would infringe (the UK equivalent of) s237. This suggests that, given s237, directors have certain fundamental duties which cannot be modified or excluded by the articles.

[510] Given the possibility of companies being permitted or seeking to utilize their articles to restrict the scope of nominee directors' duties, should those companies have a corresponding capacity to restrict the common law access rights of nominee directors to corporate documents: see [324]-[327]?

Issue #4: A statutory definition of nominee directors?

[511] If the duties applying to nominee directors are to be relaxed, which directors should receive the benefit of the dispensation? Should a special definition of nominee director be adopted and in what terms? Are the concepts of 'independent nominee directors' and 'representative nominee directors' useful or appropriate? See [102]-[104].

Issue #5: A register of nominee directors?

[512] Should a register be maintained identifying the directors who are nominees for another and subject to any relaxed standards of conduct? Should there also be included in the register the terms of any arrangement between an appointor and nominee director? Who should maintain the register - the company or the National Companies and Securities Commission (in practice, its delegates)? Who should have access to it and upon what terms?

Issue #6: What commitments should a nominee director be permitted to make to his appointer?

[513] We have seen that the present law imposes restrictions of somewhat uncertain scope upon the commitments which a nominee director may make to his appointor ([302]-[304]). However, in practice it may often be assumed that the nominee will retain his position as director only for so long as he acts in accordance with the wishes of those whom he represents. Should, therefore, the law attempt to define with some precision the scope of the commitments which the nominee may properly make to his appointor? If so, how should that

definition be expressed? Specifically; should the nominee be permitted to bind himself in advance to act in the interests of his appointor?

Issue #7: The personal liability of the nominee director for breach of duty

[514] We have seen that the personal liability of directors will often turn upon the state of their knowledge ([305]-[308]). Under present case law a director acting in a transaction on the direction of another will be fixed with the latter's knowledge of the nature of that transaction and may not rely upon his own limited appreciation ([308]).

[515] Is such an attribution a fair and equitable imposition upon the nominee director? For purposes of determining the nominee's liability for breach of duty should the nominee have attributed to him the knowledge of company affairs and transactions which his appointor possesses? Alternatively, should the appointor be permitted to insulate his nominee from such knowledge?

Issue #8: The appointor's liability for acts of the nominee director

[516] The appointor may be personally liable where he has participated in his nominee's misapplication of company property or funds ([309]-[312]). What should be the measure of the appointor's liability in this Case? In what other circumstances should the misfeasance of the nominee be visited upon the appointor? Is it possible to distinguish categories of behaviour for which the appointor should/should not be liable? Does the doctrine in Barnes v Addy ([310]-[311]), provide a sound basis for liability or should the appointor bear a greater responsibility for the acts of his nominee? Should the statutory definition of "director" be extended to apply expressly to the appointor of a nominee director? If so, should that extended definition (which would apply only for the purposes of the Code) apply only if all or a majority of the board were nominees of the same appointor? Alternatively,

should the extended definition apply to each of several appointors, and to the appointor (or appointors) of nominee directors who comprise a minority of the board of directors? If there are several appointors should their liability be joint, several or joint and several? Conversely, if the appointor is under a disability with respect to a particular transaction or generally, should that disability be imputed to his nominee upon the board of a company? For example, if an appointor is excluded from taking part i~ the management of any company (Companies Code $227; s227A; s562), should that condition be imputed to his nominee? If so, the nominee director's tenure of office will automatically cease under standard provisions in company articles (cf. Table A reg. 65(c)). Similarly, if the appointor has an interest in a contract to which the company is a party, should that interest be imputed to the nominee director for purposes of company articles (cf. Table A reg. 65(g)) and statutory and equitable doctrines requiring disclosure of directors' interests in such contracts (cf. Companies Code s228)?

Issue #9: Nominee directors and the oppression remedy.

[517] We saw above ([313]-[320]) that the conduct of nominee directors may lead to one of a wide range of judicial orders being made at the suit of an individual shareholder under the "oppression" provisions of Companies Code s320. Should action by a nominee director taken solely in the interests of his appointor expose the director, the company or the appointor to an order under Code $3207 What adjustment of the nominee director's fiduciary loyalties should acquit the nominee, his appointor and the company of a claim under this section? Should Code s320 be amended to make specific provision for the special position of the nominee director?

Issue #10: Nominee directors representing a parent company

[518] We saw above ([321]-[322]) that a major instance of nominee appointment is of persons appointed by a holding

company to the board of a subsidiary. The directors of the subsidiary must have regard to the interests of that company and its creditors, and not of other companies in the group or of the group itself. Where, however, the company is a wholly owned subsidiary, there will be little difficulty in its directors identifying company interests with those of its parent, assuming that creditor interests are not thereby put in jeopardy.

[519] Should special provision be made by statute for nominee directors appointed to the board of a subsidiary company to represent the interests of its parent company? If so, should a distinction be drawn between wholly owned subsidiaries and those with a minority of independent shareholders? Should a parent company (or its board of directors) be deemed to be the board of directors of its wholly owned subsidiary? If so, should a wholly owned subsidiary be allowed to function without directors of its own?

Issue #11: Reporting back to the appointor

[520] We have seen ([323]) that it will normally be part of the understanding between the nominee director and his appointor that the nominee will report back on decisions taken by the board, and information acquired or judgments formed in the course of acting as director. This element of the understanding will, of course, vary with the particular nominee relationship. Two groups of questions arise. Should the nominee director's own rights of access to information concerning corporate affairs be diminished by reason of his nominee status? Alternatively, should the nominee director be entitled to special treatment in the supply of information if the appointor is a significant shareholder in the company? Secondly, within what limits (if any) should a nominee director be permitted to pass on information or assessments as to the affairs of the company to his appointor?

[521] There may be other possible consequences of a reporting back arrangement that require consideration. As previously

indicated, a nominee director who acts in a transaction at the direction of his appointor may be fixed with the appointor's state of knowledge: [305]-[308]. Should the same principle apply to the passage of information. For instance, in what circumstances, if any, should the nominee director be liable where the appointor uses information passed back under the reporting arrangement to engage in insider trading? Are the relevant terms of the Companies Code s229 and the Securities Industry Code s128 suitable and adequate? Furthermore should the appointor be deemed to be in possession of information held by the nominee director that falls within the reporting back arrangement, regardless of whether the information is actually passed on? If such a deeming provision were to apply, how might this impact on the insider trading provisions. Conversely is the "Chinese Walls" defence in the Securities Industry Code s128(7) adequate to protect an appointor from 'inadvertent' insider trading where a nominee director, who is also an 'officer' of the appointor (s128(11)), obtains but does not pass on non-public price sensitive information.

Issue #12: Statutory corporations

[522] The Paper earlier referred to the duties attending persons appointed to statutory bodies: [216]-[220]. It may be that any future move towards the privatisation, or conversion of statutory corporations to incorporated companies regulated under the Companies legislation, will need, or benefit from, greater clarification of the role and duties of nominee directors. For instance, are the principles found in Bennetts v Board of Fire Commissioners of New South Wales suitable for companies which are required, or choose, to have representatives of various, potentially conflicting, interest groups on their Boards? Should particular rules be developed for this non-collegiate form of corporate government? Alternatively, would it be satisfactory that the rights and duties of sector representative directors be regulated by the company articles? Furthermore should the nature of those sector interests and the powers and obligations of their representative directors be disclosed whenever public financial participation is sought e.g. in the prospectus.

Other Issues

[523] Comment is sought on any other matters in the general area of nominee directors where it is felt that legislative change/innovation would be appropriate.

PART B

ALTERNATE DIRECTORS

CHAPTER 6

The state of legal doctrine concerning alternate directors

An introduction to alternate directors

[601] Company articles of association commonly provide for the appointment of "alternate" or "substitute" directors. The terms of such provision will vary between companies. The Table A model set of articles appended to the Uniform Companies Act and the Companies Code have contained such provisions and it is probable that they have been widely adopted. The current form of that provision is Table A article 72 which is in the following terms:

"72. (1) A director may, with the approval of the other directors, appoint a person (whether a member of the company or not) to be an alternate director in his place during such period as he thinks fit.

"(2) An alternate director is entitled to notice of meetings of the directors and, if the appointor is not present at such a meeting, is entitled to attend and vote in his stead.

"(3) An alternate director may exercise any powers that the appointor may exercise and the exercise of any such power by the alternate director shall be deemed to be the exercise of the power by the appointor.

"(4) An alternate director is not required to have any share qualifications.

"(5) The appointment of an alternate director may be terminated at any time by the appointor notwithstanding that the period of the appointment of the alternate director has not expired, and terminates in any event if the appointor vacates office as a director.

"(6) An appointment, or the termination of an appointment, of an alternate director shall be effected by a notice in writing signed by the director who makes or made the appointment and served on the company."

[602] The Companies Code, like the earlier Uniform Companies Act, makes only oblique reference to alternate directors, in the context of a provision regulating the assignment of the office of director in a public company. Section 234(2) provides that this provision "shall not be construed so as to prevent the appointment by a director (if authorized by the articles and subject to the articles) of an alternate or substitute director to act for or on behalf of the director during his inability for any time to act as director".

[603] Why and when are alternate directors appointed? The case law on alternate directors is exceedingly sparse and provides little assistance on this question. There is, however, a South African case concerning an alternate director decided in 1892 which indicates that the office is not of recent origin. In commercial practice, alternate directors seem to be appointed to maintain the number of directors in the absence of one or more directors. Maintenance of numbers is important:

(a) where the board numbers are small and it is necessary to maintain a quorum to enable the board to meet and perform its duties;

(b) where votes need to be maintained to preserve the collective voting position of nominee directors appointed by a particular shareholder.

[604] Alternate directors are often used with unlisted subsidiaries, associated companies and joint venture companies. Essentially their appointments are to fulfil an administrative purpose and such persons really act as agents of their appointor. The fact that they are appointed by an incumbent director seems to reinforce this agency role. Their appointments are often interim and short term.

[605] The practice of appointing alternate directors is also common for foreign owned corporations. Senior executives of these corporations are often appointed as directors for control purposes and to add prestige to the local subsidiaries.
However due to their residence overseas and/or pressure of other duties, their attendance is often limited to one or two board meetings annually. To overcome the administrative problems this presents to a local subsidiary with a small board, alternate directors are appointed from the senior managers of the local subsidiary. Such alternates essentially act as independent long term directors (although no doubt conscious of head office policies), between attendance of their appointors. The virtue of such an appointment is that it "ensures control is exercised over the local subsidiary by corporate officers in the home country and also allows a degree of decision-making to be delegated to Australian residents (albeit, in some instances, only nominal decision-making), thereby providing for local input in the management of local subsidiaries".[1]

[606] The case law relating specifically to the duties and liabilities of alternate directors is all but non-existent. Basic propositions relating to the office have long been stated by text writers without clear authority deriving from statute or judicial decision. This Part of the Discussion Paper seeks to identify the principal issues relating to the duties and liabilities of alternate directors, the state of legal doctrine touching on them and the reform issues which they raise. It will be apparent that both in legal doctrine and in the issues raised for discussion there is considerable overlap with Part A on nominee directors.

1. D. Petkovic, "Alternate Directors" [1985] Australian Current Law Articles 36043.

Should the Companies Code make specific provision for alternate directors?

[607] This fundamental question was addressed in 1962 by the Company Law Committee appointed by the United Kingdom Board of Trade: (The Jenkins Committee). The Committee came to the following conclusion:[2]

"It has been suggested to us that provision should be made in a new Act for alternate directors, and also that it should be expressly provided that particulars of these should be registered with the Registrar of Companies and that the information required of directors by the Act should be required of alternate directors. We do not think that the Act should be burdened with provisions about such matters as the appointment and vacation of office of alternate directors, which can suitably be dealt with in the articles of association if the company so wishes. As regards the provision of information to the Registrar and the other obligations on directors, it appears to us that an alternative director is, in the eyes of the law, in the same position as any other director, though his powers may of course be restricted by the company's articles. He is, we think, now required to provide the information about, for example, his interests, emoluments and shareholdings which other directors are required to give, and we would recommend no change in the law in this respect."

[608] This conclusion has clearly been accepted by the British Government. The Companies Act 1985, like its predecessors, contains no reference to alternate directors, not even a provision corresponding to Companies Code s234(2). Indeed, it was not until 1985 that Table A included provisions relating to alternate directors.[3] They provide:

65. Any director (other than an alternate director) may appoint any other director, or any other person approved by resolution of the directors and willing to act, to be an alternate director and may remove from office an alternate director so appointed by him.

66. An alternate director shall be entitled to receive notice of all meetings of directors and of all meetings of committees of directors of which his appointor is a member, to attend and vote

2. Report of the Company Law Committee (Cmnd 1749, 1962), para. 83.

3. See Companies (Tables A to F) Regulations 1985, Table A articles 65-69.

at any such meeting at which the director appointing him is not personally present, and generally to perform all the functions of his appointor as a director in his absence but shall not be entitled to receive any remuneration from the company for his services as an alternate director. But it shall not be necessary to give notice of such a meeting to an alternate director who is absent from the United Kingdom.

67. An alternate director shall cease to be an alternate director if his appointor ceases to be a director; but if a director retires by rotation or otherwise but is reappointed or deemed to have been reappointed at the meeting at which he retires, any appointment of an alternate director made by him which was in force immediately prior to his retirement shall continue after his reappointment.

68. Any appointment or removal of an alternate director shall be by notice to the company signed by the director making or revoking the appointment or in any other manner approved by the directors.

69. Save as otherwise provided in the articles, an alternate director shall be deemed for all purposes to be a director and shall alone be responsible for his own acts and default and he shall not be deemed to be the agent of the director appointing him.

Are "alternate directors" directors?

[609] Are alternate directors in law directors of their company or merely agents of their appointors who alone are members of the company directorate? The Jenkins Committee considered that "an alternate director is, in the eyes of the law, in the same position as any other director"[4] Recently, a judge of the Supreme Court of Queensland has expressed a similar opinion: "Although [the alternate directors] had little control over the company, they were directors within the meaning of the Companies Acts. Generally speaking alternate directors are in the eyes of the law in the same position as any other director. As such they are subject to the normal duties which a director owes to his company."[5] In 1940 the same court refused leave to an undischarged bankrupt to act as an alternate director under a provision corresponding to Companies Code s227(1). The court did not distinguish between the applicant's fitness to be an alternate director and his fitness to be a director in his own right.[6]

4. Report of the Company Law Committee, op. cit.

5. Markwell Bros Pty Ltd. v CPN Diesels (Qld) Pty Ltd. (1982) 7 ACLR 425 at 433.

6. Re Kingsgate Rare Metals Pty Ltd. [1940] QWN 30.

[610] Some text writers are, however, more tentative. For example, Wallace and Young concede that "[t]he subject of alternate directors is not free from difficulties" but consider that "[t]hey are clearly within the definition of 'director' in s5(1) and must be deemed subject to the provisions of the Act".[7]

[611] The principal question arising with respect to the status of alternate directors is whether they are directors for purposes of the judge-made principles of directors' powers and duties and the provisions of Companies Code s229. Before examining this question, however, it might be convenient to address the status of alternate directors under the other provisions of the Code.

[612] The Companies Code defines the term "director" where employed in the Code to include "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"[8]. There is, of course, a second limb of this extended definition, noted above ([312]) in relation to nominee directors, viz., "any person in accordance with whose directions or instructions the directors of the corporation are accustomed to act". However, this second limb would appear to have little application to an alternate director appointed under provisions comparable to Table A article 72 unless the alternate is also a nominee director.

[613] Despite the authority noted in [609]-[610] it is not abundantly clear that the first limb of the extended definition

7. Mr. Justice Wallace & J. McI. Young, Australian Company Law and Practice (1965), p.408.

8. Companies Code s5(1) 'director'.

applies to alternate directors generally. Can it be said that an alternate who takes his place upon the board of a company only upon the infrequent absences of his appointor is "a person acting in the position of director"? If so, is he a director only when he is acting as such in the place of his appointor? Further, the s5(1) definition is only expressed to apply for purposes of the Code subject to a contrary intention appearing. To what provisions of the Code does it therefore apply?

[614] There is some guidance on these questions in the decision of the High Court of Australia in Corporate Affairs Commission v Drysdale[9]. The defendant was charged under the predecessor provision to Companies Code s229 with failing to act honestly and with reasonable diligence in the discharge of his duties as director of a company. At the time of the acts alleged to infringe the section, the defendant's appointment as director had lapsed although he continued to act as such. The Commission argued that the defendant was liable under the section on the basis that the first limb of the s5(1) definition embraced de facto directors and this extended definition applied to the interpretation of the offence provision. (A de facto director is a person acting as director while not validly appointed as such.) Aickin J. (with whom Mason, Gibbs and Murphy JJ. concurred) said of the first limb that "the better view is that it is directed simply to the question of the name by which a person was known, who in fact occupied a position to which were attached the powers and obligations which the Act attaches to a 'director'"[10]. For example, in some foreign corporations, terms such as "governor", "controller or "vizier" are employed to describe members of the managing body.

9. (1979) 53 A.L.J.R. 144.

10. At 148. It should be noted that s5(1) did not then include the words "and whether or not validly appointed to act in the position".

[615] However, Aickin J. decided the issue of the defendant's liability under the section without resort to the extended definition. He found that a long line of judicial decisions had subjected de facto directors to the same penalities and liabilities as de jure directors and that the word "director" in the statutory provision should be so interpreted. He counselled, however, against concluding that the term "director" bears the same meaning throughout the Act: "Whether it should be given this meaning in other sections will depend upon the terms, context and purpose of such sections".[11]

[616] The interpretation placed by Aickin J. upon the first limb in Drysdale's case does not assist the view that the limb embraces alternate directors who are not also de facto directors. Secondly, it leaves to individualised enquiry the question whether the extended definition in s5(1) applies in particular provisions of the Code. The answer to this question will also, presumably, depend upon "the terms, context and purposes" of such provisions. Finally, it raises by implication the possibility that Code provisions relating to directors may also extend to alternate directors without resort to the s5(1) definition.

[617] There are numerous references in the Companies Code to directors and their "terms, context and purposes" vary markedly. They range from provisions such as s238 (requiring disclosure of particulars as to the director's name, birth and occupation) to s269(1) & (2) (requiring directors to prepare a profit and loss account and balance sheet) and s270 (requiring directors to prepare a report as to specified matters). Do the obligations under these sections apply to alternate directors? It is impossible to answer these questions with any certainty. Further, will an alternate director satisfy the requirements of s 219 relating to membership and Australian residence requirements for directors? It is said that the

11. At 151.

question commonly arises in practice as to whether a proprietary company having two overseas resident directors and an Australian resident alternate director satisfies the requirements of s219(3).[12]Wallace and Young suggest that it does not, despite their view ([610]) that an alternate director will generally be a director.[13]

The Powers of Alternate Directors

[618] The foregoing discussion on the status of alternate directors has significant implications for determining the nature and extent of powers they may enjoy. The Model Articles appear to be directed towards ensuring an equivalence between the powers of the alternate director and the appointor[14] If alternates are considered directors in their own right, or to have assumed the powers of their appointors, are they entitled to full rights of access to corporate information? As indicated earlier [324], the general common law principle is that directors are prima facie entitled to inspect all corporate documents. Is this a suitable policy for alternate directors? Should companies be entitled to introduce restrictions over the information access rights of alternate directors? Should alternate directors look primarily to their appointors for their information? Alternatively, is it a sufficient protection against possible abuse of the access right that appointment of an alternate director may require the approval of all other directors: Table A article 72(1).

The duties and liabilities of alternate directors

[619] The difficulty of establishing the application of various common law rules and statutory provisions to alternate

12. Petkovic, op. cit., p.36044.

13. Wallace & Young, op. cit., p.408.

14. Companies Code Table A article 72(3); UK Companies Act Table A article 66.

directors applies also to s229 of the Code. The obligations under s229(1),(2),(3) & (4) are imposed upon an "officer" of the company, a term defined in s229(5) to include a "director". In the absence of any decision specifically addressing the question, it is simply not clear whether this term in s229 extends to an alternate director and, if so, whether it applies only to an alternate director acting as such in his appointor's absence.

[620] It may be possible to insert a provision into a company's articles of association declaring that the alternate is not a director but merely the agent of his appointor.[15] While such a provision may be effective to exclude the judge made principles of fiduciary obligation applying to directors[16], it will not release an alternate from criminal liability arising under Code s229, should that provision be held to be applicable to alternate directors.

[621] It appears that the non-statutory duties and liabilities of directors apply to alternate directors acting in the course of their duties. In the Queensland decision in Markwell Bros Pty Ltd. v CPN Diesels (Qld) Pty Ltd. (quoted in [609]) the court treated alternate directors of the plaintiff company upon the same footing "as any other director".[17] The alternate directors were held to have breached their fiduciary duty to the plaintiff by diverting to their own company the opportunity to acquire a valuable franchise held by the plaintiff. For this breach of the conflict avoidance obligation the plaintiff company was awarded equitable damages against its defaulting alternates. Alternates were similarly

15. See, e.g., Table A (UK) article 69 which provides that "Save as otherwise provided in the articles, an alternate director ... shall not be deemed to be the agent of the director appointing him". This implies that the articles could declare an alternate director to be an agent of the appointing director.

16. However, the office of agent is also fiduciary although obligations will be owed only to the appointor.

17. (1982) 7 ACLR 425 at 433.

held liable for breach of duty in an early South African case.[18] There does not appear to be any other authority on the alternate's general law liability.

[622] The alternate director, if he is a director or other fiduciary to the company, will not find refuge from his duties by blindly following the directions of his appointor. We saw above ([302]-[304]) that directors are obliged to bring an independent judgment to bear in the exercise of their powers. If, therefore, the alternate subordinates his judgment to that of his appointor he may exacerbate, rather than avoid, his breach of duty. Of course, the relationship between alternate director and appointor may be such as to make the alternate a nominee director also. In either case similar issues arise here as arose with respect to nominee directors concerning the degree of independence the alternate must bring to board deliberations.

[623] The legal difficulties of alternate directors appear not to be widely appreciated. An Australian lawyer with experience as an alternate director in a number of stock exchange listed companies concluded a review of the law relating to alternates with these observations:

"[I]t seems to be a widely understood if unstated view, that an alternate director is not a "real" director, and need not be as fully consulted in the deliberations of a corporate board as his appointor. Indeed, in the writer's experience, insistence by an alternate on expressing a view could almost be considered impertinent by the rest of the Board".[19]

The liability of the appointor

[624] The South African decision referred to in [621] held that the alternate director and not his appointor was liable to the company for his own acts or defaults. Thus, the court

18. Trustees of the Orange River Land & Asbestos Co. v King (1802) 6 HCG 260 (High Court of Griqualand West).

19. S.R. Lacher, "Alternate Directors" Australian Director, Vol.15 No.1, February/March 1985, p.46.

said: "[The director] left an alternate behind him, as he was authorised to do ... He might very fairly have assumed that his co-directors and his alternate would perform their duties as directors during his absence".[20] Similarly, there was no suggestion in the Markwell Bros case that the appointors bore any co-ordinate liability for the defaults of their alternates.

[625] When the Companies Code was introduced in 1982 the Table A provisions relating to alternate directors were revised, apparently with the intention of removing uncertainty. However, in one respect the revision has raised doubt where none previously existed. Article 72(3) provides that an alternate director may exercise any of his appointor's powers "and the exercise of any such power by the alternate director shall be deemed to be the exercise of the power by the appointor".

[626] It has been suggested that the effect of this article is to impose personal liability upon the appointor for the acts of his alternate.[21] If this interpretation of article 72(3) is correct, the appointor is in a most vulnerable position since, as we have just seen ([622]), the alternate (if he is a director or other fiduciary to the company) may not be directed as to the exercise of his powers. It may, therefore, be expedient to consider whether express provision should be made either in the legislation or the Table A articles to exclude or, alternatively, to specify the appointor's liability for the acts of his alternate director. The United Kingdom Table A article 69 may be a useful model. It provides: "Save as otherwise provided in the articles, an alternate director shall be deemed for all purposes to be a director and shall alone be responsible for his own acts and default and he shall not be deemed to be the agent of the director appointing him".

20. Trustees of the Orange River Land & Asbestos Co. v King (1892) 6 HCG 260 at 317 per Solomon J. An appeal to the Supreme Court of the Cape of Good Hope was upheld on other grounds; see Orange River Land & Asbestos Co. v Hirsche (1893) 10 SC 71.

21. Lacher, op. cit., p.46.

CHAPTER 7

The issues for review concerning alternate directors

Issue #1: Should constraints be introduced on the capacity to appoint alternate directors?

[701] Alternate directors, particularly those appointed on an interim or short term basis may have insufficient information or continuity of knowledge to exercise any considered judgment on matters coming before the board. This disability may adversely reflect on the quality of board decisions, to the possible detriment of the company and its shareholders. One alternative may be to require, say, listed public companies to appoint a sufficient number of directors to ensure that it can function without alternates. Another possibility is to introduce a rule whereby directors of such companies may only appoint their fellow directors as alternates. Companies could through their articles ensure that suitable arrangements were in place to preserve sectional interests on the board[1]. This restriction would ensure that the quality of board decision making would not unduly suffer through the appointment of alternate directors unfamiliar with the company.

If the system of alternate directors is to be retained (in whole or part), further issues arise.

Issue #2: Should the Companies Code make specific provisions for the appointment, duties and liabilities of alternate directors?

[702] The Code presently contains only an oblique reference to alternate directors, in s234(2). In [607] we noted the opinion

1. The Articles might provide that a director acting in a dual capacity must, in respect of his alternate role only, vote in compliance with any direction of his appointor.

of the Jenkins Committee in the United Kingdom that provisions relating to alternate directors should be left to company articles. In the absence of any significant body of case law and of the apparently significant use of alternate directors, there may be considerable merit in dealing with some unresolved issues by legislation.

Issue #3: Assume that Issue #2 is resolved in the affirmative. Should the Companies Code be amended to make it clear that alternate directors are included in the provisions affecting directors?

[703] This issue is discussed at [609]-[617] above. Specifically, should the Code be amended so that sections 219, 229, 238, 269 & 270 are deemed to apply to alternate directors? Do other provisions of the Code warrant specific extension to alternate directors? Should the Companies Code or Table A be amended to make it clear that a director may be appointed as an alternate for another? If so, does (and should) the director present in his own right and as alternate for another enjoy a second deliberative vote under common form articles? For example, Table A reg. 70(1) provides:

"Subject to these regulations, questions arising at a meeting of directors shall be decided by a majority of votes of directors present and voting ..."

How should the director's dual "presence" be recorded for the purpose of any quorum requirement in the articles?

Issue #4: Should alternate directors have equivalent powers to their appointors?

[704] Discussion relevant to this issue is contained at [618]. In particular, should the common law access rights of directors to corporate information be applied, restricted or made capable of restriction in the case of alternate directors?

Issue #5: Should specific statutory provision be made to extend to alternate directors the general law principles of fiduciary liability applying to directors end?

[705] Discussion relevant to this issue is contained at [619]-[623]. Specifically, should an appointor be permitted to direct his alternate as to how the latter shall vote on matters coming before the board? Should the alternate be permitted to comply with such a direction without independent exercise of judgment? Further, when should disabilities of the appointor be imputed to the alternate? See the like discussion above (in [516] concerning nominee directors. It is relevant to note that the Australian Stock Exchange Listing Rules, in section 3L(6), provide in relation to listed companies:

"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 (emphasis added)."

For purposes of any provision relating to the imputation of the appointor's disability, or concerning alternate directors generally, should a distinction be drawn between listed and unlisted companies or between "private" and "public" companies? Somewhat similar questions were posed above (at [509]) in relation to nominee directors.

Issue #6: Should the Companies Code or Table A (or both] be amended to provide for the liability (if any) of the appointor for the acts of his alternate director?

[706] Discussion relevant to this Issue is contained in [624]-[626].

Other Issues

[707] Comment is sought on any other matters in the general area of alternate directors where it is felt that legislative change/innovation would be appropriate.

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