This paper examines the issue of company financing of election campaigns of persons who are candidates in elections to the boards of companies. It critically examines the New South Wales Court of Appeal decision of the 1986 case of Advance Bank v FAI together with previous English and Australian cases, some of which conflict with the principle set out in Advance Bank v FAI. It endeavours to distil the principles which may allow for companies so financing such campaigns and the parameters which would need to be followed for legitimate use of corporate funds for those purposes.
To my family.
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For their support, motivation, insight and direction.
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PART 1

INTRODUCTION

1.1 This thesis is concerned with the legitimate use of company funds to promote the re-election of directors. Only in limited circumstances will the law permit directors to use company funds to promote their own re-election. In Australia, a formidable body of case law makes that point very clear and has done since the late 1980’s.

1.2 In *Advance Bank Australia v FAI Insurances Ltd* (“Advance Bank v FAI”) in 1987, the Court of Appeal of the Supreme Court of New South Wales\(^1\) set down very strict criteria in relation to the furtherance by a director of his own interests in a contested election. In essence, the court held that a company is entitled to act in a manner which protects its own interests in a contested election, subject to limits and qualifications in respect of the interests of minority shareholders.

1.3 It is my purpose in this thesis to analyse that decision of the Court of Appeal of Supreme Court of New South Wales in order to identify the circumstances in which the law will, and those in which the law will not permit company funds to be used to promote the re-election of directors. The issue is of very real moment, especially in the present commercial environment where regulatory control over the activities of directors is so acute having regard to the abuses by high profile directors in recent times. That said, it is not my purpose in this thesis to analyse the statutory overlay of regulatory control on this issue. Accordingly, this thesis is a comprehensive analysis of the Court of Appeal’s judgment, which in turn involves a consideration of the complex state of case law on point.

1.4 In Australia, the decision of the Court of Appeal of the Supreme Court of New South Wales in “Advance Bank v FAI” remains the *locus classicus* on the subject. In this thesis I develop in detail the factual matrix of the events giving

\(^{1}\) *Advance Bank Australia v FAI Insurances Ltd* (1987) 9 NSWLR 464.
rise to the litigation, the state of the case law prior to the decision, the
decision of all three members of the court itself and the likely application of
the court’s reasoning to future instances involving similar or comparable
commercial activity. The main thrust of my thesis is an analysis of the
circumstances in which the law will permit company funds to be used to
promote the re-election of directors.

1.5 It is trite law that a director owes fiduciary obligations to the company of
which he is a director. That position emerged in English law from the early
1800’s when joint stock companies\(^2\) were the common form of incorporation
and limitation of liability. At that time, supervisory control over derelict
directors were exerted by the Committee of the Privy Council for Trade and
Plantations. Conventional modern learning attributes the emergence of duties
which directors currently owe to the companies which they direct to the
evolution of equitable principles\(^3\). Onto those equitable principles were
grafted statutory provisions which either improved upon or expanded those
fundamental principles of equity. It is not my purpose to exhaustively
enumerate the duties imposed upon directors, nor is it my purpose to embark
upon a treatise on the way in which the statutory provisions have added to,
qualified, improved upon or ameliorated the position in equity. My thesis is
much more specific. It provides an analysis of the landmark decision in
Advance Bank v FAI. In order to provide a springboard for that analysis, it is
relevant to have in mind the more important duties to which a company
director is subject including –
(a) the duty to act in good faith in the interests of the company as a whole;
(b) the duty to act for a proper corporate purpose;
(c) the duty to keep discretions unfettered; and
(d) the duty to avoid a conflict of interest.
Of course, if statutory duties are added the list is significantly more expansive.

1.6 Thus, in assessing whether a director is entitled to use company funds to
promote the re-election of one or more of his or her fellow directors, it is

\(^2\) See Joint Stock Companies Act 1844.
\(^3\) See Consul Development Pty Ltd v DPC Estates Pty Ltd (1975) 132 CLR 373.
critical to ascertain whether in so using those funds the director complies with – or breaches – any one or more of the duties enumerated above. Put differently, the germane enquiry is whether the director complies with each of the duties set out above if the director uses company funds in promoting himself, herself or themselves for re-election.
PART 2

PUTTING THE ISSUE INTO CONTEXT

INTRODUCTION

2.1 So as to better understand the reasoning of the justices of appeal in Advance Bank v FAI, it is necessary to put the issue of the legitimate use of company funds to promote the re-election of directors in some form of factual matrix. Accordingly, in this part I endeavour to set out the relevant factual findings which were either common ground or which were findings made by the judge at first instance. I also explore the state of learning as it stood prior to the judge at first instance, Waddell CJ in Eq, handing down judgment.

THE FACTS OF ADVANCE BANK v FAI

2.2 The Court of Appeal of the Supreme Court of New South Wales gave a significantly more detailed examination of the facts than did Waddell CJ in Eq. The facts are involved and warrant close attention. Advance Bank Australia Ltd (“the bank”) was a public listed company having carried on business prior to June 1985 as a building society. Pursuant to the bank’s articles of association, shareholding in it was limited and no single shareholder or group of associated shareholders was permitted to hold more than 10% of the bank’s ordinary share capital. FAI Insurances Ltd (“FAI”) held 9.65% of the ordinary shares in the bank. The annual general meeting

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4 This is understandable as the Court of Appeal heard argument in the appeal over three days and took over three further months to consider its judgment. Whereas Waddell CJ in Eq heard argument in relation to the summons for permanent injunctions over five days and delivered judgment after having reserved for as little as five days.

5 In what has become his customary style, Kirby P divided the factual analysis into headings. They were entitled “a contested election”, “the campaign opens” and “preliminary questions”. His Honour divided the legal analysis into eight further headings. For a review of Kirby J’s style of judgment writing, several articles warrant attention including “High Court of Australia Ten Years On” September 2005 by the Hon. Justice M.D. Kirby, “A Century of Judgment Style: Changing Patterns of Judgment Writing on the High Court of Australia” (2004) 32 Federal Law Review 256; and (2004) 78 LJ 70.
(“AGM”) of the bank was due to be held on 11 September 1986. The board of the bank was comprised of nine directors, of whom five were obliged to retire at the AGM. The retiring five were eligible for re-election. FAI nominated its own selection of four persons⁶ for election as directors. In July 1986 one of the FAI nominees, Mr Adler wrote to the chairman of the bank’s board informing the chairman that FAI intended to nominate its own four candidates. On 6 August 1986 the bank’s board met to consider what was to be done in the face of the foreshadowed contest. The board appointed a committee, one task of which was to consider and approve the form of documentation to be despatched in respect of the AGM⁷. The committee approved the despatch of a letter to be sent from the chairman. The committee instructed the chairman by that letter –

“To state in his letter to the shareholders that the board does not believe it would be in the interests of the bank if the nominees of FAI Insurances Ltd were elected as directors and, for the reasons set out in the draft letter, supports the re-election of the existing retiring directors and further resolved that a ‘how to vote by proxy in accordance with the board’s recommendation’ card should be included with the notice of annual general meeting”.

2.3 The bank’s board received a presentation from Dr A Parkes of Lloyds International Ltd who advised on commercial strategy issues. He posed several options for the board, including conceding, negotiating and opposing the FAI challenge. In the course of the presentation from Dr Parkes concerns emerged (although the reports do not reveal through whom) that the election of FAI’s candidates could lead to FAI controlling the bank, that it could prejudice the expansion of the bank, that it could jeopardise any bank application for a trading bank licence and that it could have other deleterious effects on the bank’s operation. The following day the committee approved the final form of the chairman’s letter after minor changes had been notified by the bank’s solicitors. The text of the letter was thus –

⁶ The four nominees of FAI were L J Adler, T E Atkinson, R I Viner and A G W Keyes.
⁷ The Court of Appeal in its judgment reported at (1987) 9 NSWLR 464, 466 specifically observed that the committee so created was comprised of directors who were not standing for re-election. That became significant in the Court of Appeal’s reasons for judgment.
“Five of your directors, including the chairman, are standing for
re-election to the board, and their re-election is being opposed by
four nominees of FAI Insurances Ltd (FAI). The FAI group is the
registered holder of just under 10 per cent of your company’s
issued capital. FAI is, we understand, effectively controlled by the
Adler family.

Your board does not believe that the election of the four FAI
nominees to the board, which comprises nine directors, would be
in the interests of your bank. In addition to other concerns, your
board believes that it could lead to FAI subsequently gaining
effective control of the board and thus the bank, without having to
pay shareholders the substantial premium for control normally
payable in company takeovers.

Shareholders have, in my view, been well served by the present
directors, who are entitled to considerable credit for your
company’s success. I believe there is merit in maintaining the
continuity and independence of a successful team.

Your board strongly recommends that you vote in favour of the
re-election of the existing directors by either attending the
meeting on 11 September 1986 or voting in person or by
completing the proxy form accompanying this letter. The
completed form should be posted in the reply paid envelope
enclosed with the annual report or left at any Advance Bank
branch.

Information on how to complete the proxy form in accordance
with your board’s recommendation is set out in the “How to Vote
by Proxy’s guide accompanying this letter”.

2.4 On 15 August 1986 at a special meeting of the bank’s board attended by all
board members, the board unanimously resolved to oppose the nominations
of the FAI candidates. The board further resolved to establish a committee to
initiate action to draw to the attention of shareholders why the board
considered that shareholders should support the re-election of the five
retiring directors. The board also resolved to retain Levita Telecorporation
and Telemarketing Australia Ltd (“Levita”) to conduct canvassing and
telemarketing of the bank’s shareholders. The campaign of canvassing
conducted by Levita consisted mainly of telemarketing. Levita anticipated its
cost for this service at $49,500. The telemarketing consisted of reading an
operator’s script, a search for shareholder telephone numbers and a national
telephone campaign with a minimum of three attempts to contact each bank
shareholder. When the Levita operator telephoned a shareholder, the operator began by saying –

“Mr/Mrs…

My name’s… and I work for the Advance Bank…

Look, the situation is this.

We’ll be holding our first annual meeting very shortly, and your vote, as a shareholder, may be very important to the future of your bank, and your investment.

The reason is FAI has nominated four new directors for the board and if they are elected our board believes this could result in Mr Adler and the other FAI nominees gaining control of the board and thus the bank. FAI Insurance is, we understand, controlled by Larry Adler and his family.

Your board considers that it would not be in the best interest of the bank as a whole for four of the nine board positions to pass to nominees of FAI. When the bank was established last year our rules were structured to give a widespread of shareholding so the bank would not be controlled by any one shareholder or group of shareholders.

If Mr Adler and his nominees were to be successful in this election, this could subsequently lead to control of the bank, and to control of your bank’s management, without having had to buy control from the other shareholders. They’d only own 10 per cent of our shares – but they’d control the bank’s operations – and consequently the management of your investment in Advance.

Our board points out that the first year’s results at Advance have been excellent – our profit is well ahead of target, and people who bought their shares for $1 in last June’s issue now find they’ve more than doubled their price.

Mr/Mrs… our board thinks the election of Larry Adler and the other FAI nominees would not be in the best interest of the bank.

They think it could be a step towards an attempted takeover on the cheap.

And I’d like to ask if you’d stand behind the board and other shareholders in resisting this, by casting your vote in favour of the present board and not for Mr Adler and the other FAI nominees.”
2.5 Against that background FAI applied to court *ex parte* for orders restraining the bank and its chairman from –
- continuing to issue letters and (relevantly) proxy forms;
- continuing with telephone solicitation.

2.6 The application came before Waddell CJ in Eq. His Honour granted an *ex parte* injunction on 19 August 1986\(^8\). Thereafter, Waddell CJ in Eq heard an *inter partes* application to make permanent the orders obtained *ex parte* by FAI. For reasons which do not appear among the reports of the various applications and the appeal, the proceedings (at least the two which are reported) evolved against different parties. Before Waddell CJ in Eq, FAI sought relief against Urquhart and others, the defendants being the members of the bank’s board. The appeal was in respect of the refusal of relief by Waddell CJ in Eq under s535 of what was then the Companies (New South Wales) Code\(^9\) and it involved different parties.

**THE CASES PRIOR TO ADVANCE BANK v FAI**

2.7 Before turning to the specific analysis of the FAI case, both at trial and on appeal, it is instructive to consider the state of judicial learning on the authority of a company’s board to expend that company’s resources in fighting a contested board election. In turn, that involves a review of leading Australian and English authorities on point. Many of those authorities were considered by Waddell CJ in Eq or by the Court of Appeal in FAI. Chronologically, the relevant authorities are –

- *Peel v London and North Western Railway Company*\(^10\) (judgment in which was handed down on 19 November 1906);
- *The Australian Metropolitan Life Assurance Company Ltd v Ure*\(^11\) (judgment in which was handed down on 2 August 1923);

\(^8\) see (1986) 11 ACLR 25, 26

\(^9\) see (1986) 11 ACLR 38

\(^10\) *Peel v London and North Western Railway Co* [1907] 1 Ch D 5

\(^11\) *The Australian Metropolitan Life Assurance Company Ltd v Ure* (1923) 33 CLR 199
Hogg v Cramphorn Ltd\textsuperscript{12} (judgment in which was handed down on 18 October 1966);

Howard Smith Ltd v Ampol Petroleum Ltd\textsuperscript{13} (judgment in which was handed down on 14 February 1974);

Allen v Townsend\textsuperscript{14} (judgment in which was handed down on 28 August 1977);

Scott v Jess\textsuperscript{15} (judgment in which was handed down on 5 October 1984).

In setting out the main thrust of those cases this thesis seeks to distil the state of the law on this complex subject as it presented itself to Waddell CJ in Eq when his Honour was confronted with the task of divining some guiding principle from those cases, especially in the urgent circumstances of an application for \textit{ex parte} relief of a quia \textit{timet} nature. The six cases which I analyse are themselves complex, each presenting a labyrinth of factual and legal issues, from which (in my view at least) no particularly illuminating doctrinal principle emerged.

\textit{Peel v London and North Western Railway Company}

2.8 This was a decision of the English Court of Appeal\textsuperscript{16} on appeal from Warrington J. It involved an action by shareholders against a railway company and its directors, raising the question whether the expenses incurred in sending out proxies and circulars with a view to influencing the votes of shareholders in favour of a particular policy which the board was then promoting, were payable out of company funds. The facts were relatively simple and may be shortly stated. Mr Peel represented a large number of shareholders in a dispute with directors of the defendant (“the railway company”). The dispute began in October 1901 over the management of the affairs of the railway company with reference to three principal issues, all to do with the day to day operations of the railway company. The directors

\textsuperscript{12} Hogg v Cramphorn Ltd [1967] Ch 254
\textsuperscript{13} Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821
\textsuperscript{14} Allen v Townsend (1977) 31 FLR 431
\textsuperscript{15} Scott v Jess (1984) 3 FCR 263
\textsuperscript{16} The Court of Appeal was comprised of Vaughan Williams, Fletcher Moulton and Buckley LJJ.
supported their policy in respect of the three principal issues and voiced their own contentions in opposition to the criticisms of Mr Peel at several half yearly general meetings of the railway company.

2.9 In February 1905 the railway company’s half yearly general meeting was due to be held. Mr Peel and the persons he represented intended to propose at the meeting that the operational issues about which he had been agitating should be altered. The board then despatched to all shareholders –

- a circular signed by the chairman enclosing a report produced at an earlier half yearly general meeting by which alterations to the operational issues had been negated by a large majority of shareholders;
- stamped proxy papers with the chairman’s name and two directors’ names on it.

2.10 The documents urged all shareholders to attend the meeting or alternatively to return the signed proxies. Prior to the half yearly general meeting called for August 1905, similar documents were despatched to shareholders. The expenses incurred in the mail outs and printing were paid out of company funds, charged against gross income, the accounts having been approved by a very large majority of shareholders. Mr Peel and the other plaintiffs he represented sought to enjoin the defendants from using funds or property of the railway company in one or both of two manners, namely –

“(a) the printing or sending out any proxy papers for use at any meeting of the company with the names of the proposed proxies thereon or any other proxy papers, circulars, or letters, calculated to obtain for the directors, or otherwise to influence, the votes of stock or shareholders of the company at any meeting of the company; or

(b) any services rendered or time spent or expenses incurred by any persons (whether or not officers or servants of the company) in seeking to obtain for the directors, or otherwise to influence, such votes as aforesaid.”

It is important to observe that the relief sought in Peel is different to the relief sought in FAI. Specifically, in Peel, the plaintiffs sought orders restraining the board from using company funds in paying for “(b) any services rendered or time spent or expenses incurred by any persons...” In FAI, no such application was made.
2.11 The injunction application came before Warrington J on 13 July 1906. The report of the Court of Appeal's decision reveals that his Lordship did not express any opinion of his own, but granted an injunction “practically in the terms of the plaintiff’s claim” then suspended its operation pending appeal.

2.12 On the other hand, in the judgment of Buckley LJ, his Lordship refers to Warrington J putting at the beginning of his judgment that the directors were acting *bona fide* in advocating a particular course of policy, which suggests that a brief, perhaps extremely brief judgment of some sort was given by Warrington J.

2.13 In the Court of Appeal, each member held that the appeal should succeed. The proceeding by Mr Peel and others was dismissed with costs. Each member of the court delivered separate reasons for judgment. It is necessary to analyse each judgment.

2.14 Vaughan Williams LJ based his judgment on two main platforms. The first was the directors’ authority to do the acts in issue. The second was the board’s duty to inform shareholders of the reasons for the company’s adoption of a particular policy. As to the first proposition, his Lordship held that it was incidental to and consequential upon the statutory authority of a railway company to take proper steps to call a meeting together, and therefore that the proxies could be printed and posted. His Lordship embraced the observations of Lord Selborne LC in *Attorney General v Great Eastern Railway Co* where the Lord Chancellor held that a company as a company

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18 The report does not reveal whether Warrington J gave a considered judgment or an ex tempore judgment. Reference to his Lordship not expressing any opinion of his own then suspending the operation of the orders made pending appeal suggests that his Lordship merely pronounced the orders then authorised the railway company and the other defendants to challenge the legal issue before the Court of Appeal in much the same way as a single judge of the Supreme Court of Victoria may, under s17B of the *Supreme Court Act*, reserve any proceeding or question in a proceeding for the consideration of the Court of Appeal.

19 [1907] 1 Ch 5, 19

20 [1907] 1 Ch 5, 13

21 (1880) 5 App Cas 473, 478
had a right to do not only those things which are specially authorised by the enabling Act but also, without any imputation of *ultra vires*, to do all such other things as may fairly be regarded as incidental or consequential upon those things which the legislature has authorised. So far as the second proposition was concerned, his Lordship devoted most of his speech to the propriety or otherwise of directors issuing circulars to shareholders so as to better inform those shareholders of various matters. His Lordship commenced his analysis by stating the issue thus –

"The question is not whether the directors have the right to issue these circulars, the question is whether they have the duty – a duty which might reasonably involve the issue of these circulars – for unless they have this duty, in my judgment they have no right whatever to issue them."\(^{22}\)

2.15 In answering that question, his Lordship observed that a board of directors of a company, which adopted a particular policy being impeached, had the positive duty to inform shareholders about the policy, the reasons for its initial adoption and why the board was of the view that the policy should be maintained in the future. His Lordship said it was the board’s duty to give information of the facts which the directors thought justified the policy and to put forward to the company those reasons which they thought justified the policy which the company had adopted, and to say to the company, if they thought in good faith that it was the best advice, not to listen to the persons circularising the shareholders but to leave it to the board.

2.16 His Lordship considered the situation where the persons who launched the attack on the company were not “high-minded gentlemen”\(^{23}\) but rather were persons with “a deeper interest in other and competing undertakings”\(^{24}\). In that eventuality, his Lordship said the directors had a positive duty to take care that there was a meeting at which there was full attendance of shareholders “if they think that there is a serious attack being made upon

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\(^{22}\) [1907] 1 Ch 5, 12

\(^{23}\) Given the fact that women in England only acquired the right to vote after WWI by reason of the suffragette movement, in 1905 and 1906 when the half yearly meetings of this company were held, “gentlemen” only as opposed to female and male shareholders alike were entitled to and did in fact vote.

\(^{24}\) [1907] 1 Ch 5, 13
their policy which is likely to jeopardise the interest of the company in the future”. His Lordship said that if such a duty existed, it was also their duty to ensure sufficient shareholders attend. No challenge was made to the use of company funds in printing proxy papers. The only challenge was made to the cost of stamping. His Lordship said that as stamping of proxies was not prohibited, “it is fairly to be held to be incidental to and consequent upon the duties of the directors as servants of the company and by no means ultra vires of the company itself”\(^{25}\). In the result, Vaughan Williams LJ not only reversed the decision of Warrington J below but said the decision in \textit{Studdert v Grosvenor}\(^{26}\) was wrong. His Lordship allowed the appeal.

2.17 In a shorter judgment, Fletcher Moulton LJ agreed in the judgment of Vaughan Williams LJ. His Lordship rested his decision on a single issue, namely, whether it was within the duty of directors to attempt to influence the minds of shareholders in favour of one policy or another. His Lordship said that if it was within their duty the directors had the right to do so at the expense of the company. His Lordship approached the matter by treating the obligation, or duty, of the director as an obligation or duty to put before the corporators all relevant information then advise the shareholders what course to pursue. When that was done, his Lordship said the directors were doing their duty which they were entitled to do at the cost of the corporation and they were not required to do it at their own private cost. His Lordship said that on the facts of the case the directors were doing no more than attempting to promote the prosperity of the company to the utmost of their power and that in so doing they treated each member of the corporation exactly alike. Fletcher Moulton LJ allowed the appeal proposing the reversal of Warrington J’s injunction.

2.18 Buckley LJ also allowed the appeal. His Lordship stated several propositions on point. In my opinion the reasons for judgment of Buckley LJ have the most profound application, well beyond the facts of the case. First, his Lordship said that as a general principle it cannot be \textit{ultra vires} to use the

\(^{25}\) [1907] 1 Ch 5, 14

\(^{26}\) \textit{Studdert v Grosvenor} (1886) 33 Ch D 528
company’s funds \textit{bona fide} and reasonably for the purpose of obtaining the best expression of the voice of the corporators in general meeting\textsuperscript{27}. Second, his Lordship said it was within the directors’ power as well as their manifest duty to circulate among shareholders company information for the purpose of guiding their judgment on questions of policy. Buckley LJ said Warrington J’s order was wrong so far as it affirmed that the directors ought not to have sought to influence the votes of the corporators.

2.19 Third, Buckley LJ addressed payment of company expenses. His Lordship said that the company was legitimately entitled to defray out of its assets the reasonable expense of doing all such acts as was reasonably necessary for calling the meeting and obtaining the best expression of the corporators’ views on the questions brought before it.

2.20 Fourth, his Lordship held that the decision in \textit{Studdert v Grosvenor} was wrong.

2.21 Finally, his Lordship’s reasons for judgment are most commonly extracted in the penultimate paragraph of the case. Judiciously, it begins “I wish to guard myself with one final observation”.

\begin{quote}
\textit{Those who are conversant with the affairs of joint stock companies are well aware that cases often arise in which the board in power are anxious to maintain themselves in power, to procure their own re-election, or to drive a policy not really in the interests of the corporation, but for some private purpose of their own, down the throats of the corporators at a general meeting, and in which they issue at the expense of the company circulars and proxy papers for the purpose of attaining that object. When a case of that kind comes before the court, I sincerely trust that the decision of this court in this case will not be cited as any authority for justifying the action of the directors. The point here decided is that directors \textit{bona fide} acting in the interests of the corporation, and not to serve their own interests, are entitled and bound to inform and guide the corporators in matters affecting the corporate interests, and any expenses reasonably incurred in so doing may be borne out of the funds of the company.”}
\end{quote}

\textsuperscript{27} [1907] 1 Ch 5, 18
2.22 Thus, Peel’s case stands for several propositions including one that there is no
general prohibition on directors sending out to company members proxy
forms even those wholly or partially completed in a certain way, designed to
influence the voice of shareholders along certain policy lines and that they
can expend company funds in that pursuit.

2.23 Peel’s case has received enthusiastic support in Australia on this point, at least
in the federal jurisdiction. On 12 August 1987 French J of the Federal Court of
Australia handed down judgment in *Orison Pty Ltd v Strategic Minerals
Corporation NL* in which his Honour held there is a duty on directors as
directors to keep shareholders properly informed in relation to proposed
action by a company. His Honour held that such a duty is a duty which on
one view does not fall on the company. Later, on 27 January 1995 a Full Court
of the Federal Court comprised of Black CJ, von Doussa and Cooper JJ cited
*Peel v London and North Western Railway* in *Fraser v NRMA Holdings
Ltd*. There, the Full Court said a duty to make disclosure of relevant
information arises as part of the fiduciary duties of the directors to the
company and its members in relation to proposals to be considered in general
meeting. The Full Court said a proper discharge of the duty may require the
directors to take reasonable steps to ascertain relevant knowledge for
communication to members if that information is not known to the board.
The court further held that directors must not consciously refrain from
seeking relevant information nor turn a blind eye to relevant material in order
to avoid placing before members information which may contradict or qualify
any particular position taken or advocated by directors or a majority of them.

2.24 Each of those subsequent Australian considerations of Peel’s case focused on
the undoubted propriety of the finding of the UK Court of Appeal in respect of
shareholder entitlement to information. It is fair to say that the culture of
open management for the benefit of shareholders is traceable to authorities

28 Of course, this is predicated upon the board acting bona fide and in the best
interests of the company.
29 *Orison Pty Ltd v Strategic Minerals Corporation NL* (1987) 13 ACLR 314
30 (1987) 13 ACLR 314, 330
31 *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452
32 (1995) 55 FCR 452, 466
such as *Peel* and that the culture has steadfastly developed at an increasingly sophisticated pace since 1906. Having said that, it is also fair to say that aside from the FAI decisions (to which attention is later given) *Peel* is universally upheld for its authority in the doctrine of shareholders’ entitlement to information. Its other (and for present purposes equally important) proposition, namely, the costs of getting information to shareholders was sidestepped until FAI. In many respects that is curious especially in the context of contested takeovers. Historically, those have been commonplace in the corporate arena in both Australia and the United Kingdom since 1906 when *Peel*’s case was decided.

2.25 It is probably so obvious that it goes without saying but a single thread which runs deep within all the authorities relevant to this area of the law is the *bona fides* which the directors must exhibit before their actions can attract any protection from the law. In *Peel*’s case the expenditures were made *bona fide*. For that matter, Buckley LJ proceeded (at page 19) on the express finding by the trial judge that the directors were acting *bona fide* to the best of their judgment when advocating a particular course of policy. In the FAI litigation, an important feature which influenced the Court of Appeal[33] was the conclusion of Waddell CJ in *Eq* (described by Kirby P as “an important conclusion”) that the directors and each of them had acted *bona fide* and honestly believing the election of the relevant individuals was truly in the best interests of the bank. In *Peel*’s case the court spoke of “high-minded gentlemen”.

2.26 There is no doubt that directors are not entitled to seek orders for the ratification of their acts in orchestrating a campaign of electioneering, still less are they entitled to seek payment for such activities from company funds, if those activities are not *bona fide* or if those activities are actuated by malice. The cases make it clear that the directors must be acting *bona fide* in the best interests of the company in order to attract the operation of the principle espoused in *Peel*’s case.

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[33] see for example the observations of Kirby P (1987) 9 NSWLR 464, 471
2.27 An early pronouncement at High Court level of the scope of directors’ duties when exercising their powers was given in *Australian Metropolitan Life Assurance Ltd v Ure (op cit)*. The facts of the case were sufficiently different to the facts of the FAI case to render the specific findings inapplicable. However, the court\(^{34}\) made observations about directors’ powers, the exercise of those powers and the circumstances in which the exercise of those powers may be vitiated.

2.28 A brief recital of the facts is necessary. The Australian Metropolitan Life Assurance Co Ltd (“AML”) was incorporated with an authorised share capital of £10,000 divided into 5,000 shares of £2 each. By special resolutions in 1887 and 1905, AML’s authorised share capital was increased to £100,000 by the creation of 44,000 shares of £2 each, on terms to the effect that the newly created shares were first to be offered pro rata to members in proportion to their existing shareholding. Article 21 of AML’s articles of association provided that the directors were entitled to refuse to register any share transfer without assigning any reason therefore. Frances Stephanie Ure purchased a parcel of shares in respect of which the board refused to register a transfer into her name. The directors did not give reasons for their refusal. Frances Ure applied to the Supreme Court of Queensland for relief. Lukin J ordered AML to register the share transfers. Being dissatisfied with those orders, AML appealed to the High Court\(^{35}\).

2.29 Each member of the High Court delivered a separate judgment. Each member of the court allowed the appeal. Knox CJ said the question for determination

\(^{34}\) Knox CJ, Isaacs and Starke JJ

\(^{35}\) This was an appeal from a single judge of a state Supreme Court direct to the Full Court of the High Court without the case passing through an intermediate court of appeal. In 1923 that was common enough and was expressly countenanced by operation of s35 of the *Judiciary Act* (1903) Commonwealth. For an elaboration of the historical development of s35 of the *Judiciary Act* and appeals from state Supreme Courts to the High Court see *Practice and Procedure of the High Court of Australia* by Camilleri (especially para 4965.5 et seq) and *Special Leave to Appeal – The Law and Practice of Applications for Special Leave to Appeal to the High Court of Australia* by O’Brien (1996)
was whether Frances Ure had established that the directors, in refusing to consent to the transfers, were not exercising their powers honestly or *bona fide* in what they believed to be the interests of AML. Knox CJ cited Lord Atkinson’s speech in *Weinberger v Inglis*\(^{36}\) where his Lordship posed three principles in a case where directors were entitled to refuse to register a transfer of shares. First, in refusing to consent to the transfer directors are not bound to state reasons for so refusing. Second, if the directors do not state their reasons, in the absence of evidence to the contrary, it must be assumed they have acted *bona fide* and honestly and for the furtherance in their belief of the interests they were bound to protect. Third, in order to vitiate the exercise of their powers, it must be shown that their action was arbitrary and capricious. Knox CJ further held that if the directors take the matter into their consideration and act honestly and *bona fide*, their decision cannot be reviewed in any court. The chief justice said\(^{37}\) that action by directors which is arbitrary and capricious cannot be regarded as a *bona fide* exercise of the power entrusted to them for the benefit and protection of the company and should only be exercised for those purposes. Ultimately, Knox CJ held that Frances Ure had failed to show any want of *bona fide* nor anything capricious or wanton in the refusal of directors to register the transfers.

2.30 Isaacs J referred to the conclusion of Lukin J that the refusal to register was not in good faith and instead was for the collateral purpose of keeping the directors’ section of the members in a majority and advancing their interests to the prejudice of the other shareholders.

2.31 His Honour said that the power to refuse registration, as provided in article 21 was a power which involved some discretion and had to be exercised *bona fide* - that is, for the purpose for which it was conferred, not arbitrarily, nor at the absolute will of the directors, but honestly in the interest of shareholders as a whole. His Honour said a possibility existed that the directors were not really moved by legitimate considerations but rather acted upon some

\(^{36}\) [1919] AC 606, 626  
\(^{37}\) (1923) 33 CLR 199, 206
extraneous reason – even an unworthy reason. In such a case, his Honour said the directors’ powers were exceeded. In two places Isaacs J referred to the need to ascertain the ambit of the power. First\textsuperscript{38} his Honour referred to the decision in \textit{Weinberger v Inglis} where the question of the proper or improper use of power was said to be determined by ascertaining the ambit of the power, that is to say, the breadth of the power. Second, Isaacs J held\textsuperscript{39} that acting entirely within the scope of their power, honestly basing their action on their own business opinion, the directors were exercising a function with which no court could interfere and over which no court had any jurisdiction of review or appeal.

\textbf{2.32} In much briefer reasons, Starke J held that directors were entitled to the presumption of honesty and on the facts of the case, shareholders were entitled to the benefit of the operation of article 21. His Honour said the authority given to the directors by article 21 was a fiduciary power to be exercised for the benefit of the company and with due regard to the rights of the transferor and transferee. The AML case provided early High Court authority pronounced with a unified voice, of the parameters within which directors must act in the discharge their duties. The case stands for the proposition that directors’ actions within the scope of their powers (usually as defined by the constitution) will not be impugned if made honestly and \textit{bona fide} in the best interests of the company. Conversely, actions beyond those powers or actions actuated by arbitrary or capricious reasons, will not be seen to be honest, \textit{bona fide} nor in the best interests of the company. In those circumstances, the court’s jurisdiction is enlivened to intervene by setting aside the relevant act or declaring it invalid.

\textbf{2.33} If left on the foundation of the AML case, in most instances the threshold determination for the court would be a factual determination. It would involve an analysis of the source of the director’s power to do the act in issue. Once the court made that determination, the court would then be required to assess whether the powers were applied honestly, \textit{bona fide} and in the

\begin{footnotes}
\item \textsuperscript{38} at 220
\item \textsuperscript{39} at 221
\end{footnotes}
interests of the company or whether on the facts the power was being exercised in a capricious or arbitrary manner. However, nowadays the matter is not as easy as that, as is evident from the material below.

2.34 The AML case has received support of a chequered nature throughout Australia. Some authorities prior to the Court of Appeal’s decision in FAI expressed caution about the breadth of its application\(^{40}\). One case only expressly approved it\(^{41}\) and academic writing on the issue of “honesty” in relation to the action of directors has been produced about the AML case\(^{42}\). Subsequent to the FAI case, the AML case has received other attention, mostly favourable\(^{43}\). Perhaps the most to be said about any equivocation in the applicability of the ratio in the AML case lies in the fact that it should be

\(^{40}\) Authorities which have adopted a cautious approach to the application of the AML case include Gordon v Australian & New Zealand Theatres Ltd (1940) 40 SR(NSW) 512; Federal Commissioner of Taxation v Sidney Williams (Holdings) Ltd (1957) 100 CLR 95; Re Co-operative Development Funds of Australia Ltd (No 3) (1978) 3 ACLR 437; Ascot Investments Pty Ltd v Harper (1981) 148 CLR 337; Gazzo v Comptroller of Stamps (Vic) ex parte Attorney-General of Victoria (1982) 149 CLR 227; Kinsela v Russell Kinsela Pty Ltd (in liq) (1986) 4 NSWLR 722

\(^{41}\) Magill v Santina Pty Ltd [1983] 1 NSWLR 517

\(^{42}\) Such academic writings include “The Concept of ‘Honesty’ under s232(2) of the Corporations Law” (1994) 12 CSLJ 231; “Honesty in Corporations” (1996) 14 CSLJ 4; and “Critique of the Modern Reformulation of Directors’ Duties of Care” (1996) 6 AJCL 72.

\(^{43}\) Those cases include T C Newman (Qld) Pty Ltd v DHA Rural (Qld) Pty Ltd (1987) 12 ACLR 257 in which G N Williams J applied the AML case; Australian Growth Resources Corporation Pty Ltd (receivers and managers appointed) v Van Reesema (1988) 13 ACLR 261 in which the Full Court of the Supreme Court of South Australia – King CJ, Cox and Johnston JJ – applied the AML case; Bodalla Company Pty Ltd v Dairy Farmers Co-op (1988) 15 ACLR 478 where Kearney J of the Supreme Court of New South Wales referred to without deciding on its precise applicability the AML case; Re Southern Ltd: Residue Treatment & Trading Co Ltd v Southern Resources Ltd (1989) 15 ACLR 770 in which Perry J of the Supreme Court of South Australia applied the AML case; Waters v Winmaran Pty Ltd (1990) 3 ACSR 378 in which Master Evans of the Supreme Court of Victoria applied the AML case; Blackwell v Moray (1991) 5 ACSR 255 in which Cohen J of the Supreme Court of New South Wales referred to the AML case; Gray Eisdell Timms Pty Ltd v Combined Auctions Pty Ltd (1995) 17 ACSR 303 in which Young J of the Supreme Court of New South Wales referred to the AML case; and Leaver v Taxi Combined Services (Launceston) Pty Ltd [2002] TASSC 2 in which Crawford J of the Supreme Court of Tasmania doubted any challenge to the onus of proof set out in the AML case, that is to say, that the onus lays on the applicant who seeks to show the absence of just cause in refusing to register the share transfers.
confined to cases strictly about directors refusing to register share transfers where the relevant company’s constitution permit such a refusal. Section 1072G of the Corporations Act provides statutory power for such a refusal. The FAI case went beyond such a situation. As a result, both Waddell CJ in Eq and the Court of Appeal expressed hesitation in taking the ratio of the AML case into the arena of cases where directors pay electioneering expenses from company funds.

**Hogg v Cramphorn Ltd**

2.35 Prior to the decision of the New South Wales Court of Appeal in FAI, English jurisprudence in company law recognised the concept of shareholders’ “constitutional rights”, the violation of which enlivened the court’s jurisdiction to interfere in the company’s affairs. The so-called “constitutional rights” of shareholders entitled a majority of shareholders in general meeting to pursue what course the majority chose within the company’s powers, however wrong-headed it appeared to others so long as there was no unfair oppression of other members\(^{44}\). If the directors of a company sought to exercise powers which had been delegated to them in circumstances which put the directors in a fiduciary position when exercising those powers, and the directors when exercising the powers interfered with the exercise by the majority of its constitutional rights, the court intervened.

2.36 *Hogg v Cramphorn Ltd* was a contemporary illustration of that point. Samuel Hogg was a very small shareholder in Cramphorn Ltd, a company established in 1896 by members of the Cramphorn family, the principal business of which was grain merchant activities. The Cramphorn family held a substantial interest in the company. During 1963 the authorised share capital of the company was increased by the creation of a parcel of cumulative preference shares. Upon the share capital increase being effected, a man named Baxter offered to purchase the whole of the issued shares in the capital of the company for less than their proper book value. Colonel Cramphorn, the chairman and managing director, took the view such an offer was not in the

\(^{44}\) Inferentially, the minority shareholders.
best interests of the company. Seeking a means of staving off Baxter’s overtures, Colonel Cramphorn and the board devised a scheme and put it into effect by which a block of shares would be allotted to the board bearing voting rights in the ratio of 10 to 1 per share whereas all other shares carried voting rights of one vote per share. The board made a loan from company funds to enable the shares with special voting rights to be acquired. Once those shares were acquired, the board controlled more than half of the votes.

2.37 One month later, the company’s solicitors informed Mr Baxter that the price which he proposed for the shares was inadequate. Mr Hogg, the plaintiff, acquired a modest parcel of 50 shares as an associate of Baxter and together with Baxter, became joint beneficial owners of those shares. Mr Hogg issued a writ claiming that the board’s creation of the block of shares with special voting rights attached was _ultra vires_ and void. The case⁴⁵ came before Buckley J in the Chancery division of the High Court of Justice⁴⁶.

2.38 Ultimately, his Honour made four findings to reflect the diverse nature of the applications before the court. First, his Lordship held that the purported creation of shares with special voting rights contravened the relevant company article. Hence, the directors had no power to attach special voting rights to any particular block of shares. However, his Honour held that it was not competent for Mr Hogg to procure the allotment to be set aside although it might have been open to the allottees to have done so. Second, his Honour held that the power to issue shares was a fiduciary power and if exercised for an improper motive the issue was liable to be set aside, it being immaterial that the issue was made in the _bona fide_ belief that it was in the interests of the company. Third, his said that the issue of the special shares, the execution of the deed and the loan for the purchase of the shares were all _ultra_

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⁴⁵ More properly, the “cases” came before Buckley J because Hogg issued a second proceeding claiming the company’s execution of the deed which implemented the creation and acquisition of the shares with special voting rights was _ultra vires_ and also void.

⁴⁶ Company cases are predominantly dealt with before the Chancery Division, equivalent to the Commercial and Equity division of the Supreme Court of Victoria whereas common law cases are dealt with in the Queens Bench division, equivalent to the common law division of the Supreme Court of Victoria.
vires and were invalid unless ratified by the company in general meeting. And finally, his Honour held that Hogg was justified in suing in a representative capacity.

2.39 *Hogg v Cramphorn* is a case of particular relevance in a consideration of the use by directors of a power to issue shares and whether that power is used *bona fide*. Such a variance in the facts of that case with the facts of the FAI case make the ratio in *Hogg v Cramphorn* of marginal value in a consideration of the legitimate use of company funds to promote re-election of directors, as is the subject of this thesis. Having said that, the case is instructive on the extent to which a director’s *bona fide* beliefs in the actions sought to be impugned can be upset by the court and whether those actions are in the best interests of the company. In *Hogg v Cramphorn*, Buckley J had no difficulty setting aside the relevant share allotments whether or not the allotments had been made in the *bona fide* belief that they were in the best interests of the company. His Lordship regarded the important question as being one of the director’s power, the fiduciary nature of that power and the improper motive in the exercise of that power. His Lordship said the following –

“Accepting as I do that the board acted in good faith and that they believed that the establishment of a trust would benefit the company, and that avoidance of the acquisition of control by Mr Baxter would also benefit the company, I must still remember that an essential element of the scheme, and indeed its primary purpose, was to ensure control of the company by the directors and those whom they could confidently regard as their supporters. Was such a manipulation of the voting position a legitimate act on the part of the directors?”

His Lordship answered that question in the negative, yet preserved the right of the company in general meeting to ratify the said manipulation.

2.40 As a statement of company law relevant to share issues, *Hogg v Cramphorn* has received support in Australia. Its application on the *bona fide* belief of directors about the propriety of their conduct has also been approved. In *Re*
Australian Foundation Investment Company Ltd48, Gowans J applied Hogg v Cramphorn but only in respect of the capacity of the company in general meeting to relax or suspend the operation and effect of any given article. The Full Court of the Supreme Court of Western Australia49 in Esplanade Developments Ltd v Divine Holdings Pty Ltd50 referred to Hogg v Cramphorn but in a very narrow and unrelated context. The exercise of a fiduciary power such as the issue of shares for an ulterior or impermissible purpose was squarely considered by the majority of the High Court in Whitehouse v Carlton Hotel Pty Ltd51 where the court52 held that such an exercise of power is bad even if the motives of the donee of the power in so exercising the power are substantially altruistic. At single judge level in New South Wales (post FAI in the Court of Appeal) Hogg v Cramphorn has been applied53.

Howard Smith Ltd v Ampol Petroleum Ltd

2.41 In the context of the “constitutional” approach contended for in Hogg v Cramphorn Ltd, the Court of Appeal in FAI referred to the decision of the Judicial Committee of the Privy Council in Howard Smith Ltd v Ampol Petroleum Ltd (supra). Kirby P in FAI quoted54 from the speech of Lord Wilberforce in Howard Smith to make the point about curial intervention where directors “invade” the “constitutional rights” of shareholders. In FAI, Kirby P held that the issues before the court were “separate and different” problems to those which vexed the court in Howard Smith. Ultimately, Kirby P posed sufficient doubt about the existence of the so called “constitutional

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48 Re Australian Foundation Investment Company Ltd [1974] VR 331. It is interesting to observe that senior counsel for the plaintiff was Young QC, later Sir John Young CJ and senior counsel for the defendant was Aickin QC, later Sir Keith Aickin of the High Court of Australia.
49 The court was comprised of Burt CJ, Lavan SPJ and Brinsden J.
50 Esplanade Developments Ltd v Divine Holdings Pty Ltd (1980) 4 ACLR 826, 834
51 Whitehouse v Carlton Hotel Pty Ltd (1987) 162 CLR 285
52 Mason, Deane and Dawson JJ.
53 For example, see Hooker Investments Pty Ltd v Email Ltd (1986) 10 ACLR 443; Darvall v North Sydney Brick & Tile Co Ltd (1987) 16 NSWLR 212; LMI Australasia Pty Ltd v Boulderstone Hornibrook Pty Ltd [2001] NSWSC 886.
54 (1987) 9 NSWLR 464, 477
rights” as to render cases such as Hogg v Cramphorn and Howard Smith of dubious value on that issue. Kirby P expressed his doubt thus –

“The ‘constitutional’ principle urged by FAI is likewise inconvenient at the margins, as the illustrations already cited demonstrate. If there were such a ‘constitutional’ principle in Australian law, one would have expected it to emerge clearly in an earlier case. None could be cited in support of it”.

2.42 The constitutional principle represented an important weapon in the assault advanced by FAI. Ultimately it was a weapon of much noise but little result. It drew its strength from the Howard Smith decision. It is worthwhile examining that case in some detail.

2.43 The case arose out of a struggle for the takeover and control of R W Miller (Holdings) Ltd (“Miller”). Ampol Ltd (“Ampol”) and Bulkships Ltd (“Bulkships”) together held approximately 55% of the issued shares in the capital of Miller, the other 45% being held by outside interests. At issue was the acquisition by Howard Smith Ltd (“Smith”) of 4.5 million shares which if validly issued, had the effect of converting Smith’s minority position as a shareholder to that of a majority shareholder. The circumstances of the issue to Smith of the 4.5m share were critical and briefly stated were these.

2.44 On 15 June 1979 Ampol formally made an offer to acquire all the issued shares in the capital of Miller for $2.27 per share. On 22 June 1972 Smith announced its intention to make a takeover offer for Miller of $2.50 per share, that is to say, on more attractive terms than Ampol’s offer. On 23 June 1972 the Miller board considered Ampol’s offer and rejected it for being too low. On 27 June 1972 Ampol and Bulkships issued a press statement, which relevantly said Ampol and Bulkships intended to act jointly in relation to the future operations of Miller, that Ampol and Bulkships had decided to reject any offer for their shares and that between them, Ampol and Bulkships

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55 (1987) 9 NSWLR 464, 481
56 The report does not give a detailed factual examination about whether Smith knew the terms of the Ampol offer thereby bettering it by 23 cents per share. In all likelihood, in the one week which elapsed between offers, Smith learned of and improved upon Ampol’s offer.
controlled more than 55% of the issued shares in the capital of Miller. Lord Wilberforce, who delivered the judgment of the Privy Council\(^{57}\) said\(^{58}\) the press “statement conveyed the message, unmistakably, that, with the shareholding as it was, it would be useless for the outside shareholders to accept the Howard Smith offer or to decline the Ampol offer and that it would be useless for Howard Smith to proceed”. Thereafter, Miller decided to make an issue of shares to Smith of sufficient size to convert the majority position of Ampol and Bulkships into a minority position thereby enabling Smith to proceed with its offer and given the fact that the Smith offer was better than the Ampol offer, it was likely to be accepted. Thus, Smith would acquire control of Miller. Miller had earlier obtained legal advice to the effect that a share issue could be justified if and only if it \textit{bona fide} related to capital raising. At the time Miller in fact required $10m to finance tankers then under construction. Miller calculated it needed to raise capital by allotting 4.5m shares, each at a value of $2.30 per share.

2.45 Events moved apace. On 6 July 1972 Smith wrote a letter to Miller in the following terms –

“This combination by the two largest shareholders of your company [viz. Ampol and Bulkships] would in the present circumstances effectively deprive the very large number of minority shareholders of R W Miller (Holdings) Ltd of the opportunity of securing a substantially higher price for their shares. My board would be most reluctant to proceed with a bid which, even if every shareholder other than Ampol and Bulkships accepted, could only result in Howard Smith Ltd being the largest individual shareholder in a company the future operations of which would be controlled by a combination of two smaller shareholders. We believe that your board is conscious of the injustice being suffered by your smaller shareholders and we submit for your consideration a proposal which, if it meets with the approval of your board, would enable Howard Smith Ltd to proceed with its intended offer thereby restoring to your minority shareholders the right to sell their shares to the highest bidder, and would give Ampol Petroleum Ltd and Bulkships Ltd a similar opportunity…

\(^{57}\) In \textit{Howard Smith Ltd v Ampol Petroleum Ltd}, the Privy Council was constituted by Lord Wilberforce, Lord Diplock, Lord Simon of Glaisdale, Lord Cross of Chelsea and Lord Kilbrandon.

\(^{58}\) [1974] AC 821, 830
Notwithstanding the current circumstances I believe that the opportunity of placing such a large parcel of shares at a substantial premium is likely to be of considerable benefit to your company. The infusion of $10,350,000 cash is likely to ease the financing problems your company has faced in recent years, and enable you to rearrange your borrowings with the prospect of interest savings.”

Miller’s board accepted the proposal by a 4-2 majority. The additional 4.5m shares were then allotted to Smith. That allotment diluted Ampol’s and Bulkship’s shareholding from more than 55% to 36.6% and thereby placed Smith in a position to make an effective takeover bid for Miller, which it did.

2.46 Ampol challenged the issue of the additional 4.5m shares to Smith. It sought an order from the Supreme Court of New South Wales rectifying the register of members by deleting reference to Smith as the holder of the allotted shares. The proceeding came before Street CJ in Eq. His Honour heard evidence from the directors of Miller who asserted that their primary reason for the issue of shares to Smith was to obtain more capital and for no other reason. His Honour set aside the issue to Howard Smith of the shares. Howard Smith appealed.

2.47 Lord Wilberforce in the Privy Council upheld all findings of fact and conclusions of law made by Street CJ in Eq. Among the findings of fact were findings that the Miller directors were not motivated by any purpose of personal gain or advantage. Having discounted any ulterior motive of personal gain, Street CJ in Eq considered whether the primary object of the majority of the Miller board was to satisfy Miller’s need for capital or whether the primary object of the majority of the Miller board was to destroy the majority holding of Ampol and Bulkships. Lord Wilberforce held that courts usually do not interfere in management issues nor in issues concerning the correctness of management decisions. However, his Lordship did observe that Street CJ in Eq was correct in rejecting the directors’ contentions that their primary purpose in issuing 4.5m shares was to obtain capital. Instead, Street CJ in Eq held, and Lord Wilberforce agreed, that the directors’ dominant purpose was to promote Smith’s takeover bid.
2.48 In applying legal principle to the facts as found, Lord Wilberforce said that where self-interest of directors is involved, the directors are not permitted to assert that their actions are *bona fide* in the best interests of the company. His Lordship cited *Hogg v Cramphorn* in support of that proposition. Self interest is only one albeit the most common instance of improper motive. His Lordship said that in cases involving the abuse of power, the state of mind of those who acted and the motive on which they acted is all important.

2.49 As a starting point in an examination of the proper use of a power conferred on directors, Lord Wilberforce said one first analyses the power in question, here, to issue shares. Having ascertained the nature of the power, and having defined the limits within which it may be exercised then in examining the exercise of the power, the court looks at the substantial purpose for which it was exercised. The court then reaches a conclusion whether that purpose was proper or not. The court gives due credit to the *bona fide* opinions of the directors and respects their judgment in matters of management. Lord Wilberforce said that an issue of shares purely for the purpose of creating voting power is repeatedly condemned and his Lordship referred on that point to the decision of the High Court of Australia in *Mills v Mills*. His Lordship said it was unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. The Privy Council supported the judgment of Street CJ in Eq in its entirety and recommended to Her Majesty that the appeal be dismissed. It was.

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59 In addition to citing *Hogg v Cramphorn* on point, Lord Wilberforce also cited (among others) *Punt v Symons & Co Ltd* [1903] 2 Ch 506; *Percy v S Mills & Co Ltd* [1920] 1 Ch 77 and *Ngurli v McCann* (1953) 90 CLR 425.

60 [1974] AC 821, 835

61 *Mills v Mills* (1938) 60 CLR 150

62 Upon the *Australia* Act 1976 (C’th) coming into operation, appeals to the Judicial Committee of the Privy Council were abolished. The *Howard Smith* case was one of the last of such appeals. In Victoria, the cases of *Montana Hotels Pty Ltd v Fasson* (1986) 61 ALJR 282 (Privy Council – Lord Bridge, Lord Mackay, Lord Ackner, Lord Oliver and Sir Ivor Richardson); and *Scholefield Goodman & Sons Ltd v Zyngier* (1985) 59 ALJR 770 (Privy Council – Lord Keith of Kinkel, Lord Roskill, Lord Brightman, Lord Griffiths and Sir Owen Woodhouse) were among the last of such cases. For an interesting analysis of other appeals to the Privy
2.50 In FAI, the Court of Appeal addressed the contentions about the *bona fide* use of power made by FAI in the context of bodies which were corporate (at least in the loose sense) yet not incorporated. Specifically, the Court of Appeal referred to three cases in which union controllers were required to exercise powers in good faith when a union election was involved. Kirby P quoted from one such case and cautioned against placing reliance on authorities which emanated from the industrial relations sphere. Kirby P said “the comparison of a commercial enterprise and an industrial organization is not a perfect one”\(^{63}\). Be that as it may, the law imposes obligations loosely analogous upon union officials when conducting elections as it does on directors when conducting electioneering. The decision of the Federal Court of Australia\(^{64}\) in *Allen v Townsend* bears that proposition out.

2.51 The facts of the case are involved. They pertain to a union election. By reason of the overlay of union branches and sub-branches and the relationship between the committee and other organs of the union the factual parallel between the union and the company are not straightforward. However, in the course of Federal Court’s judgment, the court made observations on the similarity of duties of members of a committee of an industrial organisation and the duties of directors of a company. The court held that in order to ascertain whether an exercise of power by a committee was *bona fide*, regard may be had to intention and motive, as revealed by surrounding circumstances, of those participating in the collegiate act. On the facts of the case, the resolution in issue was not passed *bona fide* for the purposes of the management of the organisation. The court applied *Howard Smith Ltd v Ampol Petroleum Ltd* in the context of the motive for the exercise of the relevant power.

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\(^{63}\) (1987) 9 NSWLR 464, 479

\(^{64}\) The court was made up of Smithers, Evatt and Northrop JJ.
2.52 In October 1984 the Industrial Division of the Federal Court\textsuperscript{65} heard and determined \textit{Scott v Jess}. Again, the facts are of little assistance to the matters in issue in this thesis. However, the case is important for two reasons. First, the Full Court of the Federal Court held that the members of a committee and officers of an organisation are bound to exercise the powers conferred on them \textit{bona fide} for the purpose for which the power was conferred. Second, the court applied the statement of principle in \textit{Allen v Townsend} which held that officials of an organisation are under a duty to exercise powers conferred upon them by the rules of the organisation \textit{bona fide} for the purposes for which the powers are conferred. The Full Court also referred to Lord Wilberforce’s speech in \textit{Howard Smith Ltd v Ampol Petroleum Ltd}.

2.53 The cautionary note sounded by the Court of Appeal in FAI about the dubious precedent value in a corporate environment of industrial law precedents is valid, so far as it goes. It is submitted that the two industrial cases of \textit{Allen v Townsend} and \textit{Scott v Jess} do no more than apply to a different type of organised hierarchy (that is to say to unions rather than companies) legal principles of undoubted good sense and demonstrable correctness. Thus, in \textit{Scott v Jess}, for example, Gray J\textsuperscript{66} stated the proposition apropos unions in terms which mimicked if not replicated the statement of principle espoused in company law terms by Lord Wilberforce in \textit{Howard Smith Ltd}, even to the proposition of the onus upon whom the obligation rests to prove lack of good faith. For reasons set out above, the onus falls upon the party seeking to overturn the exercise of the power and not upon the party which seeks to uphold it.

2.54 In reference to several other authorities set out above where a principle of significant value is propounded it has been a pattern in this thesis to point to other subsequent authorities which have applied, considered or rejected the principle. In the context of the industrial cases of \textit{Allen v Townsend} and \textit{Scott

\textsuperscript{65} In \textit{Scott v Jess} the Industrial Division of the Full Court of the Federal Court of Australia was constituted by Evatt, Northrop and Gray JJ, that is to say, the same two of the three members of the court which heard and determined the case of \textit{Allen v Townsend}.

\textsuperscript{66} (1984) 3 FCR 263, 287
v Jess, I do not propose to explore the cases which have subsequently considered those authorities, even though in the case of Allen v Townsend almost nine years elapsed between the date of judgment in it and in the Court of Appeal’s judgment in FAI. A much lesser interval elapsed between the date of judgment in Scott v Jess and the decision in the Court of Appeal in FAI. That is because the Court of Appeal in FAI regarded the industrial cases as authorities which must be treated with “great care in applying, out of context, the decisions reached in the industrial relations sphere”67. Kirby P continued with the cautionary remarks –

“Although it is true that, in reasoning to conclusions about the expenditure of union funds in a way advantageous to incumbent officers, the courts have frequently called upon company law analogies (as Evatt and Northrop JJ did in Scott v Jess at 271-272, 323-324, 388), the comparison of a commercial enterprise and an industrial organisation is not a perfect one. Nor has the law for each developed identically.”

2.55 One may be forgiven for thinking that the passage above represents no more than a statement identifying the fact that differences exist between company law authorities and industrial law authorities on the issue of directors'/industrial organisers’ obligations to their respective members (in the loose sense). In an endeavour to clarify the position, Kirby P gave reasons why industrial authorities should be treated cautiously when an attempt is made to draw a parallel to a company law principle –

“In respect of industrial organisations, the provisions of (the Conciliation & Arbitration Act) have, in the federal sphere, greatly influenced the insistence of the courts upon the integrity of elections, in order to achieve the statutory objective of democratic control. The democratic control by shareholders of corporations is somewhat more attenuated. It is often subject to the special powers of large shareholders.”

2.56 Pausing there, again it is suggested that Kirby P does little more than point out the self evident reality. In the first sentence extracted above, it is true that in the context of unions, battles for control are frequently determined by elections among members and the courts have striven to ensure democracy in

67 (1987) 9 NSWLR 464, 479 per Kirby P
those elections thereby achieving a democratic outcome and with it
democratic rule for the particular union. Therein lies the point. In the
industrial arena, or more specifically in the arena of union elections, the
courts have embraced company law doctrines of the sort espoused in such
high authority as Howard Smith. By reason of the importance in both unions
and companies alike of proper electioneering, the courts insist on good faith
and proper purpose as minimum standards when those who control the union
or corporations enter upon the electioneering contest. The statement of Gray
J has as much application to unions as it does to companies where in Scott v
Jess his Honour said –

“A power given to a person or persons by the rules of an
organisation [read “articles of association’] must be exercised in
good faith and for the purpose for which it is given, not for some
ulterior or extraneous purpose.”68

2.57 To that extent, it is not easy to see how or why Kirby P makes so much of the
so-called difference on this point between cases in the industrial field as
opposed to cases on this point in the company law field. His Honour observed
that the democratic control by shareholders of corporations is often subject to
the special powers of large shareholders. That much is true. However,
whether or not large blocks of shareholders are involved (as Howard Smith
amply indicates) directors are subject to the duty to act in good faith and for a
proper purpose, especially in the context of orchestrating manoeuvrings for
control. Thus, one might ask how the case law in this field of company law is
different to that of industrial law. One might further ask why Kirby P made so
much of that so-called difference, especially when the reasons for the
difference which his Honour ascribed are so wholly tenuous. It is against that
background of precedent that Waddell CJ in Eq came to adjudicate upon and
decide the first FAI case, namely FAI Insurances Ltd v Urquhart69.

68 see footnote 63
69 FAI Insurances Ltd v Urquhart (1986) 11 ACLR 25
PART 3

THE JUDGMENTS AT FIRST INSTANCE

FAI Insurances Ltd v Urquhart (No 1)

3.1 On 10 September 1986 Waddell CJ in Eq handed down judgment in the inter partes dispute, ex parte orders having been made by his Honour earlier in August 1986. This was the return of FAI’s application for permanent injunctions and orders enjoining the bank’s board from disseminating information to shareholders in the manner set out on the “how to vote” form and for orders\(^{70}\) compelling the board to send out fresh proxy forms along with a letter setting out the substance of the orders. The inter partes application was heard on 25, 26 and 27 August 1986 and for two further days on 4 and 5 September 1986. His Honour took time to consider his judgment\(^{71}\). His Honour’s recital of the applicable facts, some of which were agreed whereas others were hotly contested, is short indeed\(^{72}\).

\(^{70}\) Strictly speaking, orders compelling the board to undertake positive obligations are in the form of mandatory injunctions and not prohibitory injunctions nor quia timet injunctions.

\(^{71}\) The line up of counsel for the parties changed throughout the three applications. In the first inter partes application FAI’s senior counsel was Mr D M J Bennett QC, now the Commonwealth solicitor-general. Senior counsel for the bank’s board members was Mr A M Gleeson QC, later chief justice of the Supreme Court of New South Wales and presently chief justice of the High Court of Australia.

\(^{72}\) Brevity in the recital of pertinent facts is an idiosyncratic judicial technique which varies from one judge to another and from the urgency of one case to another. This case, affecting as it did hundreds of thousands of shareholders when time for the despatch of detailed reasons was short, called for economy in the recital of relevant facts to applicable legal principle. Conversely, when Beach J dealt in the Practice Court with National Australia Bank’s application for the appointment of receivers to the whole of the assets and undertaking of Alan Bond’s Bond Corporation Ltd, Beach J heard the urgent application as an inter partes challenge over 20 days then delivered reasons for judgment which ran for 138 pages [1991] 1 VR 386. It is fair to say that a very considerable part of the relevant volume of the Victorian Reports is dedicated to that one case.
3.2 To better understand the nature of the application before his Honour, Waddell CJ in Eq paraphrased the contentions advanced in FAI’s motion. By paragraphs 1, 2, 3 and 4 of the further amended summons FAI sought permanent injunctions in the same form as those granted earlier along with declaratory relief that the actions of the directors were invalid. In paragraph 5 of the further amended summons FAI sought orders that the board indemnify the bank against the expenses involved in the acts complained of. In paragraph 6 of the further amended summons, FAI sought an order that two of the board members at their own expense inform each shareholder that the “how to vote” recommendation was not issued with the authority of the bank or its board. In paragraph 7, FAI sought an order for the delivery up and destruction of all proxy forms which had been completed by any of the defendants. In paragraph 8, FAI sought an order restraining the defendants from counting votes at the AGM. Finally, in paragraph 9 of its further amended summons FAI sought an order that certain of the directors of the bank send out new proxy forms to shareholders, at their expense, along with a letter setting out the substance of orders made in respect of the further amended summons.

3.3 His Honour paraphrased the main thrust of the directors’ case. His Honour said the directors contended that their actions were within power and were done bona fide in the interests of the bank and were not vitiated by self interest as certain of the defendants did not vote on the resolution which addressed the chairman’s letter or on resolutions which authorised the expenditure of the bank’s money.

3.4 His Honour turned first to the precise terms of article 124. It provided as follows, its terms nowadays being mirrored in s. 198A of the Corporations Act–

“The business of the company shall be managed by the directors who may exercise all the powers of the company which are not by these articles or by the [Companies (New South Wales)] code required to be exercised by the company in general meeting.”

73 By the time the matter came before Waddell CJ in Eq, FAI had delivered its further amended summons.
3.5 His Honour said it was first necessary to determine whether the directors were exercising one of the powers of the company when they authorised the expenditure of its money on the chairman’s letter, on retaining Levita and on the employment of telemarketing operators to answer questions in a manner which favoured the re-election of the retiring board members. Once the issue was posed in that way, his Honour said FAI contended it was not permissible for a company to spend its own money to procure re-election of any members of its board. His Honour said the defendants contended that the relevant power being exercised was the power to spend the company’s money to procure the maintenance of its existing policies.

3.6 Before descending into the more detailed analysis of the parties’ respective submissions, it is necessary to consider the precise terms of the enabling power of the board by scrutinising article 124. It was in the widest of terms and deliberately so. It was in two parts. First, the business of the company was to be managed by the directors. No party suggested that the directors were not carrying on the business of the company. The second part of the article related to the exercise of “all the powers of the company”. Article 124 provided that the directors were empowered to exercise all powers of the company which were not by the articles or by the Companies (New South Wales) Code required to be exercised by the company in general meeting. Thus, two further enquiries were involved. The first was whether the company was entitled to do this particular activity for itself. The second was whether this was an activity which the articles or the code required the company to do in general meeting.

3.7 Taking first the second point, none of the reports of the three applications to the court in FAI disclose the full terms of the bank’s articles so it must be assumed that the bank’s articles did not require expenditures of the sort in issue in the case to be put before the bank’s shareholders in general meeting. So far as the first point was concerned, the primary focus of the case became whether the acts of the directors were properly characterised as being the exercise of one or more of the powers of the company. In articulating the real
matter in that way, Waddell CJ in Eq cut through several other submissions in the case. The way his Honour addressed those submissions is instructive. In respect of the defendants’ submissions, his Honour first considered whether it was legitimate for the bank to attempt to maintain the independent nature of the board, it being a bank policy from inception to have an independent board. His Honour referred to *Peel v London and North Western Railway Company*, and especially to the judgment of Buckley LJ (extracted above). Without deciding, his Honour then moved onto the next submission advanced on behalf of the defendants. The second submission drew on the High Court decision in the AML case and in particular, the concept that directors may have a legitimate concern in preventing a particular person from becoming a member of the board. His Honour rejected what he described as the wider proposition, namely, that the directors have a legitimate concern in preventing the election of any person to their board whose election would, in their view held *bona fide*, be against the interests of the company. His Honour said the AML case was authority only for the proposition that if such a power is given to directors they may have regard to the possibility that their consent to the transfer may result in the election to the board of a person whose reputation might adversely affect the business of the company74.

3.8 His Honour developed the real issue in the case. His Honour said that on the facts of the case the directors purported, on behalf and in the name of the bank, to exercise a power to take part in the election of directors by supporting particular candidates75. His Honour said in respect of such an activity “this is, of course, not one of the express powers given to the company by the memorandum or by the Companies (New South Wales) Code”. His Honour said there was neither express nor incidental power to conduct

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74 In many respects his Honour’s distillation of the AML case into that simple proposition is difficult to follow. On a precedent basis, one would think a decision of the Full Court of the High Court of Australia decisively binds a single judge of the state Supreme Court.

75 When expressed in those terms, the observations of Waddell CJ in Eq are probably best understood against a background of statutory provisions which prevailed in 1986. Nowadays, Part 2G.2 of the Corporations Act makes express provision for a director to summon a meeting of company members. Even the court is empowered to call a meeting of members in the circumstances prescribed by s. 249G.
electioneering. And so far as the most significant finding of the case is concerned, his Honour said –

“There can be no power in a company acting by its board of directors actively to support or oppose any particular person standing for election to that board. If the matter is viewed in this light the acts of the directors complained of must be seen as unauthorised.”

3.9 Thus, his Honour rested the decision wholly on a finding that there can be no power in the company to support or oppose any particular person standing for election to a board. No authority was cited for that finding. It is submitted that authority did exist. However, it pointed in the opposite direction. Peel’s case was ample authority to the effect that a board has a duty to inform shareholders of a particular policy and, in appropriate circumstances that in the board’s view the policy ought be maintained in the future. If a candidate for election carries with him or her policy views which are contrary to the board or even contrary to the interests of the company as a whole, why (one asks rhetorically) ought the board meet expenses in lobbying against that candidate from the personal resources of each board member. Waddell CJ in Eq was fully aware of and informed about the authority of Peel’s case and the AML case. In each instance his Honour read down the proposition for which the case stood and felt unconstrained by either authority to reach the finding which his Honour did. It is suggested that the reasons for declining to apply both Peel and AML are less than compelling. In fact, his Honour specifically addressed the reasoning in Peel which gave the necessary imprimatur to find against FAI76. His Honour said thus –

“Peel suggests... that a company may, at its expense, do anything reasonably necessary to obtain the best expression of the views of members on questions brought before them in a general meeting. This might probably be regarded as a power which is incidental to the calling and holding of such meetings for the purpose of deciding questions which may be validly put before it. It seems to me that there may be occasions when it would be reasonably necessary in the interests of a company for it to put before members information about a candidate for election as a director in order to protect the interests of the company and so that the

76 (1986) 11 ACLR 25, 30
best expression of the views of the members on the election might be obtained. But it is not necessary in the present circumstances to say anything more about this possibility because the chairman’s letter does not come into this category.”

3.10 Was that because the chairman was unduly partisan in his opposition to the FAI candidates? He had reason to oppose their candidature. After all, the chairman did have advice from Dr Parkes about such issues as the possibility of FAI control of the bank, of prejudice to the bank’s proposed expansion, of jeopardy to the bank’s trading licence and other deleterious effects on the bank’s operations. All of those were of very real moment to shareholders. One can hardly imagine anything of greater importance to a bank than its trading licence. Why then were those issues not properly to be raised as issues of policy before the AGM? Why were those issues not “reasonably necessary to obtain the best expression of the views of members” (to use the words of Waddell CJ in Eq)? Or why was the chairman’s letter so odious that it did not come into the category of information which was reasonably necessary in the interests of the company to put before the members in general meeting? If the letter was too emotive or personality-based and not issue-based, where does one draw the line? Waddell CJ in Eq gave no guidance whatsoever on point. For that matter, his Honour did not even say if or why the chairman’s letter failed to meet the category of letter which could be (or better still, should be) put before the members. The letter itself was issue-based. In the second paragraph of the letter it stated –

“Your board does not believe that the election of the four FAI nominees to the board, which comprises nine directors, would be in the best interests of your bank. In addition to other concerns, your board believes that it could lead to FAI subsequently gaining effective control of the board and thus the bank, without having to pay shareholders the substantial premium for control normally payable in company take-overs.”

3.11 It is fair to say the chairman’s letter was measured, tolerably objective and was impressed with the stamp of a board member who was endeavouring to inform shareholders about an issue in the interests of the shareholders. Why

77 The evidence reveals concerns by Dr Parkes on a range of issues all of which were legitimate business management issues, squarely the province of the board and not the province of the courts.
then ought the directors personally pay for doing their duty of informing the shareholders? Put another way, had the board formed a real and well grounded apprehension for reasons not personality-based, that the FAI candidates were likely to cause damage to the bank, the board would have been criticised, even exposed to a claim for breach of their duties as directors, if the board failed to alert the general body of shareholders to the information on which their apprehension was based.

3.12 One might say that is precisely what the board did. So why should the board be expected to meet the expenses of doing so from the personal resources of each board member. It is submitted that, the reasoning of Waddell CJ in Eq in that regard is not soundly based.

3.13 Ultimately, his Honour made orders in terms of paragraphs 1, 3 and 4 of FAI’s further amended summons. It will be recalled that in those paragraphs FAI sought to make permanent the temporary injunctions earlier granted. His Honour made a declaration as to the invalidity of the actions of the directors as sought in terms of paragraph 2 of FAI’s further amended summons. His Honour granted relief in terms of paragraph 5 of FAI’s further amended summons. In that paragraph FAI sought an order requiring certain board members to indemnify the bank against the expenses of the bank in the acts complained of. His Honour left it to the parties to formulate the form of order in respect of that relief. Likewise in respect of paragraph 6, his Honour granted relief in principle but permitted the parties to formulate the order. In that paragraph FAI sought an order requiring certain of the directors at their own expense to inform each shareholder that the “how to vote” recommendation was not issued by or with the authority of the bank or its board. In paragraph 9 of FAI’s further amended summons it sought an order requiring certain of the directors at their own expense to send to shareholders fresh proxy forms together with a letter setting out the substance of the orders made. His Honour also granted that order. However78, his Honour declined to grant FAI an order compelling the directors to destroy all proxy forms sent

78 Having regard to the far reaching nature of the other orders made, it is not easy to understand (despite separate reasons on point) why his Honour declined to grant this relief.
on 7 August 1986. His Honour also declined to restrain the defendants from counting votes. Subsequently, on 10 September 1986, his Honour gave reasons for that refusal, none of which are presently important.
3.14 On 22 September 1986, Waddell CJ in Eq gave judgment on the remaining claim made in FAI’s further amended summons. That was the claim made in paragraph 5, in-principle approval of its terms having been announced by his Honour on 5 September 1986. After hearing further argument on the point on 10 September, his Honour delivered judgment on 22 September 1986.

3.15 The precise nature of the relief sought may be shortly stated. In paragraph 5, FAI sought an order that the first and third defendants indemnify the bank against the cost and expense of the issuing of letters and other documents, the making of telephone calls, and the personal attendances by employees of the bank at its branches soliciting votes for the re-election of each of the first defendants. Predictably, his Honour made an order in terms of paragraph 5.

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79 The reports of the two applications before Waddell CJ in Eq are somewhat confusing. A close reading of the report in (1986) 11 ACLR 25 reveals that his Honour gave judgment in respect of the bulk of FAI’s applications in its further amended summons of 5 September 1986. On that day his Honour expressed the view [(1986) 11 ACLR 25, 31] that the relief sought in paragraph 5 of FAI’s further amended summons seemed “to be appropriate in principle” (his Honour’s words) but the parties wished to make further submissions. Whether his Honour was thereby inviting the parties to persuade his Honour to retract such approval in principle is not said. However, a close reading of the report of the second application before Waddell CJ in Eq [(1986) 11 ACLR 38] reveals that on 10 September 1986, presumably on the day when his Honour made orders and granted relief in respect of all other portions of FAI’s applications, his Honour heard further argument solely in respect of the relief sought in paragraph 5. A distillation of the relevant chronology is therefore argument in respect of paragraphs 1, 2, 3, 4, 5, 6, 7, 8 and 9 between 25 and 27 August and on 4 September 1986. Judgment in respect of the applications made in those paragraphs on 5 September 1986, his Honour standing over a concluded position in respect of paragraph 5 on that day. Argument on paragraph 5 on 10 September 1986 then judgment solely in respect of paragraph 5 on 22 September 1986.

80 The precise identity of the first and third defendants is confusingly given in the first judgment of Waddell CJ in Eq [(1986) 11 ACLR 25]. In one place, his Honour described the bank’s board comprising nine members of whom five were eligible for re-election. His Honour calls those “the first defendants”. In another place in the judgment, his Honour refers to four members of the board who do not retire, namely, Messrs Cameron, Carney, Grace and Joye, as “the third defendants”. Precisely why FAI made that differentiation (other than for ease of reference) is not easy to see as no separate relief is claimed against the first defendants as opposed to different relief being claimed against the third defendants. Elsewhere in the first judgment, Waddell CJ in Eq refers
of the further amended summons. His Honour did not rehearse any of the submissions urged on behalf of FAI. Instead, his Honour addressed the submissions urged on behalf of the first and third defendants. They advanced three main arguments—

- first, if the duty to be enforced was one owed to the company, then the company was the proper party to enforce that remedy. In other words, they said the bank, not FAI was the proper plaintiff;
- second, they said s68 of the Companies (New South Wales) Code applied;
- third, they argued that s535 of the Companies (New South Wales) Code gave the first and third defendants a statutory defence.

3.16 His Honour addressed each of the defendants’ arguments separately.

3.17 First, his Honour addressed the proper plaintiff argument: otherwise known as the rule in *Foss v Harbottle*. That rule provides that if the duty to be enforced is one owed to the company, then the primary remedy for its enforcement is one owed to the company, then the primary remedy for its enforcement is an action by the company against those in default. The first and third defendants argued that the nature of the relief sought in paragraph 5 was a claim for reimbursement of the bank’s money, the expenditure of which was held to be wrongful and therefore the proper plaintiff to pursue such a claim was the bank, not FAI. His Honour said the rule in *Foss v Harbottle* carried with it compendiously to all board members and the company they served simply as “the defendants”, where relief of an umbrella nature was claimed.

81 In a very short time between the hearings of the first and second applications before Waddell CJ in Eq, the parties were represented by different counsel. In the first application, FAI was represented by D M J Bennett QC, D E Grieve QC and A J L Bannon. In the second application, FAI was represented by P M Jacobson and A J L Bannon remained as junior counsel. In the first application, all defendants were represented by A M Gleeson QC, S D Robb and R R I Harper. In the second application, a split in representation took place. The first defendants were represented by T F Bathurst. The bank was represented by W M C Gummow (now Gummow J of the High Court) and the third defendants were represented by D E Horton QC and P Wood. No doubt the representation was separate during the second application by reason of a perception of a separation of interests and liability. Having said that, the bank in its own right had no separate interest to protect and neither direct findings nor orders were made against it in the first application.
exceptions and this was a case of the application of one of the exceptions to the rule. So much was trite law in 1986. However, the real foundation on which his Honour grounded FAI relief in respect of the proper plaintiff argument related to the nature of the remedy sought in paragraph 5 of FAI’s further amended summons and how it was ancillary to the injunctions already granted. Thus, as the plaintiffs for the injunctive relief were the FAI interests, it stood to reason that those same plaintiffs could seek and obtain relief ancillary to the injunctions, that is to say, the relief sought in paragraph 5. His Honour qualified the observations about relief in terms of paragraph 5 on the basis that such relief would not be granted if the defendants were able to maintain a defence under s68 of the Companies (New South Wales) Code. That became the second argument of the defendants.

3.18 The second argument raised a clever point both of company law and of statutory construction. It involved s68 of the Code. The defendants relied first on s68 (1)(b). In substance, that section provided that a company contravened that subsection where the company’s memorandum contained a provision stating the objects of the company and the company did an act otherwise than in pursuance of those objects. Any company officer knowingly concerned in such a contravention also contravened s68(2). Section 68(6) provided that the fact of doing a particular act by an officer of the company contravened s68(2) could be relied on in a proceeding by the company or by a member against present or former officers of the company. The first defendants (that is to say those standing for re-election) contended they did not contravene s68(2) of the Code because they did not know of the resolutions passed by the third defendants and therefore were not knowingly concerned in a contravention of the section.

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82 The rule in *Foss v Harbottle* carried with it at least five recognised exceptions. Since s236 of the Corporations Act was introduced, the rule has been abolished and in its place a statutory right to bring a derivative action has been inserted. In some instances, s236 has retrospective operation, as Santow J held in *Karam v ANZ* (2000) 34 ACSR 545 where his Honour observed that on the facts of that case the plaintiff’s right to bring such a proceeding accrued prior to the introduction of s236.
3.19 Pausing there, one might at first blush think such an argument posed an insuperable obstacle to FAI, so long as the evidence showed that the first defendants were not in fact “knowingly concerned” in the contravention alleged. In a curious application of principles of statutory construction, Waddell CJ in Eq held that s68 did not save the first defendants from liability. In properly construing s68, and in particular having regard to the nature of liability which flowed from a contravention of the section, it is suggested that his Honour should have but failed to have regard to only the wording of the section. On a careful reading of s68(2), the section provides that “the officer [of the company] contravenes this subsection”, that is to say s68(2), if the officer is directly or indirectly knowingly concerned in a contravention by the company of subsection (1). In other words, the only contravention relevant for the imposition of liability under s68 is a contravention of s68(2) by reason of conduct committed in contravention of s68(1). A contravention of the common law is not relevant, as s68(2) does not speak of a contravention of the common law. The words of the subsection are plain. They say that in the circumstances there described, and in none other the officer contravenes “this subsection”.

3.20 Waddell CJ in Eq held that s68 was not a code which displaced the general law governing the relationship between members of a company and its directors. His Honour did not cite any authority for that proposition. However, his Honour did say that s68 did not save the first defendants from liability. His Honour then addressed the third argument advanced by the defendants, namely, s535 of the Companies (New South Wales) Code. In effect, that section provides that a person found to have acted in breach of duty, may be excused by the court if the director concerned acted honestly, and having regard to all the circumstances of the case, ought fairly to be excused for the breach. Section 1318 of the Corporations Act contains a comparable provision presently in operation. The s 535 defence required an examination of facts already the subject of the directors’ liability on the primary ground as well as other facts.
3.21 As an important matter in respect of the s.535 defence, his Honour observed that the first and third defendants acted honestly and *bona fide*. His Honour also observed that the first and third defendants acted on legal advice from Dawson Waldron, an experienced and highly regarded firm of solicitors with large banking and corporate clients. Dawson Waldron gave evidence on a wide range of issues, most of which were complex. Among them were listing requirements, the legitimate lengths to which the board was entitled to go in solicitation, how the bank could oppose certain candidates, and the obligation of full and frank disclosure. His Honour found as proven facts that the matters specifically considered by the board were whether the election of the four FAI candidates would –

- lead to control passing to FAI;
- prejudice the expansion of the bank by merger with or acquisition of building societies;
- prejudice any application for a trading bank licence.

3.22 His Honour held that the material put to shareholders was very limited. His Honour said the only reason urged in the chairman’s letter opposing the election of the FAI candidates was that it could lead to FAI gaining effective control of the board and the bank without having to pay shareholders the substantial premium for control normally payable in company takeovers. His Honour said that information was not the sort of information to which shareholders were entitled.

3.23 His Honour held that s535 required all the circumstances of the case to be taken into account, not merely the honesty of those concerned. On that his Honour said –

“In the present case I do not think that the nature of the things which were done is such to justify excusing the first and third

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83 Following successive mergers between Blake & Rigall, a Melbourne firm of solicitors, and Dawson Waldron, a Sydney firm of solicitors, what has come to be known as a mega firm, was thereby created in 1988 called Blake Dawson Waldron. That firm has more than 200 partners and 1400 staff with offices in Sydney, Melbourne, Canberra, Brisbane, Perth, London, Shanghai and Port Moresby.”
defendants from liability with the consequence that the bank must bear the cost of the actions which were authorised.”

3.24 The matters which led his Honour to refusing relief under s535(1) are not easy to distil. The most obvious one was the single issue which his Honour said emerged from the chairman’s letter, namely, that the election of the four FAI candidates could lead to FAI controlling the bank. His Honour placed very little reliance on the fact that the board sought and obtained highly competent legal advice from a well known and highly regarded law firm. Nowhere does his Honour say that the advice from Dawson Waldron was condemning in nature of the board’s actions nor is there any suggestion that the directors would be penalised for undertaking the telephone solicitation. For that matter, the evidence revealed that the text of the chairman’s letter was edited by solicitors. There is no indication that his Honour did not expect the board to go behind the advice of Dawson Waldron. There is no suggestion that anyone recommended obtaining the advice of counsel, perhaps even advice from Queen’s Counsel. Thus, the text of the chairman’s letter was settled by solicitors, and there was no legal advice which told against the whole course of conduct by the board. It is also relevant that his Honour did not rely on any authority at all for his treatment of s535. However, authority did exist. On 23 July 1984 McLellan J handed down judgment in Re Price Mitchell Pty Ltd which considered specifically s535 of the Companies (New South Wales) Code and the circumstances in which a director ought fairly to be excused. There, McLellan J did not excuse scheme managers from acting as they did.

3.25 Further, Waddell CJ in Eq did not elaborate on the matters which his Honour thought ought to have been put to shareholders. Nor did his Honour reveal why the issues conveyed in the chairman’s letter were regarded by his Honour as not being the sort of information to which shareholders were entitled. One would be entitled to think the issues set out in the chairman’s letter were squarely issues which the members were entitled to know so as to make an informed decision. Having regard to the very real fear of risk to the bank’s licence, the letter assumed all the more importance. Not only was the board

84 Re Price Mitchell [1984] 2 NSWLR 273 which by then was reported in (1984) 9 ACLR 1.
prevented from so informing the shareholders they served, but the board suffered the financial penalty of reimbursing the bank for the considerable costs associated with the electioneering campaign. It could be said that both judgments of Waddell CJ in Eq were harsh.
PART 4

THE APPEAL IN ADVANCE BANK v FAI

THE JUDGEMENT IN DETAIL

4.1 On 2 March 1986 the hearing of the appeal from the judgment and orders of Waddell CJ in Eq commenced in the Court of Appeal of the Supreme Court of New South Wales\textsuperscript{85}. It ran for three hearing days\textsuperscript{86}. The court reserved its decision, eventually handing down judgment on 26 June 1987\textsuperscript{87}. The appeal was in respect of the judgment and orders given on 22 September 1986, although the appeal also brought in issue the main judgment of Waddell CJ in Eq on the permissible limits of the exercise of directors’ powers to take part in elections to company boards. In this thesis, no examination will be given to the preliminary points identified by Kirby P, namely –

- why the National Companies and Securities Commission was not a party to the proceeding before Waddell CJ in Eq or before the Court of Appeal;
- what standing FAI had, as opposed to its four candidates;
- the fact that the AGM was held between the date of Waddell CJ in Eq’s final orders and the hearing of the appeal\textsuperscript{88};

\textsuperscript{85} Current statistics from the Court of Appeal of the Supreme Court of New South Wales indicate that in the ordinary course of events, cases take longer than six months from the date of the judgment appealed against to come on for hearing on appeal. In the FAI case, Waddell CJ in Eq gave judgment in the second application on 22 September 1986 and in less than six months the Court of Appeal heard full argument on the appeal. Taking into account the intervening Christmas closure of the court, this was a remarkable illustration of expeditious judicial case management.

\textsuperscript{86} Consistent with the practice and procedure of appellate courts in most Australian jurisdictions, the Court of Appeal of the Supreme Court of New South Wales requires parties to reduce to writing their main propositions on appeal. This is done by notices of contention, the preparation of written submissions, the preparation of a chronology and of a list of authorities. Presently, those matters are dealt with in Part 51 of the Rules of the Supreme Court of New South Wales and Practice Notes 65 and 74. This enables the appeal judges to reduce hearing time on the appeal by the reading of preliminary or non-controversial material in advance and out of court hours.

\textsuperscript{87} Neither party sought special leave to appeal to the High Court.

\textsuperscript{88} Ordinarily, the court will not rule on questions of academic or hypothetical interest only. On this point, see Declaratory Orders by P W Young QC (1984) especially chapter 7.
why the bank was separately represented having regard to the fact that the bank’s position was no more than a reiteration of the position of the successful directors; and last

no challenge was made to the findings by Waddell CJ in Eq that the directors, and all of them, had acted bona fide and honestly, believing that the election of the FAI candidates was not in the best interests of the bank.

4.2 In the ultimate result, all three justices of the Court of Appeal dismissed the appeal. However, their Honours\textsuperscript{89} did so for essentially different reasons. Whether a clear and binding ratio can be said to emerge from the case is not easy to say\textsuperscript{90}. Kirby P delivered substantial reasons for dismissing the appeal. Glass JA concurred with Kirby P in both orders and his reasoning.

4.3 One could say that is a less than enthusiastic adoption of the reasoning of Kirby P. Glass JA in expressing “general agreement” with Kirby P, it is submitted can not be seen as more than a formal adoption. The reasoning of Mahoney JA differed to that of Kirby P, although Mahoney JA also dismissed the appeal. To understand the differing logic of each member of the Court of Appeal, it is necessary to analyse the judgments of Kirby P and Mahoney JA.

4.4 Kirby P set out ten propositions which his Honour said were the principles applicable to the case. Kirby P said Waddell CJ in Eq did not address the critical questions which the law asks. Kirby P said Waddell CJ in Eq’s general remarks about the bona fides of the directors, their honesty, their acting on legal advice and their conclusions concerning the best interests of the bank

\textsuperscript{89} Having said that all three members of the Court of Appeal dismissed the appeal, that is a reflection of the ultimate result to which each came as opposed to the reasoning which led each to that conclusion. It should be noted that Glass JA merely agreed with the orders of Kirby P expressing “general agreement” with the reasons therefore. Mahoney JA differed in the reasoning.

\textsuperscript{90} By parity of reasoning, in \textit{Clark v The Commonwealth} [1994] 2 VR 333, Ormiston J sitting as a member of the Full Court held that each member of the High Court reached the same result but all by different reasoning in \textit{Verwayen v The Commonwealth} (1990) 170 CLR 394 and therefore no binding ratio compelled an intermediate appellate court to follow \textit{Verwayen}. 
did not provide an answer to the tasks of classification. The ten principles were identified by Kirby P in the following terms –

(1) the relevant issue was the authority of the directors to act in the way which was criticised. The power of the company, as performed on the company’s behalf by the directors was not the issue.

(2) it was necessary to consider the purpose for which the directors acted in order to determine whether the directors’ conduct was or was not within the directors’ authority.

(3) as directors exercise fiduciary powers, they may not act otherwise than bona fide in the interests of the company as a whole and for corporate purposes.

(4) no general rule can be laid down prohibiting directors from soliciting proxies as every case depends on its own facts.

(5) directors were required to exhibit scrupulous conduct in connection with elections or proxy solicitation because of the heightened risk of confusion between private interests and the best interests of the corporation.

(6) the mere fact that directors take advantage of conduct performed for a corporate purpose may be incidental and consequential and it will not, of itself, invalidate the directors’ actions if those actions are otherwise lawful.

(7) a classification of the directors’ conduct was called for by reference to the real purpose which primarily motivated their action.

(8) directors’ statements about their subjective intent, although relevant, was not conclusive of their bona fides or of the purpose for which they acted and in the end the court must objectively assess their motives.

(9) even if the directors acted bona fide and for the purpose of the company, their conduct may still exceed their authority if in the performance of those purposes they exceeded or abused their powers.

(10) in election and proxy solicitation cases, such an excess or abuse of powers may occur where the directors (a) expend an unreasonable sum of the company’s money (b) expend the company’s money on material relevant only to a question of personality and not relevant to corporate policy; or (c) otherwise act in a manner which is excessive or unfair in
the circumstances, having regard to the corporate purpose to be obtained.

4.5 Having identified the ten points described above, Kirby P said the directors’ conduct in the election could not be sanctioned. The facts which led to the conclusion that the appeal be dismissed may be set out as follows –

- the emotional quality of the chairman’s letter and the telephone solicitation;
- the chairman’s letter which stated the election of the FAI candidates could lead to FAI gaining control was erroneous because the bank’s articles together with takeover legislation and the provisions of the code prevented FAI from gaining control;
- the self serving statements about the bank’s success and the high performance of its directors was not the supply of factual information in a proper election;
- errors existed in the telephone solicitation campaign including first, that the telephonist was an employee of the bank when in truth the telephonist was a retained contractor, second that the FAI candidates could gain control of the board and thus the bank when in truth in a board of nine, even if all four candidates were elected they were numerically outnumbered by the other five;
- the chairman’s letter and the telephone solicitation failed to disclose the real reason for the opposition to FAI’s candidates;
- the telephone solicitation material could not be classified as the provision of information for shareholders to be used by them in the performance of the functions reserved to them by law;
- the only classification open in respect of their actions was that the directors’ primary purpose was to secure re-election of the chairman and the retiring directors;
- even if the directors’ primary purpose was the best interest of the bank, the way the directors went about the achievement of that purpose fatally undermined the attainment of that purpose and to that extent, the directors abused their power and exceeded their authority.
4.6 Naturally, Kirby P dealt at length with matters of general importance to company law. The first of such matters was the doctrine of *ultra vires*, a concept eliminated by s 125(1) of the Corporations Act. Kirby P referred to the observations of Browne-Wilkinson LJ in *Rolled Steel Products (Holdings) Ltd v British Steel Corporation*91 where his Lordship urged that the use of the phrase *ultra vires* be restricted to cases where the transaction was beyond the capacity of the company and therefore wholly void. Kirby P did not actually say that Waddell CJ in Eq confused the concepts of “capacity” and “authority”, although his Honour did say the approach taken by Waddell CJ in Eq demonstrated the need to keep the two concepts separate92. Kirby P said that the bank’s memorandum did not contain any express restriction or prohibition on the exercise of any power of the bank relevant to the directors’ conduct. Thus, there was nothing of an express nature by which the directors were positively forbidden from being involved in board electioneering nor from expending the bank’s funds on such activities. It is submitted that his Honour is demonstrably correct in such a conclusion.

4.7 Kirby P then addressed FAI’s main argument, namely, that for several reasons, an absolute prohibition existed in Australian law forbidding the expenditure of funds of a corporation in a way which influenced the outcome of an election for the directors of a corporation. His Honour paraphrased the main reasons which FAI advanced in support, namely –

- as a general principle of law, it could never be proper for directors to use corporate funds for the purpose of or with the effect of influencing an election result, regardless of whether the directors acted *bona fide* and in the best interests of the company;
- courts have intervened to prevent directors exceeding or invading the constitutional rights of shareholders: see *Hogg v Cramphorn*, *Howard Smith Ltd v Ampol Petroleum Ltd*, *Allen v Townsend* and *Scott v Jess*.

4.8 Of the two propositions Kirby P dedicated the greater time to the so called “constitutional rights” issue, and as set out above, held that it was a principle

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91 *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246
92 (1987) 9 NSWLR 464, 474
which had not emerged clearly in any earlier Australian authority. His Honour said that may be because in Australia we are prepared to tolerate some use of corporate funds even where it has the effect of supporting some incumbent directors in contested elections, to ensure that shareholders are supplied with information essential to the conduct of a true election. Under the rubric “authority of the directors”, Kirby P addressed the contention that the board not only had the power but the duty to place before shareholders any matter bona fide considered relevant in the interests of the company. Over several pages of the report his Honour condensed the directors’ main points of the appeal and then set out the ten numbered points recorded above. The main propositions urged by the directors were –

(a) the mere fact that the pursuit of the best interests of the bank incidentally advantaged the retiring directors who were seeking re-election was irrelevant, and in support the directors relied on the decision of the High Court in Harlowe’s Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL\(^93\);

(b) neutrality was not a requirement imposed upon the directors\(^94\);

(c) in some circumstances, the directors’ entitlement to act in a particular manner could be elevated to a duty, and in support the directors relied on a decision of Walker J of the Supreme Court of New South Wales in Campbell v Australian Mutual Provident Society\(^95\), in which Walker J held that directors ought not to be required to pay out of corporate funds the expense of promulgating the views of dissentient members.

4.9 On the specific facts of the case, Kirby P identified a collection of indicia which the appellants said pointed by way of support to the directors’ appeal being allowed, namely –

- the directors had carefully considered the best interests of the bank;
- the bank was at a delicate stage of its evolution having recently converted from a building society;

\(^93\) Harlowe’s Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL (1968) 121 CLR 483, 493

\(^94\) Interestingly, Kirby P did not ascribe any judicial authority to this argument, possibly because none was advanced by the appellants.

\(^95\) Campbell v Australian Mutual Provident Society (1906) 7 SR(NSW) 99
the board was concerned about the intrusion of Mr Adler and his colleagues and it feared that they could vote in a block thereby effectively securing control of the bank in its day to day management;

- that might endanger important negotiations in which the bank was engaged;
- it might also lead to a takeover by FAI.

4.10 Kirby P repeated the findings of Waddell CJ in Eq that the directors had acted for a *bona fide* purpose and for the best interests of the bank. Kirby P mentioned how *Campbell v AMP* and *Peel's* case were not cases involving elections, nor was an American authority on which reliance was placed, namely *Rosenfeld v Fairchild Engine & Airplane Corporation* 96.

4.11 Leaving aside the thorny points of legal principle which the appeal presented, Kirby P addressed the judicial conundrum which arose from a critical finding of fact made by Waddell CJ in Eq. His Honour specifically found that the directors behaved in a manner devoid of moral turpitude. Waddell CJ in Equity held that all the directors acted *bona fide* and honestly, believing that the election of the FAI nominees was not in the interests of the bank 97. Kirby P also said FAI did not challenge that important factual finding. However, Kirby P then went on to say 98 that the first issue which fell for resolution on appeal was whether the Court of Appeal was permitted to apply the correct test to the conduct of the directors in view of the findings of Waddell CJ in Eq about the directors having acted *bona fide*, honestly and with proper motivations.

4.12 Kirby P resolved the conundrum by holding that Waddell CJ in Eq did not apply the critical legal questions to the facts of the case. The error of

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96 *Rosenfeld v Fairchild Engine & Airplane Corporation* 128 NE 2d 291 (1955)

97 At page 471 line F Kirby P spoke of the finding of Waddell CJ in Eq that the directors believed the election of the FAI nominees was not in the “interests of the bank”. Elsewhere in Kirby P’s judgment his Honour used the expression “best interests of the bank”. In my view more than semantic differences separate “interests” from “best interests”, the latter bringing with it a higher standard. A matter may be in the interests of another legal entity although not necessarily in the best interests of that other legal entity.

98 At page 484 paragraph E
Waddell CJ in Eq was the focus upon the powers of the company as opposed to the authority of the directors. Kirby P said Waddell CJ in Eq did not classify, by reference to the directors’ authority, the primary purpose for which they acted as they did. Kirby P said general comments about the directors’ bona fide, their honesty, acting on legal advice and whether their actions were in their own minds it was in the best interests of the bank to do as they did does not answer the task of classification.

4.13 Kirby P then pronounced the ten point analysis, giving full weight to the factual findings below that the directors acted bona fide and that the election of the FAI nominees was not in the best interests of the bank. As set out above, when the facts of the case were applied to that ten point analysis, Kirby P held that the directors abused their powers and they exceeded their authority.

4.14 The position of the directors who sought re-election as opposed to the directors who were permanently retiring was then addressed. Counsel for the directors sought to isolate those directors’ respective interests. In one camp stood Messrs Cameron, Carney and Grace. It was argued that they stood to gain no benefit merely by voting in favour of the expenditure of funds because they were not standing for re-election. In another camp stood the chairman (Mr Urquhart) and the four other retiring directors, namely, Messrs Ashton, Thame, Meyer and Service. In the last camp was the only continuing director, Mr Ian Joye.

4.15 So far as Messrs Cameron, Carney & Grace were concerned, Kirby P had no trouble concluding that their circumstances were not to be differentiated from the other directors. Kirby P held that even if it were to be accepted that the proper classification of their primary purpose was the bank’s best interests, they were still open to criticism about the way in which they translated their purpose into action. Those actions were –

- they formed the committee which approved the whole course of conduct which led to the first injunction application;
- they approved the chairman’s letter;
they authorised telemarketing solicitation by Levita;
they were parties to the unanimous resolution of the directors to oppose
the election of the four FAI nominees.
Thus, their actions did not stand them apart from the others.

4.16 Kirby P attached a far more nefarious characterisation to the conduct of
Messrs Urquhart, Ashton, Thame, Meyer and Service. Below, Waddell CJ in
Eq held that those directors –
- did not participate in any way in the chairman’s letter;
- acted strictly in accordance with legal advice;
- abstained from voting on critical issues; and
- did not engage in canvassing bank shareholders.

4.17 Conversely, Kirby P said those directors –
- were deeply involved in the unanimous resolution to oppose the
  nomination of the four FAI candidates;
- did not follow legal advice which advised them not to participate in
  board meetings at which decisions were made about proxy solicitation
  and other strategies;
- and the chairman signed the letter when he was himself a candidate for
  election.

4.18 Kirby P was scathing in his criticisms of the attempts of those candidates to
distance themselves from the decisions of the continuing directors. His
Honour said thus –

“In these circumstances, the efforts of the candidates to distance
themselves from the decisions of the continuing directors must
fail. They must be seen for what they were: an ineffective and
purely formal endeavour to give the appearance of non-
participation in decisions designed to authorise the use of
company funds in ways which would inevitably favour their re-
election and disadvantage their rivals.”99

99 At page 489 paragraph C
4.19 So far as the position of Ian Joye was concerned, Kirby P rejected the submission that Mr Joye’s circumstances were unique because he was overseas at the relevant time. One would think Mr Joye thereby stood in an almost unassailable position. After all, he was not even in the country when the acts complained of were committed. No, said Kirby P. Absence was not enough. Among the reasons for rejecting Mr Joye’s implores of separate treatment, Kirby P said –

- the request for special treatment could have been but was not made at trial;
- Mr Joye was present at the board meeting when it was resolved to oppose the appointment of the four FAI nominees;
- nowhere did Mr Joye divorce himself from the chairman’s letter.

4.20 And in respect of all of the directors, Kirby P said their primary purpose was to secure the re-election of the retiring directors and to defeat the FAI intruders. Kirby P said their purpose was to advance their conception of the best interests of the bank and in that pursuit they were doubtless honest and they acted *bona fide*.

“But they acted, all of them, in a way which amounted to the abuse of such authority as they had as directors to conduct a proper election. They confused their own interests and advantage with their fiduciary duty to the bank and to its shareholders.”

4.21 It is important to observe that Kirby P has not closed the door altogether on directors using company funds in electioneering. Nor has Australian law absolutely prohibited such activity. The tiniest insight into permissible limits, at least so far as Kirby P sees it, emerged in the concluding passages of Kirby P’s judgment. There, his Honour said<sup>100</sup> –

“It is the reason why such expenditure should normally be kept to a minimum, confined to the supply of essential information, avoid self-praise and irrelevant issues of personality and, so far as issues of policy are concerned, present information in a way

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<sup>100</sup> At page 490 paragraph A
which promotes an informed decision and thereby contributes to the proper corporate objective, namely, a due election.”

Kirby P then held the decision in *Campbell v AMP* did not fully state present day duties of directors101.

4.22 Almost as a postscript to the judgment itself, Kirby P addressed the directors’ appeal from the refusal by Waddell CJ in *Eq* to grant them relief under s535 of the Companies (New South Wales) Code. Essentially, Kirby P held that the orders made by Waddell CJ in *Eq* were in respect of a discretionary application and even if an appellate court were entitled to interfere in a decision on such an application, Kirby P said any such interference would be pointless as his Honour agreed with the conclusion expressed by Waddell CJ in *Eq*102. Kirby P based his unwillingness to interfere in the conclusions below on the telemarketing campaign. His Honour expressed the position thus –

“*The letter and the soliciting script contained at once too much irrelevant, prejudicial and inaccurate information which was misleading and did not contain some of the countervailing information which directors, properly discharging their duties in these circumstances, would place before the shareholders.*”103

4.23 Kirby P used the submissions in respect of s535 as yet another opportunity to finally impugn the directors’ conduct. His Honour said the directors’ conduct was a clear abuse of their authority as directors, pursued for the primary purpose of securing re-election of the retiring directors. Kirby P proposed orders dismissing the appeal with costs.

\[\text{101} \quad \text{In this context, Kirby P was referring to the appeal to the Privy Council in } \text{*Campbell v AMP*, reported (1908) 24 TLR 623. Strictly speaking, a decision of the Judicial Committee of the Privy Council is of persuasive authority only and therefore did not directly bind a Supreme Court, even an intermediate Court of Appeal of a Supreme Court. While it was, as a matter of stare decisis, correct and open to Kirby P to decline to follow a decision of the Judicial Committee of the Privy Council, it was a comparatively rare event for an intermediate Court of Appeal to do so. On the subject of the precedent value of decisions of the Privy Council on state Supreme Courts see } \text{*Cook v Cook* (1986) 162 CLR 376 and } \text{*Barns v Barns* (2003) 214 CLR 169.}\]

\[\text{102} \quad \text{Like Waddell CJ in *Eq*, Kirby P did not give any consideration to authorities or academic learning in respect of s535 of the Code.}\]

\[\text{103} \quad \text{(1987) 9 NSWLR 464, 491}\]
4.24 Glass JA also proposed orders dismissing the appeal with costs. As set out above, the reasons of Glass JA were perfunctory, to say the least\textsuperscript{104}.

4.25 Mahoney JA affirmed the orders of Waddell CJ in Eq and, like Kirby P and Glass JA, dismissed the appeal. However, Mahoney J provided reasons which differed from “those of the majority”\textsuperscript{105}. His Honour rested the outcome of the appeal on a consideration of three main questions, namely, whether –
(a) the bank had power to do what was done;
(b) the directors had power to cause the bank to do what was done;
(c) if both had such power, were the acts done within the scope of the proper exercise of the power and in accordance with the fiduciary duty owed to FAI as a shareholder of the bank.

4.26 Having posed the issues for determination, Mahoney JA rejected FAI’s primary argument that it was not open to a company, albeit \textit{bona fide}, to seek to influence the outcome of an election of directors. His Honour held that a company may take steps to ensure that its directors are proper persons to hold that office. His Honour said a company is not required to stand neutral in a contested election. His Honour said a company may have a legitimate interest in the suitability and efficiency of those who comprise its board. A company may, his Honour said, legitimately take steps to inform shareholders of the fact that –
- the nominees would, if elected harm the business of the company or its reputation;
- the nominee was a criminal seeking to control the company for organised crime; or
- the election of a director may cause the company to lose a valuable asset.

\textsuperscript{104} It is not infrequent for a member of a full court or full bench to express agreement in the judgment and orders proposed by another member of that court or bench by using terminology such as “I concur in the judgment of Mr Justice Smith and have nothing useful to add.” At its extreme, that may read “I concur” or “I agree”.  
\textsuperscript{105} (1987) 9 NSWLR 464, 491
4.27 His Honour said that the essential principle is that a company’s powers and funds may only be used for the purposes of that company. Whether the relevant act is done for the purpose of the company as a whole is to be judged according to whether it is done for this purpose. His Honour said views may differ as to what are the interests of a particular company. A company is entitled to pursue what generally is the assessment of its good by those who exercise the powers of the company. Thus, his Honour held that a company may act to protect or further its interests in the context of a contested election. So far as the second issue was concerned, Mahoney JA said article 124 authorised the board to conduct such an election. His Honour said no more about whether the directors had the power to do what they did. So far as the third issue was concerned, his Honour put it in the following context –

“If it be accepted that the directors could do for the bank what in principle was proposed to be done, it remains to be determined whether, in doing what they did, they went beyond what could be done.”

4.28 The argument advanced on behalf of FAI was expressed in two ways. First, FAI said although the directors could have caused the bank to act in respect of the election for the good of the bank as a whole, the directors in fact acted for another purpose, namely, for securing the re-election of the retiring directors. The second argument was that in pursuing the good of the bank as their purpose, they did things and failed to do other things. As such, the exercise of their power miscarried.

4.29 In answering those submissions, his Honour said he did not accept that the directors abused their power nor did his Honour accept that what they did was for the primary purpose of securing the re-election of their colleagues. Having made that observation, his Honour said that what was done allegedly

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106 In this context, Mahoney JA cited Mills v Mills (1938) 60 CLR 150 and Ngurli Ltd v McCann (1953) 90 CLR 425.

107 Implicitly, his Honour’s encapsulation of the test means that the powers may only be used for the purposes of the company as a whole, not diverse or discreet sects of the company.

108 Mahoney JA did not say in the judgment that this argument was put as something of a hypothetical because FAI’s position was and always had been that the directors had no power to do what they did.
pursuant to the directors’ purposes went beyond what could properly be done. Mahoney JA said the chairman’s letter could not be justified, nor could the telephone soliciting nor the personal attendances. Thereafter, his Honour said Waddell CJ in Eq was correct and Mahoney JA dismissed the appeal.

4.30 And so, unanimously, the judgment of Waddell CJ in Eq was upheld but for split reasons.

4.31 It is interesting to observe that in total, Mahoney JA referred to only five authorities, namely –

- *Foss v Harbottle*<sup>109</sup>;
- *Mills v Mills*<sup>110</sup>;
- *Ngurli Ltd v McCann*<sup>111</sup>;
- *Peters’ American Delicacy Co Ltd v Heath*<sup>112</sup>; and
- *Howard Smith Ltd v Ampol Petroleum Ltd*<sup>113</sup>.

Having regard to the fact that Mahoney JA upheld the case for permissible directors’ conduct in electioneering, his Honour’s treatment of the case opposing the view of Kirby P could be seen to be superficial.

4.32 Expressed most basically, it seems to me that Kirby P’s principal concern was the proper exercise by its directors of a company’s legitimate corporate purpose. When each of the ten points which his Honour identified is scrutinised, each (or for that matter all of them in the aggregate) involves a consideration of one aspect or another of the concept of the proper exercise by its directors of a company’s legitimate corporate purpose. In expressing the proposition as a “company’s legitimate corporate purpose”, that takes in the hypothetical situation posed by Mahoney JA of a criminal seeking to control a company in furtherance of that company’s purpose in organised crime. Naturally, acts done by that company’s directors to give effect to that

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<sup>109</sup> *Foss v Harbottle* (1843) 67 ER 189  
<sup>110</sup> *Mills v Mills* (1938) 60 CLR 150  
<sup>111</sup> *Ngurli Ltd v McCann* (1953) 90 CLR 425  
<sup>112</sup> *Peters’ American Delicacy Co Ltd v Heath* (1939) 61 CLR 457  
<sup>113</sup> *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821
company’s illegal purposes could never be the pursuit of the company’s legitimate corporate purpose as its very existence as a company is predicated on illegitimate, indeed illegal activities. However, for companies engaged in mainstream conventional commercial activities, Kirby P’s ten point analysis is appropriate. Thus the enquiry is essentially twofold – first, what is the company’s legitimate corporate purpose and next, whether the directors are engaging in a proper exercise of that corporate purpose. If there be any doubt in the distillation of Kirby P’s ten point analysis into such a proposition, one need only attribute each of the ten points of the analysis against one of those propositions. Thus, for corporate purpose, Kirby P addressed points 4, 5, 6, 7 and 8, and for the proper exercise of that corporate purpose by its directors, Kirby P addressed points 1, 2, 3, 9 and 10.

A harsh result

4.33 The Court of Appeal’s decision in Advance Bank v FAI sets the bar too high for ascertaining whether and in what circumstances a director can legitimately use company funds to promote his or her own re-election. In my view, the regime prescribed by Kirby P is unrealistic. His Honour’s distillation of principle in the ten points is undeniably correct both as to fact and law. However, applying those ten points is anything but straightforward. The starting point is the classification of the directors’ purpose in acting in the way they did. Thus, an analysis must be undertaken of the real purpose which motivates their action. Deceptively simple as is may be to state that concept, applying it in a practical context is anything but simple. For example, as a matter of common human experience no director will admit to acting otherwise than for a proper corporate purpose. Thus, notwithstanding the assertion that his or her purpose is proper, one needs to look further in order to ascertain whether the real purpose which motivates the director is in fact a proper corporate purpose. And while subjective intent is merely passingly relevant, in the end the court must determine objectively the director’s motive and purpose in acting in the way he or she does. That begs the question. The director will only ever find himself or herself questioned by the court if some transaction or event goes astray and ends up in court. Only then will the
director’s real purpose in acting in the way he or she did be exposed and tested. Of course, for reasons relating to resources and funding, the particular transaction or event may never end up in court, in which case the director’s real motive in acting in the way he or she did may never be subjected to scrutiny. On the other hand, if the director is challenged in court about his or her real purpose in undertaking the course of conduct in which he or she engaged, the court would be required to objectively assess the director’s motive, regardless of the director’s professed motive. Then, even if on an objective basis, the director’s purpose was *bona fide* in acting in the way he or she did, it is next necessary to ascertain whether the purpose of the director’s actions was within his or her power and authority. Each of those enquiries is not easily answered. Those enquiries require persons at board room level to address searching, complex questions of fact and law. Often, the director will not be equipped to answer those questions, even with the benefit of sophisticated accounting and legal advice. For example, an enquiry about a director’s power ordinarily leads to a consideration of the company’s constitution. Upon a consideration of the constitution, the director may ascertain whether some particular activity is or is not within power. But that is only part of the enquiry answered. If power exists, the director must then consider whether in the exercise of that power, the power is being abused. In other words, the director must ask whether he or she exceeds or abuses the power conferred by the constitution by undertaking the particular activity in question. If he or she does, then the exercise of the power is invalid and *prima facie* illegal. An example illustrates the conundrum in a practical context. For this illustration the reader is invited to make a number of assumptions. These assumptions are -

(a) Capital Ltd., a public listed company (“Capital”), is controlled by a board of five members;

(b) one member of the board of Capital (“Exuberant”) is charismatic, flamboyant and extravagant as well as being very gifted in commercial matters despite his risk-taking;

(c) Exuberant has held a seat on the board of Capital for five years during which he alone has orchestrated some stunningly successful investments;
(d) not all of Exuberant’s investments have been successful and on one occasion, following a huge loss, a significant block of shareholders requisitioned the holding of an extraordinary general meeting where a vote for Exuberant’s removal from the board was narrowly defeated;

(e) Capital wishes to exploit a potentially lucrative business opportunity by entering into a joint venture with a mining company, Gold Mines NL (“GMNL”);

(f) GMNL sees Exuberant as a “wild card”, potentially detrimental to the joint venture and has publicly stated that the joint venture will not proceed if Exuberant remains on the board;

(g) Capital is very keen to push ahead with the joint venture with GMNL and the board of Capital has received several deputations for and on behalf of GMNL concerning its reservations about the board-level acumen of Exuberant;

(h) Capital’s banker, Moneybags Ltd. (“Moneybags”) has been Capital’s banker for over 25 years, including during the period of Exuberant’s successful and failed investments. Moneybags is also GMNL’s banker. GMNL has told Moneybags that GMNL will look elsewhere for its banking needs if the proposed Capital/GMNL joint venture proceeds with Exuberant remaining on the board of Capital;

(i) the proposed Capital/GMNL joint venture is highly speculative in nature and carries with it enormous opportunities if successful as well as the need for substantial financial backing in the early phases of the project;

(j) all members of Capital’s board are acutely aware that the joint venture involving GMNL will be to the benefit of Capital’s shareholders and that Capital’s prospects of participation in the joint venture hang on one issue only, namely Exuberant’s tenure on Capital’s board;

(k) Exuberant retires at the forthcoming annual general meeting and is eligible for re-election, as are the other board members.

4.34 Against that factual background, is Capital’s board entitled to use Capital’s resources in the promotion of the re-election of four but not five of the members of Capital’s board? Is it proper for four board members to use Capital’s funds either to actively dissuade shareholders to vote for Exuberant
or to promote themselves for re-election but not Exuberant? Does it matter that in addition to his investment successes and failures, Exuberant’s tawdry personal life has been very much in the public eye over the preceding twelve months? Is it relevant that market research which is brought to Capital’s board’s attention shows that Capital’s share price fell during the period when Exuberant was engaging in entrepreneurial activities, both successfully and unsuccessfully? Is it relevant that the four board members honestly believe that it is for the good of Capital that they inform shareholders about the position of Moneybags and its unwillingness to fund the joint venture if Exuberant remains on Capital’s board? Should the board bring to the attention of shareholders legal advice which the board has obtained about the liability of the four board members, that it to say not Exuberant, for their failure to control Exuberant during his high-risk investments?

4.35 The answer to these questions lie in a careful examination and application of the judgment of Kirby P in Advance Bank v FAI. There are several stages to the process. The first is the ascertainment of the director’s power (or authority) to engage in the process of “campaigning” while engaged in activities connected with the election of directors. That compels the enquirer to consult Capital’s constitution. It will be rare indeed to find that the rules of Capital’s constitution contain a specific provision authorising the directors to expend Capital’s resources on matters relating to re-election of directors. More likely will there be a deliberately imprecise provision permitting expenditure on something for the beneficial advancement of Capital’s objects and purposes. The question therefore becomes whether the expenditure of Capital’s funds on re-election of its board is an expenditure for the beneficial advancement of Capital’s objects and purposes. Assume an affirmative answer to that question, especially having regard to the fact that over very many years, Capital in annual general meeting has ratified expenditures of this nature in the re-election of its board. The next issue is by far the more vexing. It is the ascertainment of the directors’ purpose in engaging in conduct which promotes the re-election of only four of the five-member board, Exuberant excluded. In investigating this issue, let us assume that the four directors have publicly stated that their heartfelt desire and intent in
undertaking the re-election campaign was for the betterment of Capital because they honestly (perhaps also reasonably) believed that Exuberant’s continued presence on the board was likely to torpedo the joint venture between Capital and GMNL and also the prospects of obtaining finance from Moneybags. But in the end, the most critical issue for examination and answer is the board’s motive in engaging in the campaigning for their re-election and for the rejection of Exuberant. That involves a consideration of the “real purpose” which primarily motivates their action. On the facts of this illustration, the real purpose is finely balanced. In support of the contention that the four directors’ conduct in campaigning in the contested election is for a proper corporate purpose, the following factors may be given –

- the benefit to Capital in establishing a joint venture with GMNL;
- the benefit to Capital of keeping in status quo the banking arrangements and financial accommodation between Capital and Moneybags;
- the benefit to the future joint venturers of keeping in status quo the banking arrangements and financial accommodation between Moneybags and GMNL.

Hence, with Exuberant on the board of Capital, none of those objectives could be fulfilled. Without those objectives being fulfilled, Capital and its shareholders stand to miss out on significantly beneficial opportunities.

4.36 The argument cuts both ways, of course. A creditable submission can be advanced to the effect that it is not legitimate for the four directors of Capital to use Capital’s funds to promote solely their own re-election. Among the reasons for that contention are -

(i) it is never legitimate to expend the company’s funds on a question of personality and thus, insofar as campaigning is directed at attacking Exuberant’s personal capacity to be a director, the campaigning is not legitimate;

(ii) any unreasonable sum of money which is spent on the campaign is not legitimate;

(iii) any unfair conduct in the campaign is not legitimate.
Naturally, those last two points beg other questions. When is the expenditure “unreasonable” in quantitative terms and when is the conduct of the four directors “unfair”? So far as the unreasonableness of the expenditure is concerned, while no hard and fast amount can ever be said to be “reasonable”, no more than any hard and fast amount ever be said to be “unreasonable”, it seems to me that the reasonableness or otherwise of the expenditure will be assessed by reference to objective criteria such as

- the amount of the expenditure;
- Capital’s net tangible asset base;
- the proportion represented by the expenditure compared to other entries listed as expenditures in Capital’s profit and loss account;
- how much time Capital’s management and staff is devoting to re-election campaign issues as opposed to time being devoted to Capital’s core business;
- how much a company of comparable size and net worth to Capital would regard as a reasonable expenditure for a like expenditure; and
- how much expert accountants and company directors would regard as reasonable for the expenditure of funds for the re-election of the board.

4.37 So far as any “unfairness” may be involved in the campaign process which would taint the expenditure, again, no hard and fast formula can be postulated. That said, it seems to me that conduct could probably be described as “unfair” if -

- the campaigning involves an untruth levelled against Exuberant;
- the campaigning in reality takes the form of a smear upon Exuberant’s behaviour as a director or in his personal life; or if
- Exuberant is not given the opportunity of putting his version of any event which to a reasonable shareholder would call for explanation or comment.

4.38 There may be more. The case against the director becomes all the stronger if the relevant unfairness is said to be grounded in emotive, inflammatory or erroneous language or information which is put in the public arena as part of the campaign. Thus, if campaigning takes the form of putting before shareholders information about a director which is said to be factually correct,
the campaigning may be nevertheless unfair if the information is couched in language which is emotive or inflammatory.

4.39 The possibilities on this issue are almost limitless. But a few illustrations come to mind such as statements in advertising material expressed –

- “Would a responsible director attend only 5 board meetings?”; or
- “He voted in favour of greater pay to the company’s executives. What was he thinking?”; or
- “Do we really need unbridled extravagance in fiscal management?”; or
- “How much more of this rapacious conduct will you tolerate?”

4.40 Each illustration immediately above may well be justifiable in conversation among shareholders but when circulated to shareholders with the approval of the board and under its aegis, those questions expressed in that way are likely to be construed by a court as being unfair. If expressed without the hyperbole, in my view much if not all of the criticism attaching to the questions evaporates. Taking the first question first, if expressed as a fact (namely, the director attended 5 board meetings) the point becomes unarguably correct and unobjectionable. But the imputation that the director is not a responsible director by reason of the fact that he or she has attended only five board meetings is almost certainly to be construed as being unfair. There may be any number of reasons why the director attended only 5 meetings of the board – illness, personal indisposition, being overseas on company business to name a few. In any of those situations the director does not cease to be a responsible director for having missed more than one board meeting. And the suggestion that he is not responsible for having missed those meetings is in the circumstances unfair. Take the second question rhetorically posed above. As a statement of fact it may very well be the truth that the director voted in favour of greater pay to the company’s executives. It may also be the fact, as is likely, that the increase in executive’s salaries took place because the board as a whole or a majority of it voted for the increase. It may also be the fact that the increase was approved because it was long overdue. In other words, the fact of the increase has a much less odious complexion to it on any of those explanations. In those circumstances, the addition to the statement that the
director voted for executive salary increases the sentence “what was he thinking?” is pejorative, provocative and argumentative. It is likely to be construed as being unfair. As for the last two illustrations, they are likely to be seen as being insulting, defamatory, pejorative and almost certainly unfair. In my opinion, it would take very little persuasion to convince a court of that conclusion. The words “unbridled extravagance” when levelled against one member only of the board smacks of a serious personal insult, to say nothing of the fact that the unbridled extravagance said to be attributable to the one director was an act of the board as a whole, undifferentiated in personam. In those circumstances, along with others, the phrase will almost certainly be condemned. Likewise, the words “rapacious conduct” are insulting, pejorative, provocative and argumentative. It is unimaginable that they could be supported. The phrase is likely to be condemned.

**4.41** The matters raised in the paragraphs immediately preceding highlight the pitfalls associated with the selection of material which is used in the re-election campaign. The facts sought to be conveyed may very well be true. However, if those facts are put forward in a manner which is unacceptable according to the proscriptions of legal principle, the information which is sought to be imparted in the re-election campaign is amenable to being struck down. In my view, with good reason. After all, in the case of large public companies the expenses associated with re-election are enormous. The number of people who are reached in their capacity as shareholders is commensurately enormous. Half-truths, untruths, or scant regard to the truth reach a vast block of the population at horrific expense to the shareholders. Why, one asks rhetorically, ought the shareholders be punished by the diminution in their shareholder’s equity by inflammatory, pejorative expressions between warring factions? Is it not right and just, indeed consonant with good commercial practice that slanging matches between boardroom combatants be conducted without resort to the coffers of the company? Why should the company be vexed by infighting among those who direct it? Better still, why should the company’s owners be vexed by that infighting? On the other hand, is it right and just that in respect of a company matter, namely the composition of the board, that the competing directors
should themselves fund from their own resources the challenge for the boardroom control? Does that not impose an impossible financial burden on the directors, especially where the company is a large public institution the shareholding of which is vast and geographically disparate? Put another way, why should the directors be required to privately fund on a potentially large scale a matter which is incontrovertibly relevant wholly and solely to the affairs of the company? He or she should not be required to bear that burden personally. Hence, the law prescribes strict rules which govern the circumstances in which company funds may legitimately be used to promote the re-election of directors.
Scrupulous conduct

4.42 Kirby P identified the concept of “scrupulous conduct” in connection with election of proxy solicitation. His Honour said election or proxy solicitation heightened the risk of confusion between private interests and “the best interests” of the corporation. It is easy to see how the two can be confused. The concept of the best interests of the corporation has its origins in the law relating to fiduciaries. The concept requires the director to prefer over his or her own personal interests the interests of the company. Thus, in any given situation, the director is not permitted to exploit for himself an opportunity which he or she should present to his or her company for exploitation. Nor in a contest between duty and interest may the director permit personal interests to prevail. The scope for confusion between private interests and the best interests of the company is acute, even if the director stands to gain no direct financial accretion from the election or proxy solicitation. Naturally, where the director stands to directly gain from the election or proxy solicitation, the situation is much more poignant. Transparency is called for. A simple illustration amply makes the point. Assume the director who seeks re-election also directs a company which has extant contractual interests with the company to which the director seeks re-election. Successful re-election will ensure on going contractual relations between the two companies which in turn will ensure enhanced director’s emoluments to the director. In that illustration, no one could seriously suggest that there was not an appreciable risk of confusion between the director’s private interests and the best interests of the company, relevantly, the company to which he seeks re-election. It might also be said that the confusion is bilateral. Not only is the director confused about the greater interest which he must uphold, but the shareholders who are invited to re-elect the director may themselves be confused about the loyalty which the director holds highest – his private contractual benefits or his obligations to his company. So in those circumstances and I venture to say they are not remote, unusual nor extreme, Kirby P considered it necessary to point out as one of his Honour’s ten points that scrupulous conduct was called for. Precisely what his Honour had in mind by way of scrupulous conduct, his Honour does not say. However, it is
submitted that conduct which an objective independent right-thinking director in like circumstances would regard as proper. If the conduct is sustainable in the eyes of an objective corporate governance expert, so much the better. Scrupulous conduct in the context of the director with financial benefits likely to be derived from related company contracts, to my mind calls for full disclosure of the existence, amount of and personal gain from the related company contract. That disclosure could appear on how-to-vote leaflets and in my view it is sufficient if the disclosure appears once only. Telephone solicitation carries with it risk warranting tremendous care. True, telephone solicitation is a mode of rapid communication of information and is thereby effective with relative cost efficiency. Telephone solicitation is commonly used in takeovers. However, the scope for confusion and misinformation in telephone solicitation is substantial. As a feature of common human experience, people “hear” what they believe they hear, whether the words allegedly heard were in fact uttered. So as to avoid evidentiary issues associated with a disputed version of what was in fact said, a permanent record in writing of the words used is better given in the form of how-to-vote cards. Further telephone solicitations made at inappropriate or inconvenient times heightens the contention that the campaign tactic or technique was “unfair”. Conversely, how-to-vote cards which arrive in the ordinary course of prepaid post alleviate the spectre of any such unfairness.

**Drawing the threads together**

4.43 The law as stated in *Advance Bank v FAI* is not altogether easy to interpret and it is more complicated still to apply. For a director facing the daunting possibility of a contested election, especially one in which the legitimate use of company funds in the re-election campaign has already been raised as an issue of concern, the law is unduly complex and presents nothing short of a minefield of likely problems. In the passages which follow, an endeavour has been made to set out what is considered to be the critical matters for the board to address before a company is called upon to apply its funds towards the re-election of directors. The critical issues have been divided into the following–
(a) gathering information before formulating the campaign;
(b) matters relevant to the company;
(c) matters relevant to the directors; and
(d) the campaign itself.

The matters set out below are intended to be something akin to a corporate governance checklist to be applied as a first point of reference.

**Gathering information**

4.44 Before even formulating the campaign a number of issues must be addressed for the very good reason that those issues are likely to arise during the running of the campaign, whether by the director seeking re-election or by the board which seeks to stave off the re-election of a particular director. Among the more important matters about which relevant parties should be satisfied are the following –

(a) incontrovertible evidence of the number of directors’ meetings each director has attended (including the compilation of a set of all minutes of those meetings), the committees each director has sat on or chaired, details of the workings of each such committee and relevant contribution made to each such committee by each director;

(b) financial budgets within the control of each director;

(c) performance results of the company as a whole and of any discrete group or segment of the company for which each director is specifically responsible;

(d) if performance results reveal that a specific segment of the company is performing poorly, and that a particular director is responsible for the performance results of that specific segment of the company, financial evidence should be obtained explaining the reason or reasons for such poor performance results. If available, evidence should be obtained which compellingly and incontrovertibly links the poor performance of the company’s segment to the director whose responsibility it is to direct the operations of that segment of the company. The proper purpose test
will only be met if the compilation of this evidence does not reveal any form of vendetta aimed at a specific person;

(e) newspaper and internet articles about each director and about the company as a whole over a period spanning the life of the office of each director who is offering himself or herself for re-election;

(f) a costing of the expense of the re-election campaign, certified by one or more independent external experts to be reasonable.

**Issues relevant to the company itself**

4.45 Once information set out above has been gathered of an historical nature, it is then necessary to focus on aspects of the company itself, especially having regard to the acute strictures of proper corporate purpose and the need to separate private interests from the best interests of the company. In the sub-paragraphs which follow I set out some of the more important matters of relevance to the company itself, namely –

(a) that the company is sufficiently resourced, preferably from its own assets, to meet the costed expenses of the re-election campaign as referred to in paragraph 4.44(f) above;

(b) that a separate body of shareholders exists which is capable of representing the company and to advise on corporate governance issues, as well as on whether the company should make any claim against one or more directors for breach of duty;

(c) that the annual general meeting at which the vote on the re-election of directors is proposed has been convened properly and regularly in accordance with the constitution of the company;

(d) that the constitution of the company expressly provides for the retirement of directors and for their re-election and that all relevant regulatory bodies have been notified of the appointment of all directors, as required by Part 2D.3 of the Corporations Act;

(e) that the timing of the AGM is correct, that is to say, it is in strict conformity with the company’s constitution and moreover, that the AGM has not been convened with undue haste or with any truncated period of notice of its proposed holding;
(f) that the AGM is held sufficiently far in advance that all shareholders have sufficient time to consider and seek advice in respect of all proposed resolutions;

(g) that no confusion emerges from the resolutions to be considered at the meeting and that the resolution for the re-election of directors is a stand-alone resolution fully independent from any other business to be transacted at the meeting.

The directors’ eligibility

4.46 Having addressed matters which arise even before the campaign is formulated and having considered issues from the perspective of the company itself, it is next necessary to turn attention to the directors, especially their eligibility. That requires consideration of the following –

(a) that the correct number and the correct identity of directors is given, especially those who offer themselves for re-election;

(b) that no director who seeks re-election suffers from a disabling circumstance which would disentitle the director from seeking re-election, such as a conviction for an offence involving dishonesty, bankruptcy, or an order forbidding the director from holding office as a director.

The campaign itself

4.47 Once the preliminary corporate governance issues referred to in paragraphs 4.44, 4.45 and 4.46 have been considered and addressed, the critical issue next is the campaign itself. The whole subject of the campaign is fraught with pitfalls. The sub-paragraphs which follow represent a distillation of the key matters about which Kirby P opined in Advance Bank v FAI in the context of a company funded campaign. They include –

(a) the campaign itself must not be personality-based. Thus, it is not permissible to address the personality traits of the protagonists, their physical features or their character;
(b) the campaign must focus instead on the benefit to the company which the policies each protagonist can advance;
(c) the campaign itself must be consistent with one or more of the company’s corporate purposes as set out in the company’s constitution. Unless the campaign is consistent with one or more of the company’s corporate purposes, it is *prima facie* invalid;
(d) the campaign must not, whether directly or indirectly, advance the interests of any particular faction within the company over the interests of the company as a whole. The interests of the company as a whole must be advanced;
(e) extreme care must be taken with telephone solicitation, with the script vetted with precision;
(f) how-to-vote cards should be used, but in no case should they contain inflammatory language;
(g) the how-to-vote cards should state matters including formal matters such as –
   (i) the name and address of the candidate seeking re-election;
   (ii) the candidate’s directorship, any committees to which the candidate belongs, his/her position within the company;
   (iii) information about any significant projects in which the director has been involved;
   (iv) information about funds under the management or control of the director;
   (v) the director’s position on significant matters of company policy;
   (vi) a declaration about the candidate’s connection, if any, on inter-company contractual relations, shareholdings or other links of a legal character between the company and its associated entity;
   (vii) a declaration that the candidate is not advancing his or her own interests ahead of those of the company;
   (viii) a declaration that the candidate has been instructed in the need to advance the interests of the company ahead of his or her own personal interests;
   (ix) a declaration that in the opinion of the director mentioned on the how-to-vote card, the expenditure on the campaign is reasonable.
Will that make the campaign bullet-proof?

4.48 Even with the precautions set out above, it cannot be said that the campaign is bullet-proof nor will it be immune from challenge. The avenues of challenge are seemingly limitless. A challenger need only assert that the real purpose in the campaign is a purpose other than a proper corporate purpose, or that the campaign is directed to a personal smear upon the director facing re-election. In either case, an assault is levelled upon the whole of the campaign. In those circumstances, the challenger director will almost certainly seek to agitate his or her concerns about the campaign in court. It seems to me that it is almost impossible to design a campaign the implementation of which renders a challenge unlikely or impossible. That said, a legal advisor can only advise in relation to the state of the law as it presently stands. As the law presently stands, the law is as pronounced by the Court of Appeal of the Supreme Court of New South Wales in *Advance Bank v FAI*. Regrettably, the statement of the law in that case is lamentably unclear. Naturally, the director against whom a claim is made for breach of trust, negligence, default or breach of duty and who asserts that he or she has acted honestly and that his or her conduct ought fairly to be excused may apply to the court for an order under s. 1318 for relief against liability. The above distillation is an attempt to divine some sense of principle from the present state of the law.
PART 5

PRACTICAL IMPLICATIONS OF THE DECISION IN

ADVANCE BANK v FAI

Introduction

5.1 Earlier parts of this thesis have touched on certain discrete practical implications of the decision of the Court of Appeal in Advance Bank v FAI. In particular, issues arising out of the re-election campaign itself have been highlighted in Part 4 above. In this part four issues are discussed which are likely to confront both the director and advisor and which do not admit of easy answer, notwithstanding that those issues are basic to the legal matters associated with the re-election campaign. The four matters are –

(a) in reality, most boardroom challenges have at their heart personality grievances;

(b) it is well nigh impossible to definitively characterize directors’ conduct by reference to “the real purpose” which animates their conduct;

(c) the reasonableness of expenditure in the re-election process is almost impossible to quantify before the expenditure becomes unreasonable; and

(d) in proxy and solicitation cases, no yard arm exists against which a director can reliably measure abuses of power which is excessive or unfair.

Each matter will be considered in turn.

Most boardroom challenges are in reality personality grievances

5.2 Advance Bank v FAI sounded repeated warning bells to the effect that in a contested re-election, the law will not countenance monetary expenditure from company coffers if the expenditure is based solely or predominantly on campaigning on personality issues rather than on corporate policy issues. In my respectful view, the Court of Appeal correctly stated the law to that effect.
However, it is submitted that most if not all boardroom challenges have as their motivation personality issues associated with the protagonist party or parties. Accordingly, most directors will hold a genuine belief that campaigning to oppose the re-election of a particular director is justified on the basis that the re-election is not in the best interests of the company. In other words, the opposing director's subjective state of mind which is genuinely held is to the effect that the opposition to the re-election is well founded for the simple reason that re-election is not in the best interests of the company. At a practical level, such an assertion is very easy to make. It is difficult to disprove. However, when pressed about why the director who opposes the re-election genuinely believe that the re-election is not in the best interests of the company, that director is likely to give a reason which points to his opposition being grounded in the personality of the party seeking re-election and not his or her policies. For example, the director who opposes the re-election of the director who seeks re-election does so on the ground that he or she has a concern that the director who seeks re-election will, for example –

(a) cause the company to embark on a period of uncontrolled spending of the company’s resources;
(b) cause the company to pursue ventures which the company is unable to sustain or support;
(c) take the company into areas in which the company has no proven track record nor core business experience; or, most commonly
(d) inveigle his family members to acquire controlling interests in the company, or controlling operational interests in the company with the result that the company becomes the *de facto* if not the *de jure* emanation of that director’s family company.

5.3 In all of those illustrations one common theme emerges – a fear that the director seeking re-election will do something adverse with the company when he or she is re-elected. Depending on where one draws the line, something appearing to be a “personality” matter may in truth be a “policy” matter. But whatever may be the characterization, the most obvious follow-up enquiry is on what hard evidence is the fear based that the director who seeks
re-election will do something adverse to the company? Is it based on some known or assumed behavioural characteristic possessed by the director who seeks re-election, such as his adventurous spirit, his cavalier attitude or his nonchalant approach to persons in authority? Is the fear based on something said or done which is directly attributable to the director who seeks re-election, such as a comment “I intend, if re-elected, to turn this company around and expose it to new adventures”. In either case, the fear is baseless or, at least, the fear is grounded in events which may never eventuate because of the composition of the board or the ever-changing commercial environment in which the company operates. Whatever may be the true position, the short point of this is that at a practical level, most boardroom challenges are in reality personality grievances and as such, personality grievances can never be a proper basis for spending company funds in a contested re-election campaign. How therefore, one asks rhetorically, can a board which opposes the re-election of a “cowboy” director, ever lawfully oppose his re-election when in reality, the opposition is based on the very fact that the boardroom cowboy is just that – a cowboy? To my mind, this is an important practical implication of the decision in *Advance Bank v FAI*.

**How does one ever know “the real purpose”?**

5.4 It is all very well for a director to engage in campaigning and electioneering professing that his purpose in campaigning in a particular manner or that his purpose in electioneering in a particular manner is the best interests of the company. In *Advance Bank v FAI* the Court of Appeal instructs us that a director’s say-so about his purpose and subjective intent, although relevant, is not conclusive of the *bona fides* or purpose for which he or she acts. The Court of Appeal further instructs us that it is necessary to ascertain “the real purpose” which motivates the director action before one can definitively say whether the purpose is a “corporate purpose” or whether the purpose is private. If the real purpose in opposing a director’s re-election is a proper purpose, then the expenditure of a reasonable sum from the company’s coffers is legitimate. But if the real purpose in opposing a director’s re-election is, say, a private purpose or a personality-related purpose, then the expenditure
of a sum, no matter how reasonable from the company’s coffers will not be legitimate. Hence, it is critical to divine the “real purpose” which motivates the director in opposing the re-election. To that end, merely asking the director for his or her purpose behind his or her actions will be insufficient because whatever reason is given, it is subjective and undoubtedly self-serving. The Court of Appeal in *Advance Bank v FAI* commands shareholders, advisors, even fellow directors, to seek to distil on an objective basis the motives which cause the director or directors to engage in the conduct in which they engage in opposing the re-election of another director. Only then can one glean legitimacy in their conduct.

5.5 That is easier said than done. At a practical level, how can someone external to the board ever learn of the real purpose which motivates the board? The board will not volunteer that information to a stranger. A shareholder has only limited access to board information and a stranger such as a private advisor has no right to board information. So how does anyone ever learn of the “real purpose” which motivates the board, short of eliciting that information in cross-examination, which of itself presumes a trial in an adversarial context? Of course, any reader of the financial press can speculate about the real reasons or “purposes” which motivate a person at board level. However, at a practical level, on an important subject such as the ascertainment of a director’s real purpose behind expending the company’s resources in fighting a contested re-election campaign, in my opinion it is well nigh impossible to ascertain that “real purpose”. If one cannot ascertain the real purpose, one can travel precious little way down the path of either challenging the legitimacy of or in upholding the legitimacy of the board’s conduct or purpose in opposing the re-election of a director. In short, the Court of Appeal’s pronouncement of the need to ascertain the “real purpose” of the impugned conduct is akin to the quest for the Holy Grail. In both cases the real purpose is either wholly illusory or an accurate statement of it simply will not be forthcoming.
How “reasonable” must the expenditure be?

5.6 The third issue in the list of practical implications of the decision in *Advance Bank v FAI* relates to the very pragmatic matter of the reasonableness of the expenditure and when the magnitude of the expenditure renders it “unreasonable”. It will be recalled that the Court of Appeal in *Advance Bank v FAI* held that in the specific arena of election and proxy solicitation, the directors’ power to undertake a re-election campaign may be abused where an unreasonable sum of the company’s money is expended in the campaign process. In that eventuality the expenditure, being unreasonable, renders the use of company funds in the promotion of the re-election illegitimate. Thus, the question arises, how “reasonable” must the expenditure be before it becomes “unreasonable”? An associated question is whether the whole of the expenditure is unreasonable or whether some of it can be classified as reasonable whereas the excess between the total expenditure and the reasonable portion of it can be excised for being unreasonable?

5.7 Tremendous uncertainty exists on how one can properly characterize any particular expenditure as reasonable whereas one can characterize another as being unreasonable. Reasonableness in this context is to be assessed according to known facts. Among them are the magnitude of the expenditure compared to expenditures on comparable items in an identical or largely similar company. Therein lies the point. No two public companies will be the same. Their net shareholders’ equity will differ. Their shareholder base will differ. Their board will differ as to size and make up. Their re-election campaign will differ as will the magnitude of the expenditure to which the companies commit in the re-election campaign. In large public companies involving millions of shareholders, it is both unreasonable and unthinkable that the individual members of the board should be required to pay, let alone contribute to the costs of the re-election campaign. For that matter, it is almost axiomatic that re-election costs are met out of company funds. When millions of shareholders are involved, the postal expenses alone are phenomenally large. A recent illustration was provided in the contested election for Coles Myer Ltd. where Solomon Lew sought re-election on a
platform involving the loyalty programme and shareholder discount card. Postal expenses were immense, running into many millions of dollars. More than one mail-out was made to the shareholders on the subject of the loyalty programme and the shareholder discount card. To require individual directors to meet those postal expenses alone would have spelled their financial ruination. So when does the expense associated with the mail-out become reasonable (and thus legitimate) and when does it become unreasonable (and thus illegitimate)? It is seemingly impossible to measure the postal expenses against a yardstick in order to gain some insight into the reasonableness of the expense when no yardstick exists. So when an advisor is approached with the enquiry whether the mail-out expense is legitimate, given that it runs to many millions of dollars, what answer is the advisor to give? To my mind, this is yet another practical implication of the decision in *Advance Bank v FAI* which admits of no easy answer.

**When is it all “excessive or unfair”?**

5.8 The fourth and final practical conundrum which in my opinion is thrown up by the decision in *Advance Bank v FAI* again relates to the specific arena of election and proxy solicitation. In addition to the Court of Appeal holding that the expenditure of an unreasonable sum is likely to render the expenditure illegitimate, acting in a manner which is excessive or unfair will also render the expenditure illegitimate. But one need only pose the question to learn how it begs one other – what does it mean to behave in a manner which is excessive or unfair? Is the unfairness or excess to be reckoned against a class of shareholders? Is it to be reckoned against the opposing party who seeks re-election? And when does the conduct, by whomsoever the conduct is proscribed, in fact become unfair or excessive? The “unfairness” or the “excess” cannot be a reference to the “amount” of the expenditure as that issue is already addressed in the context of the reasonableness of the quantity of the expenditure. The “unfairness” or the “excess” cannot be a reference to excess or unfairness in the conduct of the campaign itself as matters pertaining to the campaign are also addressed elsewhere. So, to what conduct
is the reference to excess or unfairness? In my opinion the answer is none too easy to tell.

5.9 That very confusion itself presents as the fourth practical implication of the Court of Appeal’s decision. The imprecision of identification of the conduct said to be proscribed permits, in my view, all manner of criticism. One need only complain that the conduct of the board in spending money in opposing the re-election of a board member is “excessive or unfair” and *ipso facto*, the expenditure becomes liable to being struck down as an illegitimate expenditure. That kind of criticism resembles the criticisms in an equity context of dispensing palm tree justice or that justice in equity is as long as the Chancellor’s foot! Imprecise and woolly concepts which are devoid of definition and characterization or concepts based on policy issues rather than legalistic precepts inevitably invite problematic application. This practical implication of the Court of Appeal’s decision in *Advance Bank v FAI* is of very real moment and quite properly sends cold chills down the spine of board members and advisors alike.

5.10 From these four matters considered in this part, make it readily apparent that the application of the principles of *Advance Bank v FAI* in any given fact situation is anything but straightforward.
PART 6

WHERE THE BOARD IS IN DISCORD – THE DERIVATIVE ACTION
AND OTHER REMEDIES

Introduction
6.1 Elsewhere, this thesis has endeavoured to set out the substantive law on the legitimate use of company funds to promote the re-election of directors. Under the rubric of substantive issues, matters of an evidentiary nature have also been touched upon. This part focuses upon matters of practice and procedure when dealing with a contested re-election campaign. For the purpose of the analysis in this part, I am assuming that the company is a public listed company, its head office and main operations are in the State of Victoria, its shares are traded on the Australian Stock Exchange at its office in Melbourne and the directors who direct it are predominantly residents of the State of Victoria. Consequently, any litigation about the company’s activities associated with the re-election of its directors is likely to be conducted either in the Federal Court of Australia, Victoria Registry or in the Corporations List of the Supreme Court of Victoria, currently a judge managed list within the commercial and equity division of the court. Several serious scenarios are postulated, namely –
(a) litigation in which the director who seeks re-election sues his company and fellow directors;
(b) litigation in which the other board members sue the director who seeks re-election;
(c) litigation in which the company itself sues the director who seeks re-election;
(d) litigation in which a block of shareholders sue the company;
(e) the derivative action.

Each combination is set out below.
**Director seeking re-election v the company and the board**

6.2 This scenario contemplates a set of circumstances in which the director who seeks re-election applies to court alleging that the board is conducting the campaign unfairly, either because the board is electioneering on personality issues or because the campaign being advanced against the director who seeks re-election is wildly extravagant, expensive or is factually inaccurate. The director who seeks re-election complains and wishes to enjoin the board and the company from further conducting the campaign in that manner. He brings his proceeding before the Corporations List of the Supreme Court of Victoria.

6.3 In that situation his only basis of relief lies in his status (if any) as a shareholder. Unless he is a shareholder, he has no separate entitlement to complain in his capacity as a director. It is trite law that a director owes fiduciary duties to his company. However, no principle of law or equity stands for the proposition that a director owes fiduciary duties to a fellow director. The position is no different by virtue of the provisions of the Corporations Act. Accordingly, the director who seeks re-election has no remedy directly against his or her fellow board member on conventional principles of company law. Of course, if the factual inaccuracies which are put against that director also amount to a libel or slander, then the director who seeks re-election may have remedies against his or her fellow directors in defamation. As against the company, the position is no different. A company owes no statutory or fiduciary duties to its directors. So, the director who seeks re-election will not be heard to complain that his fellow directors are somehow offending some duty allegedly owed to him because no such duty exists. Nor will the director who seeks re-election be heard to complain that his company has somehow contravened a duty allegedly owed to him, because again no such duty exists. However, if the director who seeks re-election is a minority shareholder or has Australian Securities Investment Commission (ASIC) permission under s234(e) of the Corporations Act, he may be able to bring himself within the Part 2F.1 of the Corporations Act, that is to say, the sections which deal with oppressive conduct of the affairs of the
company. As a minority shareholder, the director who seeks re-election has standing under s234 to apply for relief to seek any of the remedies conferred under s233(1) of the Corporations Act, of which relevantly, s233(1)(c) provides for the regulation of the conduct of the company’s affairs. Hence, under s233(1)(c), the director seeking re-election may seek orders by which the court alters the conduct of the affairs of the company. In my opinion, that would probably include conduct said to be contrary to his or her interests as a candidate seeking re-election. However, the position cannot be expressed definitively. That is because conduct which is proscribed by s232 of the Corporations Act addresses action and inaction by the company towards certain categories of shareholders, especially minority shareholders. The same conduct which attracts application of s233 of the Corporations Act, may not have the same effect even if committed upon the same person, if committed in a different capacity. Subject to s234 of the Corporations Act, even if the company carries out the very same conduct towards the same person, the conduct may be injurious if committed upon the person in his capacity as a shareholder although not at all injurious to him in his capacity as a director. For example, conduct committed upon X which has the effect of reducing the value of his minority shareholding may have no effect upon him if the conduct fails to touch upon his directorship. Accordingly, the director who seeks re-election may well have remedies against his company for conduct committed during the re-election campaign but only if the conduct is injurious towards him in his capacity as a minority shareholder and not otherwise. An application under s233 of the Corporations Act is made by notice of motion in accordance with form 10 to Chapter V to the Supreme Court Rules and is supported by affidavit to be sworn in this illustration by the director seeking re-election. In the usual course of events, an application under s233 is likely to undergo two or three directions hearings before being tried. The usual duration between date of issue and trial is less than six months, of course assuming an estimated duration of trial of three days or less. Cases of longer duration are likely to take longer to get to trial.
The board v directors seeking re-election

6.4 This (possibly unreal) scenario envisages a set of circumstances in which the director who seeks re-election is campaigning in an extravagant way by arranging the printing of an outrageous number of how-to-vote cards which name him alone, all at enormous cost to the company. The board takes exception to the anticipated cost of the printing, there being no question that the director concerned has the necessary ostensible authority to enter into such a contract with a printer. The board wishes to enjoin the director seeking re-election from distributing the how-to-vote cards.

6.5 On the hypothesis there posed, the board will fail to enjoin the director from manufacturing the how-to-vote cards. The extravagant number of how-to-vote cards have already been printed and the significant expense in the making of the cards has already been incurred. The activity which the board seeks to enjoin is the distribution of the cards. Let us further assume in this illustration that the how-to-vote cards themselves are factually accurate and do not engage in personality propaganda. In those circumstances, the board will be without remedy. It has no cause of action against the director who seeks re-election. Nor does the board have standing to sue. It is not an entity – rather, it exists as the sum total of its constituent directors. As we have seen earlier, directors owe no duties, whether fiduciary or statutory, as between each other.

6.6 As stated there are no enforceable duties as between directors. But even if duties did exist, what duties have been breached? Or if any have been breached, can further breach be prevented by injunction. In my opinion, the answer to both questions is in the negative. No duties have been breached and even if they were, the cards have been printed rendering any consequentially enforceable remedy, if one exists at all – which in my opinion one does not – sounding only in damages. For the reasons already given, the board could not pursue the director who seeks re-election on this illustration.

The company v the director seeking re-election
6.7 Two factual situations present themselves in this permutation as likely eventualities in a contested re-election. In the first, the company, controlled by the board which as a majority opposes the re-election of the director who is seeking re-election, seeks to enjoin that director from committing some act said to be a breach of his duties as a director. In that circumstance the company wishes to prevent that ongoing conduct. Here, the cause of action is a breach of both fiduciary and statutory duties. No real challenge to the justiciability of such a cause of action is likely to arise. However, the factual matrix which is alleged to constitute the breach may be more problematic.

Electioneering, of itself, is not a breach of statutory or fiduciary duty. Indeed, electioneering is specifically countenanced in *Advance Bank v FAI*. But if a breach of a statutory or fiduciary duty can be proved, then litigation to compel compliance with the duty will follow. The difference in this illustration from the scenario where the director sues as a minority shareholder lies in the procedure in court. As canvassed above, the minority shareholder seeks relief from oppression usually by applying the rules and procedures prescribed by Chapter V of the Rules of the Supreme Court. That is because the rules apply to parties relying on a provision of the *Corporations Act*. Conversely, a company (as opposed to a minority shareholder) seeking to enjoin an errant director from breaching the duties he owes to his company need not rely only on a statutory basis for relief. The company may invoke the court’s equity jurisdiction, by reason of the fact that a breach of a director’s duty is a breach of a fiduciary duty and since the *Judicature Act*, causes of action at common law and in equity have been enforceable in reliance upon the inherent jurisdiction of the Supreme Court. Challenges by a company against one of its directors are routinely dealt with by the court. The aspect of this illustration which attracts most intrigue is the precise articulation of the duty said to have been infringed.

**Shareholders’ block v the company**
6.8 This illustration is something of a variation on the illustration of the minority shareholders who challenges the company alleging oppression or comparable relief under s233 of the Corporations Act. This scenario envisages a collection of shareholders or a single shareholder which owns a block of shares, albeit of a minority interest, who assert that the re-election campaign in which the company is engaged is wasteful. The factual matrix in which this illustration is set is not unduly complex. It has at its heart an allegation that the re-election campaign conducted by the company is unjustifiable as to expense and as to the commercial wisdom of conducting it. This scenario has parallels to the fact situation in Advance Bank v FAI. So far as the legal position is concerned, the shareholders who advance the challenge have standing as minority shareholders. Their cause of action is statutory. They rely on the fact that the affairs of the company are being conducted in a manner prejudicial to their interests or in a way which is unfair. Their application is brought in the Corporations List. Of course, the biggest obstacle is the factual distillation of the campaign as being unfair for one reason or another. That said, having regard to the findings of Advance Bank v FAI, in my view it would not require enormous persuasion to convince a court that by reason of factual errors in the campaign, excesses of expenditure, general unfairness, a personality-based campaign or pejorative wording, curial intervention is warranted. The relief which the court may grant is very wide.

The derivative action

6.9 A very real practical conundrum presents itself where the board is conducting itself not only in breach of the duties each board member owes the company, but in circumstances in which no one will bring the errant directors to heel. Frequently the board of a company is composed in such a way that the board will not procure the company to sue one or more members of the board for dereliction of office, especially breach of duty. Thus, in this illustration the board commits breaches of duties, the company is the victim of those breaches, the only organ of the company with power to cause the company to sue is the board and yet the board is comprised of the very people who are
committing the breaches and therefore is unlikely to instruct the company to sue the board. In those circumstances, who has power to sue given that only the company owns the chose in action or the right to sue the directors? After all, the board owes duties to the company and who, if not the board, can commission the institution of a proceeding? The answer is simple. Long ago company law recognised this very eventuality and devised “the derivative action”. In pursuance of that action, a shareholder may apply to the court for leave to bring a proceeding in the name of the company against the directors who are at the heart of the breaches. Nowadays, the Corporations Act recognizes the modern statutory version of the derivative action in s236. The principle is the same, however. It enables a shareholder to apply to the court (here, to the Corporations List of the Supreme Court of Victoria) for leave to commence a new proceeding in which the company sues the directors for one or more breaches of duty. The applicant for leave must satisfy the requirements of s 237(2) of the Corporations Act. Often, the court grants leave for the company to bring the new proceeding on condition that it is separately represented, that is to say, in a manner unconnected with the shareholder who applies for leave and also in a manner unconnected with the board members who are to be sued. In practical terms, separate representation of that sort is limited to a supervisory role so as to ensure that no procedural step is taken to the detriment of the company. Were it otherwise, a significant duplication of costs and effort would be occasioned. The proceeding which is activated in this way acquires its own existence through the interlocutory stages, to trial and even to a negotiated settlement in appropriate cases.
PART 7

Two case studies: Clime Capital and Coles Myer

7.1 In theory the shareholders elect the directors to manage their company. Section 201G of the Corporations Act provides that a company may appoint a person as a director by resolution passed in general meeting. Normally the constitution of public companies will make specific provision for the election of directors by shareholders. For example the constitution may provide that ‘one third of the Company’s Directors, other than the Managing Director, or the number nearest to but not exceeding one third must retire at every annual general meeting. The Directors longest in office since last being elected or re-elected must retire unless re-elected’.

7.2 The shareholders also have an enshrined power to remove directors of public companies. Section 203D provides that a public company may by resolution remove a director from office despite anything in the company’s constitution (if any) or an agreement between the company and the director.

7.3 The reality is different. Shareholders do not usually determine the composition of the board of directors. Genuine contests for election to the board are rare with members of the board standing for re-election usually being successful. New directors, in practice, are not chosen by the shareholders but by the nomination committee of the board with the annual general meeting merely rubberstamping that choice.

7.4 One situation where a genuine contested election may occur is where a powerful entrepreneur attempts to move onto the board of a small public company. In a small company the entrepreneur can amass a significant voting bloc. Examples include the attempt by Farooq Khan to force his way onto the board of Biota Holdings and by David Tweed to secure board representation at Clime Capital. In such situations the board may consider using the company’s resources to repel the attackers.
7.5 Clime Capital is an Australian boutique investment company. David Tweed, a well-known share predator, became a major shareholder in the company and requisitioned three extraordinary general meetings calling for the resignation of chairman Roger Montgomery and the election of Tweed or his nominees. It was estimated that these three meetings cost the company over $100,000. In each meeting, Tweed was overwhelmingly defeated.

7.6 In the third meeting on 21 November 2005 Tweed proposed the election of a nominee Michelle Ellis. The directors, at the company’s expense, sent an explanatory memorandum to shareholders for the third meeting. Ultimately nearly 75% of the shareholders rejected the application to remove Montgomery and elect Tweed’s nominee.

7.7 The explanatory memorandum for the third meeting stated: ‘If appointed, Michelle Ellis would be National Exchange’s representative on the Board of Clime. National Exchange Pty. Limited and other companies associated with Mr. Tweed have engaged in off-market trades in ASX listed companies as principal. Unsolicited offers made by National Exchange Pty. Limited and other entities associated with Mr. Tweed have generated significant publicity over recent years. Relevant offers have included offers made at a substantial discount to the price at which listed shares trade on ASX or at an offer price above the current market price but with payments to be made over a long period of time. By way of example, in relation to offers recently made for OneSteel limited, payment terms for shares purchased off-market were 15 years from trade without interest or security for the payment obligations. Adverse publicity relating to these activities has been generated in part by litigation undertaken by Mr. Tweed and his associated entities to enforce such share purchase contracts. In addition, the terms of offers made by Mr. Tweed and his associated entities have been the subject of strong opposition by companies including

114 Section 249D provides that the directors of a company must call an extraordinary general meeting on the request of members with at least 5% of the votes that may be cast or at least 100 members. The meeting must be held for a proper purpose, s 249Q, which includes the removal and election of directors.
Commonwealth Bank of Australia Limited and Aveum Limited in the Federal Court. Proceedings have also been brought by the Australian Securities and Investment Commission regarding offers made by National Exchange Pty. Limited for OneSteel Limited shares. The existing Directors of Clime consider that any adverse publicity associated with these prior activities of entities associated with National Exchange and Mr. Tweed could have an adverse impact on the reputation of Clime. The addition of Ms. Ellis to the Board will increase directors’ fees payable by Clime to the ultimate cost of Clime shareholders. In view of the role of existing directors, the appointment of an additional Director will not be to the advantage of Clime.... If appointed to the Board of Clime, Michelle Ellis would be entitled to appoint another person, such as David Tweed, as her alternate Director to attend and exercise her Directorship powers in her place. Accordingly, it is possible, notwithstanding that shareholders have already voted against his appointment as a Director that, if Michelle Ellis were to be appointed as Director and nominated David Tweed as her alternate, David Tweed could attend Clime Board meetings and exercise powers as a Director. There is obviously increased reputation risk for Clime if this were to occur’.

7.8 Clearly the board in the Clime Capital contest used the company’s funds to promote their own re-election against other candidates. The company had funded a powerful attack on candidates challenging the incumbent board through the explanatory memorandum sent to all shareholders.

7.9 In major public companies genuine contests over board representation are less frequent than in small companies like Clime Capital. However it is not uncommon too see symbolic contests where a shareholder activist, a unionist or an environmentalist contests an election without any real expectation of securing majority support from shareholders. For example shareholder activist Stephen Mayne describes himself as Australia’s most unsuccessful board candidate. He has had 21 tilts at public company windmills beginning with a run for the AMP board in May 2000.\footnote{Including AMP, Woolworth, NRMA, Commonwealth Bank, WA News, John Fairfax, ASX, Gunns, Telstra, News, David Jones, PMP, NAB, Southern Cross, Axa Asia Pacific, Westfield.} In 2003 his bid for a seat at News Corp
protesting about the company’s record $12 billion loss, was defeated by only seven votes on the floor with 79 votes for and 86 votes against. However the proxy votes, dominated by institutional voting, were another story with 162 million for his bid and more than one billion against.

7.10 Occasionally, however, there are genuine contests over board representation in major public companies, where candidates opposed by the board had a significant chance of winning. Examples include the Coles Myer election in 2002, the boardroom battle between Cathy Walter and the other directors at NAB in 2004 and the Tattersalls’ board election in 2005.116

7.11 The Coles Myer election in 2002 was one of the most public and costly board election campaigns in Australian corporate history. Solomon Lew, a former chairman of Coles Myer, was dumped from the board at the company’s annual general meeting. His re-election had been opposed by Coles Myer chairman Rick Allert, chief executive John Fletcher, and six other directors on the 10-member board. The conflict began when newly recruited Coles Myer finance director Phillip Bowman, was sacked in July 2002. Bowman claimed that he was sacked because he tried to find out about a transaction dubbed the ‘Yannon affair’. Yannon Pty. Ltd., a shelf company, had bought preference shares in Solomon Lew’s publicly listed Premier Investments under an indemnity from Coles Myer which resulted in an $18 million loss for Coles Myer.

7.12 Coles Myer was one of the most widely held companies in Australia, with 560,000 shareholders. Lew was the single largest shareholder in Coles Myer, through his 51 percent-held Premier Investments, which has a 5.9 percent stake. Another 3.8 percent of Coles Myer was held by First Retail Investments, controlled by the Lew family.

7.13 Solomon Lew waged an aggressive fight to retain his position as a Coles Myer director. His campaign included expensive newspaper advertising claiming he

116 The Tattersalls’ election is particularly interesting as the challengers, Dr. Michael Vertigan and Julien Playoust, were successful in defeating the incumbent board member, Peter Kerr.
was the only director with broad retail experience. He also raised significant differences in corporate strategy, calling for the reintroduction of a shareholder discount card and an independent inquiry into ‘Project Gold’: a plan to break up Coles Myer.

7.14 While Lew campaigned, the eight Coles Myer directors initially remained silent. Some received letters from Mr. Lew’s legal advisers threatening that if they spoke out against him they would be sued. Eventually the directors opposing Lew sent a letter at their own expense to shareholders saying Lew should not be returned to the board because he had already served for 17 years, he had extensive related-party transactions and he and his family had interests that competed directly with Coles Myer.

7.15 Unlike the Clime Capital election, the directors in the Coles Myer ballot chose not to expend the company’s funds in their campaign opposing Solomon Lew. The directors personally funded their own election materials. This thesis examines the legal position of the directors in using company funds in election campaigns. It considers not only the formal legal position but also how clear in practice the rules are on the expenditure of company funds in promoting the re-election of directors.

117 Leonie Wood ‘Lew puts mouse where money is’, The Age, October 18 2002.
118 However the 2003 annual report revealed Coles Myer paid $577,625 to cover directors’ legal expenses in the 2002 election.
PART 8

CONCLUSION

8.1 From the foregoing, I have endeavoured to achieve a number of things. First, I have attempted to analyse the case law in Australia to demonstrate that there is no absolute prohibition on the use of company funds to promote the re-election of directors. However, the manner in which that simple concept is translated in practical terms in a contested re-election campaign makes the application of the concept of special difficulty. Next, I have sought to identify the real, every day implication of the decision in *Advance Bank v FAI*.

8.2 Finally, I have sought to put forward a handful of scenarios where the re-election campaign could end up in court and I have postulated the likely outcomes of those separate scenarios.

8.3 None of this is straightforward. The law on this subject is immensely complex. But that is only part of the story. In the stressed, fast evolving setting of the boardroom and the quest for its control, issues having legal, commercial and accounting ramifications, to say nothing of share price consequences, move at lightning speed and carry with them vast expense. When one bears in mind that the balance sheet position of the company may very well be affected by the costs of a contested campaign, the legitimate use of company funds to promote the re-election of directors, especially in a public company, is a matter of acute concern.

8.4 The issue of mediation has not been considered. In these days of increased recourse to mediation in complex commercial situations it may be open to competing board factions or shareholders to seek mediation before litigation.

8.5 The foregoing has been an attempt to clear much of the fog. The law is as stated at September 2005.
SILVANA MORTALE WILSON

February 2006
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<td>Studdert v Grosvenor</td>
<td>1886</td>
<td>Ch D</td>
<td>528</td>
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<td>T C Newman (Qld) Pty Ltd v DHA Rural (Qld) Pty Ltd</td>
<td>1987</td>
<td>ACLR</td>
<td>257</td>
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<td>Verwayen v The Commonwealth</td>
<td>1990</td>
<td>CLR</td>
<td>394</td>
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<td>Waters v Winmardun Pty Ltd</td>
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