2 The Origins of Company Law

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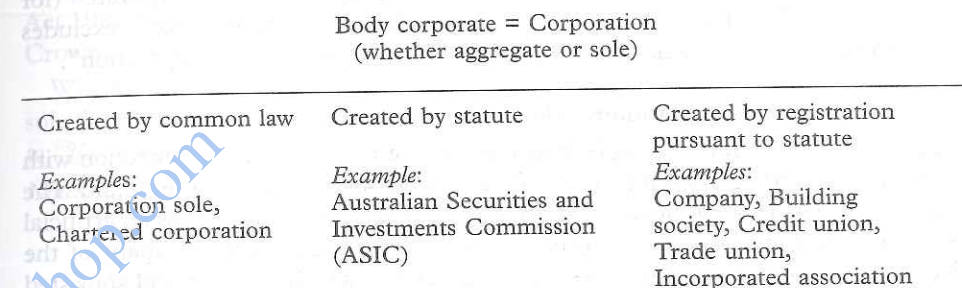
[2.010] Scope of this chapter

An understanding of modern Australian company law requires some reference to history.

This chapter describes the development in England of corporations, the emergence of large partnerships or joint stock companies and the ultimate statutory creation of the incorporated joint stock company, the immediate ancestor of the modern Australian registered company formed under the Corporations Act 2001 (Cth).

The chapter then gives a broad account of the evolution of company legislation in the Australian states and territories and the cooperation between them and the Commonwealth which produced the Australia-wide regime now in force under the Corporations Act.

The following diagram shows the categories of corporations referred to in the ensuing treatment.



The expressions "body corporate" and "corporation" refer to an artificial legal entity as the object of rights and duties in contrast to an individual, that is to say, a natural person.[1]

Notes

1. Bodies corporate are not the only examples of artificial legal entities. Courts acknowledge the existence of another type of artificial legal person when a party before them is a foreign state which is recognised under international law by the executive arm of government. Such a state, although not regarded as a body corporate, is treated as an artificial legal person: Marston G, "The Personality of the Foreign State in English Law" [1997] *Camb LJ* 374.

The development of common law corporations

[2.020] The need for corporations

Makers of law find it necessary to create artificial legal entities.[1] By doing so they facilitate enjoyment of legal rights by continuing institutions and groups free from limitations imposed by human mortality. The convenience of perpetual succession was described by Sir William Blackstone in *Commentaries on the Laws of England* (1765) vol 1, 455:

> As all personal rights die with the person; and as the necessary forms of investing a series of individuals, one after another, with the same individual rights, would be very inconvenient if not impracticable; it has been found necessary, when it is for the advantage of the public to have any particular rights kept on foot and continued, to constitute artificial persons, who may maintain a perpetual succession, and enjoy a kind of legal immortality. These artificial persons are called bodies politic, bodies corporate (*corpora corporata*), or corporations.

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English judges and lawyers in shaping the common law developed two main types of corporation, the *corporation sole* and the *corporation aggregate*.

Notes

1. Pollock and Maitland, *The History of English Law* Cambridge: CUP (1898) vol 1, 486; Holdsworth W S, *A History of English Law* London: Methuen vol 3 (1942) 5th ed pp 469ff.

[2.030] Corporations sole

This book focuses on companies and they are corporations aggregate rather than corporations sole. But corporations sole should be noticed if only because they are within those provisions of the Corporations Act, the Corporations Regulations and instruments made under them which refer to a "body" or "body corporate" (for example, s 250D). But s 57A's special definition of a "corporation" excludes corporations sole from such of the Act's provisions as refer to a "corporation".

[2.030.3] Origins of corporations sole

Common law corporations sole originated in the middle ages in connection with the holding of title to church land by office-holders in the Church of England. The common lawyers treated the occupant of the office and his successors as an artificial person in which title to church property could be vested. Each occupant of the office for the time being represented the corporation which however still subsisted during a vacancy in the office. Problems arising from transfers of property to the corporation during a vacancy were met by legislation providing for the property to vest in the successor upon his appointment: Law of Property Act 1925 (UK) s 180 reproduced in Property Law Act 1958 (Vic) ss 176–178; Property Law Act 1974 (Qld) ss 223–225. Apart from ecclesiastical corporations sole the Crown has been treated as a corporation sole: *Halsbury's Laws of England* 4th ed vol 9, para 1207 and see the explicit reference to the Crown in the Law of Property Act 1925 (UK) s 180.

[2.030.6] Corporations sole in Australia

Whether any common law corporations sole exist in Australia, apart from the Crown, is problematical: *Archbishop of Perth v "AA" to "JC" inclusive* (1995) 18 ACSR 333. Ministers of the Crown are not common law corporations sole: *Hubbard Association of Scientologists International v A-G (Vic)* [1976] VR 119.

Corporations sole can be created by Royal Charter or by statute. Some Australian statutory corporations sole follow the common law model of a succession of office-holders: for example, the Roman Catholic Church Property (Amendment) Act 1916 considered in *Archbishop of Perth v "AA" to "JC" inclusive* (1995) 18 ACSR 333. Others depart from that model. The Property for Public Purposes Act 1901 (Cth) s 50(1), for its purposes, deemed the Commonwealth to be a "corporation sole by the name of 'The Commonwealth of Australia'". In some jurisdictions there is a Public Trustee who is a corporation sole: see, for example, Public Trustee Act 1913 (NSW) s 7. Under the Bankruptcy Act 1966 (Cth) s 18 there exists a corporation sole known as the "Official Trustee in Bankruptcy" made up of the natural persons holding statutory office as Official Receivers in Bankruptcy, they being regional heads (in the bankruptcy districts into which Australia is divided) of the Insolvency and Trustee Service of Australia, a Division of the Commonwealth Attorney-General's Department dealing with bankruptcy matters.

In Australia, courts have disposed of many cases involving governments without having to consider whether they are corporations sole. In *Bank of New South Wales v Commonwealth (the Bank Nationalisation Case)* (1948) 76 CLR 1 at 362–3 Dixon J said of the Commonwealth Constitution:

> From beginning to end it treats the Commonwealth and the States as organizations or institutions of government possessing distinct individualities. Formally they may not be juristic persons, but they are conceived as politically organized bodies having mutual relations and amenable to the jurisdiction of the courts.

In *Workcover Authority of New South Wales (Inspector Keelty) v Crown in right of NSW (Police Service of NSW)* (2000) 50 NSWLR 333 Hungerford J held that the Crown in right of the State of New South Wales is a "body corporate". The Property Law Act 1958 (Vic) s 176 and the Property Law Act 1974 (Qld) s 223 expressly treat the Crown as a corporation sole.[1]

Whether liability in a particular matter can be imposed on a statutory corporation sole depends on the provisions of the constitutive statute: *Archbishop of Perth v "AA" to "JC" inclusive* (1995) 18 ACSR 333.[2]

Notes

1. For discussion of corporate theory applied to governments, see Sawer G, "Government as Personalized Legal Entity" in *Legal Personality and Political Pluralism* (ed Webb L C) Melbourne: MUP (1958), p 158. See also Maitland F W (1901) 17 *LQR* 131; Moore, Harrison (1904) 20 *LQR* 351; Mathieson D L "Does the Crown have Human Powers?" (1992) 15 *NZULR* 117. On the question of the powers of the Crown, see Wade H W R, "Procedure and Prerogative in Public Law" (1985) 101 *LQR* 180 at 191 distinguishing between the prerogative powers of the Crown unique to it and the powers of an ordinary person, "for example the power to make contracts, to convey land, to transfer chattels or money, and so forth". On the divisibility of the Crown, see Winterton G, "The Evolution of a Separate Australian Crown" (1993) 19 *Mon ULR* 1.
2. For more detail on corporations sole, see *Halsbury's Laws of England* 4th ed vol 9 paras 1206 ff; Grant *The Law of Corporations* Butterworth & Co, London, 1950; *McVicar v Cmr for Railways (NSW)* (1951) 83 CLR 521 at 534; *Crouch v Cmr for Railways (Qld)* (1985) 159 CLR 22 at 35.

[2.040] Corporations aggregate

A corporation aggregate, of which a registered company is an example, is a legal entity constituted by two or more members (corporate or individual) associated for some common venture or by a single member with whom others could associate for some common venture. Incorporation as a corporation aggregate facilitated the holding of property by a fluctuating group of persons, such as local government organisations and university colleges, and the dealings of the group with other persons in order to advance the group's collective aim.[1]

Kyd, *Treatise on the Law of Corporations* (1793) Vol 1 p 13 was describing a body corporate in the form of a corporation aggregate when he referred to:

> a collection of many individuals, united in one body, under a special denomination, having perpetual succession under an artificial form, and vested, by the policy of the law, with a capacity of acting, in several respects, as an individual, particularly of taking and granting property, of contracting obligations, and of suing and being sued; of enjoying privileges and immunities in common, and of exercising a variety of political rights, more or less extensive, according to the design of its institution, or powers conferred upon it, either at the time of its creation, or at any subsequent period of its existence.[2]

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The Corporations Act allows registration of a one-member company. The fact that the company has only one member does not make it a corporation sole. It is a corporation aggregate because it could easily become an association by acquiring more members.

Notes

1. Holdsworth W S, *A History of English Law* London: Methuen vol 3 (1942) 5th ed, pp 479ff.
2. Kyd wrote the preface to his book while a political prisoner in the Tower of London. Eventually the Attorney-General declined to offer any evidence against him, and he was discharged. He died in 1811.

[2.050] Incorporation of a corporation aggregate by royal charter

It became settled in England that a corporation aggregate could not arise spontaneously: it could be created only by the consent of the monarch expressed in a grant of a royal charter.[1]

Grantees of charters included university colleges and local governments such as boroughs. Other recipients included groups of merchants trading outside England. They obtained charters of incorporation which also gave them trading monopolies in a sphere of influence. For example, in return for a promise of an annual payment, Elizabeth I in 1600 incorporated the Levant Company and gave it a monopoly for 15 years of bringing goods into England from the Mediterranean and the Venetian Dominions.[2] It lasted until 1825 when it was dissolved by Act 6 Geo IV chap 33.

The noteworthy parts of the charter were a grant of incorporation as "one body corporate and politic in deed and in name by the name of The Governor and Company of Merchants of London trading into the Levant Seas". The charter ordained that:

- by that name they were to have succession;
- that they and their successors be capable to acquire property in the corporate name;
- that they be capable of suing and being sued; and
- that they could have a common seal.

The East India Company, the Hudson's Bay Company and the Massachusetts Bay Company, all incorporated in the 17th century, are other famous examples of incorporation by royal charter. The East India Company was granted a charter by Elizabeth I in 1600 and the company existed until 1874. The history of the company is documented in Philip Stern, *The Company-State: Corporate Sovereignty and the Early Modern Foundations of the British Empire in India* (Oxford University Press, 2011).

[2.050.3] Bodies politic

The charter of the Levant Company declared it to be "one body corporate and politic". The expression "body politic" originally drew attention to the fact that a body corporate was a human creation. Sir Edward Coke in his commentary of 1628 on *Littleton's Tenures* referred to "persons natural created by God" and "persons incorporate or politick created by the policy of man . . . either sole or aggregate of many.": Co. Litt 2a. As the Levant Company charter shows, "body politic" came to mean a body corporate with a government. Other examples in which the one entity is referred to as a "body politic and corporate" are found in the Bank of New South Wales Act 1850 (NSW); the Public Charities Funds Act 1935 (SA) s 10 and the Western Australian Bank Act 1896 (WA) s 4.

In modern times "body politic" refers only to people constituting a political unit with a government. The prime example is the state or organised society. In Australia there is a Commonwealth body politic (*Re Patterson; Ex parte Taylor* (2001) 182 ALR 657 at [13]) and each state constitutes a body politic: *Bass v Permanent Trustee Co Ltd* (1999) 198 CLR 334 at [23]. The Australian Capital Territory and the Northern Territory of Australia were each established as a "body politic under the Crown": see Australian Capital Territory (Self Government) Act 1988 (Cth) s 7 and Northern Territory (Self Government) Act 1978 (Cth) s 5.

It should have remained true that a body politic is only a special kind of body corporate but there are instances of legislation in which it is open to the interpretation that the framer considered a body politic to be something different from a body corporate. See, for example, the definition of "entities" in Income Tax Assessment Act 1997 (Cth) s 960100. In *Workcover Authority of New South Wales (Inspector Keelty) v Crown in right of NSW (Police Service of NSW)* (2000) 50 NSWLR 333 Hungerford J considered, after a review of many authorities, that the terms "body corporate" and "body politic" are not mutually exclusive and that a body politic is a body corporate that has been constituted for a public purpose.

Notes

1. Holdsworth W S, *A History of English Law*, 5th ed, Methuen, London, 1942, vol 3, pp 475ff.
2. *Select Charters of Trading Companies*, AD 1530-1707, Publications of the Selden Society, vol 28 (1913) pp 30–43.

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[2.060] Chartered corporations today

In modern times grants of charters have been mainly confined to benevolent institutions, learned societies, professional and scientific institutions, bodies promoting the arts or education, and similar organisations which are not run for private profit. Grantees are normally institutions which have been established long enough in some other structure to prove their stability and utility — The Institute of Chartered Accountants in Australia being one example. In Australia the powers of granting supplemental charters and the revocation and approval of alterations of existing charters were vested in the Governor-General by assignment from the Queen on 8 December 1987.

Whether a member of a chartered corporation is liable without limit to contribute for the debts of the corporation depends on the terms of the charter.[1]

Chartered corporations are not the primary subject of the Corporations Act. But by force of expressions defined in that Act some of its provisions apply to a chartered corporation, or to persons or things related to it. Among the expressions having that effect are "body" (see s 9); "body corporate" (see s 9); "Part 5.7 body" (see s 9); "corporation" (see s 57A) and "company" (see the extension in s 9's definition beyond a company registered under the Corporations Act).

Notes

1. Originally, members could be liable through the corporation levying assessments or "leviations" beyond their original investment. *Salmon v The Hamborough Company* (1671) 1 Ch Cas 204; 22 ER 763 has been thought to be authority that Chancery could force a corporation to levy an assessment but a later study suggests that that was a case where fraud justified such an order: Jenkins D, "Skinning the Pantomime Horse: Two Early Cases on Limited Liability" (1975) 34 *CLJ* 308. Later it became common for the charter to limit the members' liability to the corporation to the capital they contributed.

[2.070] Equating a corporation to an individual

For centuries, judges have felt compelled to use the metaphor of a natural person, when describing the attributes of a company. Thus, in *Sir James Smith's case* (1691) Carth 217 it was said that a corporation is:

> [An] artificial entity composed of divers constituent members like the human body, and that the ligaments of this body politic or artificial body are the franchises and liberties thereof which bind and unite all its members together, and the whole frame and essence of the corporation consist therein.

(See also *H L Bolton & Co Ltd v T J Graham & Sons Ltd* [1957] 1 QB 159 per Denning LJ.) But there are limits to this "anthropomorphic" approach: see [4.110].

[2.080] Corporate personality: fictional or real

A corporation is often described as a legal fiction: see, for example, per Brennan J in *Northside Developments Pty Ltd v Registrar-General* (1990) 170 CLR 146 at 171. Theorists who regard incorporation as nothing more than a legal fiction have the support of Sir Edward Coke who described corporations as "invisible, immortal, and resting only in intendment and consideration of the law": *Sutton's Hospital Case* (1612) 10 Co Rep 1 (a) 32.

To the fictionalists a corporation is no more than a creature of the state. Opposed to the fictionalists are the realists who argue that when the state incorporates a group of persons it is merely providing formal recognition of a pre-existing social entity constituted by a group with a collective will of its own.[1]

The arguments of the realists were relied on by groups, principally in Europe, who were concerned for political reasons to deny any dependence on the state for their existence.

In England and other common law jurisdictions there has been less need for debate as to whether a corporation is anything more than a fiction. The indigenous law of trusts enabled groups (including some nonconformist churches and trade unions) to obtain many of the benefits of incorporation by holding property through trustees without having to approach the state to ask it to "grant" their existence and without subjecting themselves to the state's control over corporations.[2]

The provisions of the Corporations Act s 119 dealing with the creation of a new corporation in the form of a registered company are consistent with the fiction theory. Section 119 provides that a company comes into existence as a body corporate at the beginning of the day on which it is registered. In the former Corporations Law the nearest corresponding section to s 119 was s 123 which could be read as saying that registration of a company involved incorporation of the persons who had applied to ASIC for its registration. Section 119 carries no suggestion that corporators become incorporated or that a registered company is only a legal bracket encompassing certain members.

Notes

1. For discussion of the competing theories, see Derham D P, "Theories of Legal Personality" in *Legal Personality and Political Pluralism* Melbourne: MUP (ed Webb L C) (1958), p 1. For the part played by fictions in the development of law generally, see Paton G W, *A Text-book of Jurisprudence*, (ed Paton G W and Derham D P), 4th ed, Clarendon Press, Oxford, 1972, pp 57–9, 130, 483.
2. For further detail, see Holdsworth W S, *A History of English Law*, 3rd ed, Methuen, London, 1945, vol 4, p 478; also 3rd ed, 1944, vol 9, pp 47, 69–70; Paton G W, *A Text-book of Jurisprudence*, (ed Paton G W and Derham D P), 4th ed, Clarendon Press, Oxford, 1972, pp 407–19.

Statutory corporations

[2.090] Corporations created by statute

In England, at least from the 16th century, parliament could create a corporation. A petition for a grant of incorporation by private Act of Parliament was an alternative to a petition to the monarch for a charter. Parliament also created many corporations to perform public functions.

[2.090.3] Power to create statutory corporations in Australia

The Commonwealth and the state parliaments each possess wide powers to create corporations, either sole or aggregate. The Commonwealth Parliament can create corporations for implementing any of its legislative powers expressly granted to it by the Constitution: *Jumbunna Coal Mine NL v Victorian Coal Miners' Assn* (1908) 6 CLR 309. It has created public corporations to conduct a public activity which calls for some independence from direct ministerial control. For example, the Australian Securities and Investments Commission. The states have also created statutory corporations for public purposes. A modern public statutory corporation differs from registered companies and incorporated associations in being incorporated without having some pre-incorporation corporators who have sought to be incorporated: *Mune v Centro Argentino Victoria Inc* [1996] 2 VR 82 at 91.

Any group now seeking incorporation for other than public purposes would not normally procure the passing of a special Act of incorporation; they would have to seek incorporation by registration under a general incorporation statute such as the Corporations Act.

A corporation created by parliament, like any other corporation, is subject to the general law of corporations to the extent that its incorporating statute does not make special provision.

Statutory corporations that are public authorities are best studied as part of administrative law, and they are not considered further in this book. Their number is being reduced in the modern trend towards privatisation.

[2.090.6] Corporations created pursuant to a statute

Legislatures in Australia possess constitutional power to authorise a regulatory authority to grant corporate status. The Commonwealth Parliament in the Corporations Act has authorised ASIC to grant incorporation upon application (see Ch 5) so that that grant of corporate status operates throughout the wide jurisdiction governed by the Corporations Act. The Commonwealth Parliament's constitutional power to do that rests largely upon references made by state parliaments to the Commonwealth Parliament of matters, including incorporation of companies, to enable the Commonwealth Parliament to pass laws on those matters under its constitutional power conferred by s 51(xxxvii) of the Commonwealth Constitution. For details, see Ch 3.

Statutory bodies with corporate attributes but undefined status

[2.100] Parliament's intention as to body's status

When Parliament now legislates to establish a body or to empower some public authority to register a body the statute will usually be definite on the question whether the body is to be a corporation. For example, the Corporations Act s 119

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leaves no doubt when it provides that "a company comes into existence *as a body corporate* at the beginning of the day on which it is registered". In the past bodies have sometimes been created by statute or registered under statute but the statute has not been definitive as to their status. Uncertainty as to status has arisen when the statute has given the body some of the attributes of a corporation. Those attributes include the ability to sue, the liability to be sued, the power to hold property and continuous existence. Uncertainty as to status can be a practical problem, as where some other legislation or instrument imposes duties in relation to a "corporation".

In some cases courts have considered that the range of attributes given justifies an implication that Parliament intended the body, although not called a corporation, to be a discrete legal entity separate from its members in the same way and to the same extent that a corporation is a discrete legal entity. That is particularly so where the Act provides that legal proceedings by or against it can be taken in the body's name: *Chaff and Hay Acquisition Committee v J A Hemphill & Sons Pty Ltd* (1947) 74 CLR 375 at 385.

If only a limited range of attributes is given to the body it may not be held to be equivalent to a corporation: *Mayor of Salford v Lancashire County Council* (1890) 25 QBD 384 at 389; *Bonsor v Musicians Union* [1956] AC 104.

Some provisions of the Corporations Act extend beyond corporations to unincorporated bodies with limited corporate attributes. For example, under s 601CA if a body that is not a registered company carries on business in a state or territory within the total geographical area governed by the Act (see "this jurisdiction" as defined in s 9) it must be registered with ASIC under Pt 5B.2 as doing so unless it has its place of origin or its head office or principal place of business in that state or territory. The non-company bodies required to register are comprehended in the expression "registrable Australian body". The definition in s 9 of a "registrable Australian body" includes not only corporations that are not companies but also any unincorporated body that under the law of its place of formation may sue or be sued or hold property, in either case, in the name of its secretary or an officer appointed for the purpose.

At one time the Australian Gas Light Company (now named "AGL Ltd") was an example of an unincorporated body with corporate attributes. It was formed before there was legislation under which companies could be incorporated by registration. It was given, by private Act of the Legislature of NSW in 1837, various powers including power to sue and to be sued in the name of the secretary for the time being. Subsequent Acts assimilated it in many respects to a company registered under subsequent companies legislation. For example, an Act of 1883 limited the liability of the shareholders. Finally the New South Wales Parliament, in the AGL Corporate Conversion Act 2002 (NSW) constituted it as a body corporate and authorised it to apply for registration under the Corporations Act as a public company limited by shares. Westpac Banking Corporation was another example.

The evolution of joint stock companies

[2.110] Formerly they were alternatives to corporations

Commercial developments in the 18th century necessitated the raising of large sums of capital and encouraged the solicitation of funds from the public. It was not always possible for a new enterprise to obtain a charter or the passing of an Act. This

led to the formation of large quasi-partnerships known as joint stock companies. "Company" here meant simply association. It was an unincorporated association. To attract investment, the promoters had to arrange for shares to be readily marketable. Unlike the position in a partnership in the strict sense, membership shares were issued on terms that they were transferable without the consent of other investors in the company. This created opportunities for speculation in shares in joint stock companies and in some economic conditions a market boom could develop. Such a boom occurred in the early part of the 18th century.

Parliament attempted in the so-called "Bubble Act" of 1720 to stem the growth of joint stock companies, not only in order to dampen the boom, but also to reduce competition with the South Sea Company for investors' subscriptions: Cooke *Corporation Trust and Company* at 82; Gower (1952) 68 *LQR* 214. Parliament wanted to end the creation of joint stock companies which presumed to act as corporate bodies without a charter or statutory authority and which pretended to make their shares transferable without the authority of an Act of Parliament. Some new companies were created by special Act of Parliament. However, over time prosecutions proved to be difficult because the offence of presuming to act as a corporation could not be clearly defined.

Industrial expansion encouraged the continued formation of large joint stock companies. They laboured under difficulties. The rules of partnership law that applied were not suitable for a large association. For example, each of the many investors was liable for the joint stock company's debts; each investor had power to bind the others to a contract with outsiders; and if the joint stock company wanted to sue a debtor, all investors had to be joined as plaintiffs.

[2.120] Deed-of-settlement companies

In time many large commercial associations met some of the difficulties by resort to the law of trusts. A large partnership would be constituted by a deed of settlement containing rules for government of the partnership. A few of the partners named in the deed were appointed trustees to conduct the business of the association on trust for the other partners in accordance with terms set out in the deed: Holdsworth W S, *A History of English Law*, London: Methuen vol 13 (1952), p 368.

The small number of trustees could sue and be sued. Shares in the partnership were transferable. The deed provided that every person to whom a share was transferred would promise to perform all the duties of an investor as laid down in the deed. Transferees of shares agreed to be bound by the deed and signed a supplementary deed. For matters not dealt with in the deed the general law of partnership applied.

The deed provided that stockholders should be liable only to the extent of their contributed capital. That was a dangerous invitation to speculate. It could not save stockholders from liability to third persons. Notwithstanding the provision in the deed, stockholders in a joint stock company were partners and liable as such. From early in the 19th century, when the trustee-partners made contracts they attained a form of limited liability: they stipulated in each contract that the other party would look for recovery only to the partnership property and not the personal assets of stockholders. This practice begun by insurance companies was taken up by trading companies: Du Bois, *The English Business Company after the Bubble Act 1720–1800*, New York (1938) p 223. Compare s 526 of the Corporations Act.

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The result was later described by James LJ in *Re Agriculturist Cattle Insurance Co (Baird's case)* (1870) LR 5 Ch App 725 at 734:

> There were large societies on which the sun of royal or legislative favour did not shine, and as to whom the whole desire of the association, and the whole aim of the ablest legal assistance they could obtain was to make them as nearly a corporation as possible, with continuous existence, with transmissible and transferable stock, but without any individual right in any associate to bind the other associates, or to deal with the assets of the association.

The "Bubble Act" lay dormant until a boom in 1805 prompted recourse to its provisions in several prosecutions. But because the deed-of-settlement company was seen to serve the economic needs of the country's burgeoning industrial expansion the Act could not be applied rigorously and by 1811 it was held that it should not apply to a company whose objects were not prejudicial to the public interest: *R v Webb* (1811) 14 East 405; 104 ER 658.

The "Bubble Act" was repealed in 1825 and the deed-of-settlement company continued to flourish. Some joint stock companies, notably public utilities such as canal, railway, waterworks and gas companies, sought incorporation by private Act. They usually desired not only the benefits of incorporation but also special powers, such as the power to acquire land compulsorily. In some cases there was no grant of incorporation but the company was empowered to sue or be sued in the name of an officer. Attempts were made to provide incorporation for other types of company by the Bubble Repeal Act 1825 and the Letters Patent Act 1834. They were not successful since they still treated incorporation as a privilege to be specially granted rather than something to be obtained as of right.

The Board of Trade commissioned a barrister, Bellenden Ker, to report on the law of partnership. He proposed the establishment of a registration system of partnerships and joint stock companies and suggested that all partnerships consisting of more than 15 members should be illegal unless formed by registered deed of settlement. The latter suggestion is the inspiration for the current provision against outsize partnerships now in s 115 of the Corporations Act: see [1.240].

[2.130] Incorporation by registration

The Act that was passed after Ker's report, the Chartered Companies Act 1837, clung to the idea that incorporation should be a specially granted privilege and few deed-of-settlement companies sought registration. In 1841 a select committee was set up to inquire into the law about joint stock companies.

In 1844, its chairman, Gladstone, furnished its report and the outcome was the Joint Stock Companies Registration and Regulation Act 1844 which took over the deed-of-settlement company and made it a statutory incorporated creature generally available on presentation to the Registrar of Joint Stock Companies of prescribed papers and payment of certain fees.

The 1844 Act is the legislative ancestor of modern company law. Registration under the 1844 Act was in two stages. On applicants filing prescribed particulars about the company the Registrar issued a certificate of provisional registration. This did not form the company. To obtain complete incorporation a deed-of-settlement company had to be formed. The deed could be filed with the Registrar only after it had been completed by one-fourth of the subscribers covering one-fourth of the shares which it was planned that the company should issue. The deed of settlement did not differ greatly in form from that which had evolved before the 1844 Act. It was the repository of the rules for the internal government of the company.

It has been argued that the main thrust of the 1844 Act was not so much to confer the privilege of incorporation but rather to ensure that potential investors and creditors would be able to obtain information from a public source about commercial enterprises in which there were more than 25 associated persons: Stoljar S J, *Groups and Entities*, Canberra: ANU Press (1973), pp 99–100. Later legislation reduced the threshold to 20 persons.

A system of general incorporation with no sustained examination by the government of the merits of the enterprise came earlier in the United States than in England.[1] In the 18th century, shortly after the American Revolution, incorporation in America involved obtaining a charter from the state legislature. This was granted with standard corporate attributes. The rejection of monarchical power to grant charters was taken to imply equality of rights to incorporation. Eventually the notion of freedom of incorporation led to the enactment of general incorporation laws under which legal personality could, in most states, be obtained simply by filing appropriate papers with an executive official, the Secretary of State in the particular jurisdiction.[2]

Thus American business corporations are descendants of the chartered corporation. English registered companies, on the other hand, are not simply chartered corporations created another way. They are descended from the unincorporated joint stock company, an association having some of the features of a large partnership but with features from the chartered corporation added to the joint stock company. These differences in development explain the difference in terminology whereby what in Britain, Australia, New Zealand, Singapore, Malaysia, South Africa and Hong Kong has been called a company is in the United States termed a corporation.

Notes

1. On contrasts between British and American corporation law, see Gower (1956) 69 *HLR* 1369.
2. The first general incorporation Act in a common law jurisdiction was an Act of New York state of 1811.

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[2.140] Introduction of limited liability

Incorporation does not necessarily imply that the members of the corporation are free from personal liability for the debts of the corporation. The 1844 Act did not exclude the personal liability of members for company debts but creditors had to exhaust their remedies against the company first. The granting of incorporation by the interposing of an entity between shareholders and the company's creditors facilitated the granting of limited liability once the community was ready to concede it.

The financing of the new railways needing large amounts of capital engendered a climate of thought favourable to limited liability. The Limited Liability Act 1855 (UK) gave corporators the option of forming a company on the principle that the liability of the members would be limited to what they agreed to contribute to the company.

That obviated the need to stipulate in each contract made by the company that the other party would look only to the funds of the company.

[2.150] Later developments in the United Kingdom

The ultimate outcome, after almost 20 years of reform following the 1844 Act, was the consolidation of English company law in the Companies Act 1862. Despite

subsequent amending and consolidating Acts many of the fundamental features of company law in British Commonwealth jurisdictions, including the Corporations Act, can be traced back to the Act of 1862. During the century after the 1862 Act, company law reform in the United Kingdom generally proceeded on the recommendations of special committees established by governments from time to time (such as the Greene Committee (1926 Cmnd 2657), the Cohen Committee (1945 Cmd 6659), and the Jenkins Committee (1962 Cmnd 1749). These reforms were usually adopted by the Australian states. The United Kingdom, by entering the European Economic Community as from 1 January 1973, became obliged to bring its company law and other commercial law into harmony with that of other countries in the Community. In many respects, United Kingdom companies legislation is today becoming divergent from the model which the United Kingdom provided for its colonies.

In 2006 the UK Parliament enacted a massive Companies Act, designed to reform and re-state the whole of UK statutory company law. The Act was based on reports of the Law Commission of England and Wales and by a specialist committee set up by the Department of Trade and Industry.

[2.160] Equity's influence on company law

The Court of Chancery was for long the court for judicial administration of company law. Its connection with company law went back to the 18th century when, in the absence of legislation allowing easy incorporation, the trust was employed in "deed-of-settlement companies". After the Companies Act 1862 the Court of Chancery continued in that role. Following the Judicature Acts 1873–1875 the Chancery Division succeeded to the work.

Chancery in dealing with company law matters applied many doctrines of equity. For example, in formulating the fiduciary responsibilities of directors: see Chapters 8 and 9. It also followed equitable procedures, as in the winding up of a company. Winding up involves administration of the company's assets with a view to payment of creditors and distribution of any surplus to members. This was only another example of Chancery's jurisdiction to administer estates, the others being administration of the estates of deceased persons, general administrations of trust estates where trustees were in serious breach of their duties, contested dissolutions of partnerships and administration of estates of individuals declared bankrupt.

All of these were in Chancery's jurisdiction because it had developed better procedures for taking accounts than were available in the common law courts. However, by the early 19th century Chancery's administration procedures were in the woeful state depicted in Dickens' novel *Bleak House*. Legislation abolished abuses and the better aspects of judicial administration survived. Jurisdiction in bankruptcy of natural persons passed to a specialised court but windings up of companies, both insolvent and solvent, remained with courts of equity.

Even today when the Federal Court or a Supreme Court (see [3.330]) orders that a company be wound up it is the court that administers the winding up through the insolvency practitioner (qualified as a registered official liquidator) whom it appoints as liquidator and whom it treats as an officer of the court.

Equity influenced company law in Australia, particularly in New South Wales, which did not fully adopt the Judicature Acts until 1972. In that state most company cases still go to the Equity Division of the Supreme Court of New South Wales where there is a specialist Corporations List conducted every weekday.

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The evolution of Australian company law

[2.170] Moves from colonial (and later, state) legislation to the current national law

Before federation in 1901 each Australian colony had companies legislation based on the Companies Act 1862 (UK). Victoria was responsible for some notable innovations. A new form of mining company, the no liability company, was introduced in 1871. In 1896 compulsory audit and annual presentation of financial statements were required by legislation following spectacular company failures in the land boom. The Davey Committee in England had in 1895 recommended similar measures. The controls introduced by Victoria were regarded as the strictest in the British Empire: Waugh J, "Company Law and the Crash of the 1890s in Victoria" (1992) 15 *UNSWLJ* 356. The new requirements applied only to public companies and it was necessary to define the companies which were exempted. These were called "proprietary companies". This special type of company is discussed in Chapter 5.

McQueen R, "Limited Liability Company Legislation — The Australian Experience" (1991) 1 *Aust Jnl of Corp Law* 22 maps the evolution of company law in the Australian colonies. For the period 1901–1961 see McQueen R, "An Examination of Australian Corporate Law and Regulation 1901–1961" (1992) 15 *UNSWLJ* 1. See also Lipton P, "A History of Company Law in Colonial Australia: Economic Development and Legal Evolution" (2007) 31 *MULR* 8 and McQueen, R, *A Social History of Company Law: Great Britain and the Australian Colonies 1854–1920*, Ashgate, 2009.

When on 1 January 1901 the Australian colonies became states sharing legislative power with the new central Commonwealth they continued to be responsible for companies legislation. The new Commonwealth Constitution's grant of limited legislative powers to the Commonwealth Parliament did not include plenary power to legislate with respect to corporations. See generally Corcoran S, "Corporate Law and the Australian Corporation: A History of Section 51(xx) of the Australian Constitution" (1994) 15 *Jnl of Legal History* 131.

By the 1960s there were calls from commercial interests for companies legislation to be made uniform across Australia.

[2.170.3] The 1961–62 cooperative regime

In 1961 the Australian states first enacted uniform companies legislation. Coming into force in 1962, that regime was administered by state regulatory bodies, later overseen by the Interstate Corporate Affairs Commission made up of law ministers of the participating states. In the following years the state bodies evolved from being merely registrars responsible for incorporations and maintaining public records about companies to assuming an active role in the supervision of companies and stock markets. That evolution was in response to growing community concerns that companies which raised funds from the investing public should provide adequate disclosure and that stock markets should be free of abuses. Many reforms (for example, in the fields of takeover regulation and disclosure of substantial holdings) were made after recommendations of the "Eggleston Committee" (Standing Committee of Attorneys-General), which carried out its work in the period 1967–1971.

See generally, Sawer G, "Federal–State Co-operation in Law Reform: Lessons of the Australian Uniform Companies Act" (1963) 4 *MULR* 238 and Barrett R I, "Towards Harmonised Company Legislation — 'Are We There Yet'?" (2012) 40 *Federal Law Review* 141.

For further discussion, see Mees B and Ramsay I, "Corporate Regulators in Australia (1961–2000): From Companies' Registrars to ASIC" (2008) 22 *AJCL* 212.

[2.170.6] The 1981 cooperative scheme

In 1981 the 1961–62 regime was replaced when the Commonwealth, relying on its undoubted constitutional plenary power under s 122 of the Commonwealth Constitution to make company law for the Australian Capital Territory, became a participant with the states and the Northern Territory in the enactment of new uniform legislation. The Commonwealth Parliament enacted the Companies Act 1981 and each state passed a so-called Companies Code which was broadly uniform with the Commonwealth's Act. A Ministerial Council for Companies and Securities comprising relevant Commonwealth and state ministers supervised the scheme's operation. The Commonwealth established the National Companies and Securities Commission (NCSC) to work in cooperation with state regulatory bodies.

[2.170.9] The Commonwealth's unilateral bid for sole control

The Commonwealth perceived defects in the 1981 cooperative scheme and sought to assume sole responsibility for company law. Believing that it possessed the necessary constitutional power, the Commonwealth legislated independently of the states to introduce a national scheme of regulation in the Corporations Act 1989 (Cth). The Commonwealth also legislated to establish the Australian Securities Commission to replace the NCSC. The Commonwealth's belief in the width of its power proved to be unfounded. The High Court in *NSW v Commonwealth* (1990) 169 CLR 482 held that it lacked power to make laws about the incorporation of companies generally.

[2.170.12] The 1991 cooperative scheme

The Commonwealth, the states and the Northern Territory enacted new cooperative legislation. Instead of each state and the Northern Territory passing comprehensive and uniform Acts the new scheme involved, among other things:

- the Commonwealth amending the failed Corporations Act 1989 to make it the law for the Australian Capital Territory designated "the Corporations Law";
- the Commonwealth amending the legislation establishing the Australian Securities Commission to authorise it to exercise powers conferred by legislation of the states and the Northern Territory;
- each state and the Northern Territory enacting a Corporations Act which, among other things, adopted the Corporations Law to be its Corporations Law;
- cross-vesting jurisdiction in corporations law matters in the Federal Court of Australia and state Supreme courts; and
- treating offences against state and Northern Territory Corporation Laws as if they were offences against Commonwealth law and empowering Commonwealth officers and institutions to act under grants of power from the states and the Northern Territory so that there would not be divided administration.

The new regime operated from 1 January 1991. The scheme sustained two set-backs. First, the High Court held that the cross-vesting of jurisdiction was unconstitutional to the extent that it purported to confer jurisdiction on the Federal Court of Australia with respect to matters under the Corporations Law of a state: *Re Wakim; Ex parte McNally* (1999) 198 CLR 511. Secondly, the High Court in *R v Hughes* (2000) 202 CLR 535 in a strict view of the federal nature of the Constitution appeared to cast doubt on the validity of the scheme in so far as it involved states purporting to confer powers on Commonwealth officers.

Re Wakim; Ex parte McNally and *R v Hughes* prompted moves for the Commonwealth Parliament to re-enact corporations and financial markets law on the firmer constitutional basis of uniform references by each state to the Commonwealth of corporations and cognate matters. Those references would enlarge the Commonwealth's legislative power in the manner contemplated by s 51(xxxvii) of the Commonwealth Constitution which empowers the Commonwealth Parliament to make laws with respect to matters referred by a state. The more radical remedy of seeking to enlarge the Commonwealth's powers at a constitutional referendum was considered impracticable as involving unwanted delay and as being problematical as to outcome.

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[2.170.15] Cooperation by state referral of corporations matters to the Commonwealth Parliament

Ultimately all states agreed to refer corporations and related matters to the Commonwealth to enable the Commonwealth to enact the current Corporations Act 2001 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth), both Acts relying to a large extent on s 51(xxxvii) of the Commonwealth Constitution. This new legislation operated from 15 July 2001.

The position arrived at under the current scheme is not quite the same as if the Constitution had given the Commonwealth plenary power over corporations and financial markets. A referral by a state is revocable.

[2.170.18] Recent Australian reforms

Within the last 25 years there have been some fundamentally important reforms to Australian statutory company law. A process of simplification of legislation, carried out during the period from 1994 to 1996, led to the enactment of the First Corporate Law Simplification Act 1995 (Cth), which simplified the register requirements and share buyback provisions and re-defined the concept of a proprietary company. The Company Law Review Act 1998 (Cth), though enacted after a change of government, reflected previous work on the simplification of basic company law provisions. For example, the old memorandum and articles of association and "Table A" articles were replaced by the concept of a corporate constitution and "replaceable rules". The law concerning share capital and its maintenance was overhauled in basic ways, for example by removing the concept of par value and permitting a reduction of capital without the need for court approval. Concurrently, the Managed Investments Act 1998 (Cth) introduced a new regime for the regulation of collective investment schemes.

Beginning in 1996 and continuing to the present time, after the transfer of responsibility for corporate law reform from the Attorney-General to the Treasurer, the government has undertaken a program of economic reform of company law. The Corporate Law Economic Reform Program Act 1999 (Cth) made important changes to directors' duties (including a statutory business judgment rule) and to

shareholder rights (including a statutory derivative action), and overhauled the fundraising and takeover laws, also reconstituting the Takeovers Panel. The Financial Services Reform Act 2001 (Cth) was enacted as one of many enactments which implemented recommendations of the Wallis Committee, which reviewed the Australian financial services sector in 1998 (see [3.020]). This legislation replaced the old concepts of securities and futures contracts with a much broader concept of "financial products", including derivative instruments of various kinds and insurance-related products. It reconstituted the system of regulation of financial services (including offers of or advice about financial products) and expanded the powers and responsibilities of the Australian Securities and Investments Commission.

The Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth) (CLERP 9 Act) was introduced after the collapse of some large Australian corporate groups including the HIH Insurance Group, and in response to the enactment in the United States of the Sarbanes-Oxley Act 2002 after the financial collapse of the Enron and WorldCom Groups. Amongst many reforms, the CLERP 9 Act introduced strict new requirements for auditor independence and more extensive disclosure obligations for listed companies concerning directors' remuneration, as well as a new penalty notice procedure for contraventions of the continuous disclosure requirements of the Corporations Act.

More recently, the Corporations Amendment (Insolvency) Act 2007 (Cth) enhanced protection for employee entitlements when a company is under voluntary administration and introduced a pooling process in the winding up of related companies. The Corporations Amendment (Improving Accountability on Termination Payments) Act 2009 (Cth) strengthened the regulatory framework for termination payments for directors and executives. The Corporations Amendment (Financial Market Supervision) Act 2010 (Cth) made ASIC responsible for supervising trading on financial markets which have a domestic Australian market licence — such as the Australian Securities Exchange. This was previously the responsibility of the market licensees. The obligation on market licensees to supervise their market was replaced with obligations to have adequate arrangements to operate the market and to monitor and enforce compliance with the market's operating rules. The Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011 (Cth) strengthened the non-binding shareholder vote on the remuneration report by requiring a vote for directors to stand for re-election if they do not adequately address shareholder concerns on remuneration issues over two consecutive years.

For further details about the evolution of Australian company law, see the looseleaf edition of this book [2.170]ff and for discussion of the current scheme, see Ch 3.

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3 Regulating Companies

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[3.010] What is involved in regulating companies?

This chapter is about the relationship of companies, their promoters, directors, managers and members to government and other external regulators.

The main features of regulation of companies in Australia are:

- prescription by the Commonwealth legislature of the conditions for the formation, operation and winding up of companies;
- registration of companies by ASIC;

- maintenance by ASIC of registers open to the public on which significant information about companies and persons connected with them can be entered;
- policing by ASIC of the legislative prescriptions, subject in some instances to direction by the Commonwealth Treasurer;
- exercise by ASIC of discretions conferred on it by the legislature to grant exemptions from prescriptions or to vary them;
- publication by ASIC of information about the exercise of its discretions and its policies and procedures;
- supervision of the winding up of companies, a function allocated to the judiciary, notably the superior courts, as a derivative of the jurisdiction of the Court of Chancery in England to supervise the taking of accounts on the dissolution of partnerships and the administration of bankrupt and other estates.

[3.020] Why is regulation necessary?

Companies, like natural persons, are subject to legal regulation under many compartments of the general law applicable to all legal persons — for example, the law of contract, trade practices law, the law of torts and criminal law.

Companies, whether large public companies or small private companies, raise special legal problems in their relations with other persons. A company, being a creature of law, inevitably attracts more regulation than a natural person. Regulation continues throughout its life until such time as its name is removed from the register of companies and it is dissolved.

[3.020.3] Regulation to provide information

People affected by acts of agents or employees of a company need information about the company. If a company employee negligently causes damage, the person injured may want to know the exact identity of the corporate employer, its financial resources and where legal process can be served upon it in proceedings to make it vicariously liable. A person negotiating a contract with persons who purport to be the board of directors of a company may need assurance that they have been properly appointed directors and have authority to commit the company to the proposed contract.

If regulation were needed only to provide information, the regulatory authority might have to do no more than receive and classify information and make it available to anyone interested. It would need only enough coercive power to ensure provision of the information. That was the position at one time; older cases refer to a "Registrar of Companies" rather than a securities commission.

[3.020.6] Regulation setting standards for corporate governance

Regulation now goes further and sets standards of behaviour for companies, their promoters, directors and managers. The interest of the community requires exclusion from management of companies of persons with records of dishonesty. Standards of fiduciary administration for promoters, directors and managers are needed, particularly where not all members participate in management. Those standards are discussed in Chs 8 and 9.

For listed companies, the standards of corporate governance now go well beyond the personal integrity of directors, and much attention is concentrated on the establishment of structures that will generate "checks and balances" within the

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system of corporate management. Standards with respect to the composition of the board are typically found outside statutory company law, for example in the *Corporate Governance Principles and Recommendations* (3rd edition, 2014) of the ASX Corporate Governance Council. However, the Corporations Act now contains very detailed provisions on such matters as auditor independence and disclosure of directors' remuneration in listed companies, matters that are considered in Ch 11.

[3.020.9] Regulation in capital markets

In corporate fundraising the intangible nature of investment opportunities in companies offered to the investing public allows scope for abusing the trust of less knowledgeable offerees. Hence there are further standards of disclosure required by Ch 6D of the Corporations Act of those who offer company securities. They are treated in Ch 22.

Where the company is listed with the ASX so that its securities may be traded on the Australian stock market, stringent disclosure requirements continue while the company is listed so that securities markets can be informed, efficient and fair. Continuing disclosure is dealt with in Ch 11.

The regulation of fundraising from the public extends in some cases to specifying the structure of the investment opportunity. For example, in general, a company that borrows from the public must arrange the appointment of an independent trustee for debenture-holders to supervise the borrowing company and to ensure that any default by it will not go unnoticed. Those requirements are described in Ch 19.

[3.020.12] Regulation correlative to limited liability

Limited liability companies are subject to more regulation than unlimited companies. That is required in the interests of their creditors. The details of that regulation are discussed later in Ch 20 dealing with the protection of creditors.

[3.020.15] Regulation of the market for corporate control

Some areas of regulation are more controversial than others. In the last 40 years company law in Australia has developed its own peculiar form of close regulation of participants in the market for control of companies. Chapter 6 of the Corporations Act contains much detailed "black letter" law imposing restrictions on bidders in takeovers and incumbent directors of target companies. The restrictions exist for the benefit of shareholders in target companies who are not near the action and who may be misled into disposing of their shares without adequate time for deliberation, without adequate information and at a price which does not give them a share of any premium for control which the bidder is prepared to pay holders of large blocks of shares. That last requirement of equality of opportunity is particularly controversial. The regulation of takeovers is described in Ch 23.

[3.020.18] Regulation of the securities industry

Regulation extends beyond companies to the market in which their securities are traded. There is a measure of regulation of securities markets conducted by securities exchanges. Persons in the business of dealing in securities are required to be licensed subject to conditions. For example, one condition looks to the adequacy of their capital. Standards of honest trading for all persons dealing, such as the prohibitions of market manipulation and insider trading, are set in CA Pt 7.10 to promote confidence in the honesty, efficiency and fairness of Australian securities markets. Those who provide advice to investors in securities are also required to be

licensed. They are subject to regulation under the Corporations Act (which, for example, imposes disclosure requirements on those who provide financial services (Pt 7.7)), as well as by ASIC under licence conditions. The regulation of the securities industry was substantially changed upon the enactment of the Financial Services Reform Act 2001, most of which commenced on 11 March 2002.

The FSR Act expanded the pattern of regulation of securities markets and those who carry on a financial services business, by subsuming the regulatory requirements for the securities industry (and also the futures industry) into a broader regulatory regime covering financial services and financial products. The new regulatory regime extends beyond securities and futures contracts to other derivatives, general and life insurance, superannuation, and certain deposit accounts and non-cash payments.

This publication is devoted mainly to regulation of companies rather than regulation of the securities industry or the financial services industry.

[3.020.21] Regulation of the financial sector

Australian investors today have many choices. In addition to direct investments in shares or debentures or listed unit trusts, they may invest in other market-traded securities such as options traded on the Australian Options Market and warrants traded on the ASX's market. They may invest in markets which do not deal in securities: most notably, currency and commodity markets and markets which trade commodity and financial futures, such as the futures market of the Sydney Futures Exchange (which is part of ASX as a result of a merger in 2006). They have access to similar securities and futures markets overseas, thanks to financial deregulation and modern methods of communication.

Rather than investing directly in a market, investors frequently prefer, and are sometimes required to use, indirect forms of investment such as managed funds, superannuation funds and life insurance products, or tailor-made option or futures contracts negotiated with a financial institution ("over-the-counter or OTC derivatives").

Comprehensive investment advice would involve assessing the investor's particular circumstances and reviewing all of the alternatives before making a recommendation to suit the investor's situation.

Investors are consumers of investment products and advice. They look to governments for protection of two kinds. First, they expect the investment products, especially products available to "retail" or private investors, to be transparent and supported by appropriate capital and solvency arrangements. Prudential regulation endeavours to respond to this expectation. Second, they expect governments to set standards for the provision of investment advice, and to have recourse if they are victims of fraudulent, misleading or incompetent investment advice.

From the point of view of the investor, many investment products serve the same functional purpose and are, within limits, substitutable, even though they are offered by financial institutions of different types. For example, a retail investor may rationally regard a bank term deposit, a building society or credit union account, a cash management account with an investment bank, an insurance or friendly society bond, and a managed master fund as alternatives to pursue certain kinds of investment objectives. Until 1998, however, the regulatory system for the Australian financial sector was organised on institutional rather than functional lines, with different regulatory systems for the investment products offered by different types of financial institutions. Thus, life insurance companies and their products were

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regulated by the Insurance and Superannuation Commission; banks and their deposit products by the Reserve Bank of Australia; managed investments (including cash management trusts) by ASIC; and building societies, credit unions and friendly societies and their deposit products by the Australian Financial Institutions Commission — in each case, under a different set of separate legislative requirements.

Dissatisfaction with this regulatory structure led the Commonwealth government to establish the Financial Sector Inquiry ("Wallis Committee") in 1996. The Committee reported in March 1997. The Commonwealth government accepted the Committee's main recommendations and enacted the first tranche of implementing legislation with effect from 1 July 1998. The legislation, which amended the Corporations legislation and the legislation which regulates superannuation, banking and life insurance, includes the Australian Prudential Regulation Authority Act 1998, the Financial Sector Reform (Amendments and Transitional Provisions) Act 1998 and the Financial Sector Reform (Consequential Amendments) Act 1998.

Under these arrangements, the Reserve Bank of Australia is responsible for monetary policy, financial system stability and the regulation of the payments system. The Australian Prudential Regulation Authority is responsible for providing prudential regulation for deposit-taking institutions, life and general insurance companies, and superannuation funds. It is also responsible for providing prudential regulation for credit unions, building societies and friendly societies by virtue of state and territory enabling legislation. The Australian Securities and Investments Commission is responsible for:

- corporate regulation;
- the regulation of financial markets, clearing and settlement facilities and compensation schemes;
- the regulation of providers of financial services;
- market integrity and consumer protection functions in connection with bodies which are prudentially regulated by the Australian Prudential Regulation Authority;
- consumer protection functions for the finance sector, previously performed by the Australian Competition and Consumer Commission; and
- oversight and coordination of industry initiatives for consumer protection in the areas of new technology in the financial sector.

Additionally, a Council of Financial Regulators has been established to facilitate the cooperation of the financial regulators.

As previously noted, the main subject of the present publication is the regulation of companies, not the regulation of the financial sector as a whole.

[3.030] Who regulates?

The participants in the Australian system of corporate regulation are:

- the Commonwealth Parliament which by legislation prescribes the standards to be applied to companies and persons connected with them and delegates to the executive branch of government power to prescribe by subordinate legislation;
- the parliaments of the states which have supported the Commonwealth legislation by referring legislative power to the Commonwealth Parliament;

- the executive arm of government acting through a Commonwealth Minister and regulatory authorities, the main one being the Australian Securities and Investments Commission;
- the judiciary, through which the prescriptions of law-makers are interpreted and applied to the facts of particular cases brought before the courts;
- for companies wanting their shares and other securities to be quoted on the stock market conducted by the ASX, that Exchange is a co-regulator with the Australian Securities and Investments Commission in that it prescribes standards for companies admitted to the Official List of the Exchange and reserves power to police those standards; the standards are in the ASX Listing Rules, the ASX Operating Rules and the operating rules of its securities clearing house;
- on matters of company accounting and auditing, the Financial Reporting Council, the Australian Accounting Standards Board and the Auditing and Assurance Standards Board; additionally the professional bodies representing accountants have an influence on the formulation of accounting standards, some of which acquire legal force upon approval by the Australian Accounting Standards Board;
- other extra-legal bodies, such as The Governance Institute of Australia and The Australian Institute of Company Directors, play a part in the setting of standards of corporate behaviour.

Until March 1996 the Commonwealth Minister responsible was the Attorney-General but when the Liberal/National coalition government assumed office in March 1996 it transferred responsibility for legislation on corporations and securities to the Commonwealth Treasurer. That was perceived as playing down legal regulation and giving more scope for economic regulation. That government's emphasis on the economic impact of corporate and financial sector regulation has led to the development of the Corporate Law Economic Reform Program (CLERP). Policy papers were released, dealing with such matters as accounting standards, directors' duties and shareholders' rights, fundraising, takeovers, electronic commerce, financial markets, and the administration of the ASIC Information Division. The first four papers, and part of the fifth, were reflected in the Corporate Law Economic Reform Program Act 1999 (Cth). The sixth paper led to the Financial Services Reform Act 2001, which, commencing 11 March 2002, replaced the former Chs 7 and 8 of the Corporations Act (dealing with the securities industry and the futures industry respectively) with a new Ch 7 dealing more broadly with financial products, financial markets and providers of financial services. The ninth paper led to the enactment of the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth), which deals with a wide variety of "corporate governance" matters including auditor independence, disclosure of directors' remuneration and a system of penalty notices for failure to comply with the continuous disclosure requirements of the Act (see especially the discussions of these matters in Ch 11).

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The national legislation

[3.040] The Corporations Act

In Ch 2 we traced the emergence of national company and securities laws during the period from 1961 to 2001. The history of statutory reform of company law during that period has been very largely a history of attempts to overcome

constitutional limitations upon the Commonwealth's legislative power over corporations. The referral of power made by each state during the year 2001, by their respective Corporations (Commonwealth Powers) Acts, has for the first time given the Commonwealth Parliament ample national power to make laws with respect to the formation of corporations, corporate regulation and the regulation of financial products and services. But the referral of power is subject to some limitations, which are noted at [3.070]. Additionally, the referral of power was made in the context of an intergovernmental reference agreement, which is intended to be replaced, in due course, by a more formal Corporations Agreement between the Commonwealth and each of the states and the Northern Territory. Further restrictions arise out of the intergovernmental agreement: see [3.080].

The Commonwealth has enacted two principal statutes in the exercise of the referred power, the Corporations Act 2001 and the Australian Securities and Investments Commission Act 2001, referred to together as "the Corporations legislation". In addition, provision is made for subordinate legislation.

The Corporations Act replaced the Corporations Law. It comprises over 2200 sections, divided into 30 chapters. The shape and content of the Act is indicated by the subject matter of the chapters: Ch 1 (introductory), Chs 2A to 2P (formation, administration, corporate governance, capital and reporting), Ch 5 (external administration), Ch 5A (deregistration and transfer of registration), Ch 5B (registrable bodies), Ch 5C (managed investment schemes), Ch 5D (licensed trustee companies), Ch 6 (takeovers), Ch 6A (compulsory acquisition), Ch 6B (rights and liabilities in respect of takeovers and compulsory acquisition), Ch 6C (information about ownership of listed entities), Ch 6CA (continuous disclosure), Ch 6D (fundraising), Ch 7 (financial services and markets), Ch 9 (miscellaneous) and Ch 10 (transitional provisions). There is also a small business guide and there are several schedules. The Corporations Regulations 2001 are also a substantial set of provisions.

Unlike the Corporations Law, which operated in each state as state law by virtue of application legislation, the Corporations Act is a direct enactment of the Commonwealth Parliament for the whole of Australia. For the most part, it is identical in content with the Corporations Law, and most of the chapter, part and section numbers have been retained. But the fundamentally different basis of the new law has necessitated some substantive changes to the text of the legislation, and other substantive changes emerge from the new context of law. Thus, it is no longer necessary for the text of the legislation to reflect eight different laws, and therefore (for example) it is unnecessary to make provisions about recognition of companies formed in one state under the laws of the other states and territories. The consequences of replacing a national scheme based upon the exercise of state legislative power with a scheme based upon Commonwealth legislation are explored at [3.090].

The text of the legislation has been changed to reflect constitutional matters such as the separation of powers — for example, under the previous s 1322 (the power of the court to correct irregularities) the court was not to make an order unless it was satisfied that it was in the public interest that the order be made — arguably, a non-judicial criterion. Now the court must not make an order unless it is satisfied that it is "just and equitable" that the order be made. Some constitutional aspects of the new law are discussed at [3.100].

The new context of the legislation, that it is Commonwealth legislation applying nationally, means that general Commonwealth laws dealing with criminal and administrative law and the interpretation of statutes apply without any special application provisions. The breadth of the Commonwealth Parliament's power to legislate extra-territorially has tended to simplify the issues arising out of the extra-territorial scope of the legislation, but at the same time it has been necessary to insert complex new provisions to deal with the possibility that a state might cease to be a referring state. Section 109 of the Constitution would expose some previously and subsequently enacted state legislation to invalidity, but for some elaborate interpretation provisions in Pt 1.1A of the Act.

The strategy underlying the transitional provisions of the new Act is that the Act replaced the Corporations Law on 15 July 2001, and generally did not purport to preserve the old law for transitional matters. However, the Act contains some broad provisions designed to provide for a smooth transition from the old to the new regime: s 1370. For example, s 1383 provides that where court proceedings began under the old law, a new proceeding equivalent to the old proceeding is taken to have been brought under the provision of the Act that corresponds to the relevant old provision; and s 1399 states that things done before the commencement of the Act which have ongoing significance have effect for the purposes of the Act as if they were done under the corresponding provision of the new legislation.

[3.050] The ASIC Act

The Australian Securities and Investments Commission Act 2001 (ASICA) replaced the Australian Securities and Investments Commission Act 1989 (Cth) on 15 July 2001. ASICA continues the corporate existence of the commission (ASICA, s 261) and contains provisions generally identical to the substantive provisions of the 1989 Act, subject to the same kinds of adjustments as have been made in the replacement of the Corporations Law by the Corporations Act.

The 1989 Act was more complicated than ASICA because of the cooperative Commonwealth-state nature of the legislative scheme. The 1989 Act constituted the Commission as a Commonwealth body which received functions and powers through a combination Commonwealth and state legislation under the scheme. The Commonwealth legislation gave the Commission powers and duties in the Australian Capital Territory, and the state and Northern Territory application laws gave the Commission equivalent powers and duties in each state and the Northern Territory. The application laws adopted and applied, as laws of each respective jurisdiction, that part of the 1989 Act that was designated as the "ASIC Law".

Until June 1998 the Commission was called "the Australian Securities Commission" or "the ASC". To reflect its broader responsibility for consumer (investor) protection in the financial sector, the Commission was renamed the "Australian Securities and Investments Commission" or "ASIC" and its powers were expanded by amendments to the 1989 Act, taking effect on 1 July 1998. No new body was created at that time — the Commission merely acquired new powers and a new name.

The 1998 amendments (introduced by the Financial Sector (Consequential Amendments) Act 1998 (Cth)) inserted provisions into the 1989 Act for the regulation of financial services. Those provisions closely followed the consumer protection provisions of Pt V of the former Trade Practices Act 1974 (Cth) (now the Competition and Consumer Act 2010 (Cth)). The same 1998 amending legislation stated that Pt V of the former Trade Practices Act did not apply to the supply or

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possible supply of services that are financial services. In the result, the consumer protection provisions applicable in relation to financial services have thereafter been found in the ASIC Act rather than in the Trade Practices Act. Since the provisions of the two Acts are in virtually identical terms, the only real significance of the change has been to pass the administrative responsibility for consumer protection in relation to financial services from the Australian Competition and Consumer Commission to ASIC. ASICA continues these consumer protection provisions.

While the present publication is about company law and does not set out to explain comprehensively the consumer protection law which applies to financial services, the consumer protection provisions are discussed in Ch 22 (so far as they relate to prospectuses and other disclosure documents) and Ch 23 (as regards takeover documents).

[3.060] The triggers for referral of power by the states

As noted in Ch 2, the movement for a new Commonwealth Corporations Act supported by state referral of power was initiated by the Commonwealth government after some decisions in the High Court of Australia, which found the cross-vesting of jurisdiction under the national scheme to be partly defective, and raised doubts about the constitutional validity of administrative arrangements under which Commonwealth bodies were authorised to exercise powers under state laws.

The Commonwealth, state and territory corporations legislation which comprised the former national scheme contained provisions which cross-vested jurisdiction in Corporations Law matters to the Federal Court of Australia and the Supreme Courts of the states. In *Re Wakim; Ex parte McNally* (1999) 198 CLR 511 the High Court held that this cross-vesting scheme was unconstitutional to the extent that it purported to confer jurisdiction on the Federal Court of Australia with respect to the Corporations Law of a state. The effect of the decision was to deprive the Federal Court (and other federal courts including the Family Court) of jurisdiction in most Corporations Law matters, except where ASIC was a party or there was an occasion for the exercise of accrued jurisdiction.

The constitutional problem identified in *Re Wakim* was not a problem about the corporations legislation or the structure of the national scheme as such, but was a problem about any cross-vesting scheme which purported to confer on federal courts powers arising under state legislation. The High Court's reasoning is equally applicable to the general cross-vesting legislation, the Jurisdiction of Courts (Cross-vesting) Acts 1987 of the Commonwealth and the states. However, the impact of the decision on the adjudication of matters arising under corporations legislation could be removed if the corporations legislation ceased to be state-based and became Commonwealth legislation applying nationally.

The Commonwealth government has not decided against proposing a constitutional amendment to address the *Wakim* problem directly, so as to empower the Commonwealth Parliament to legislate to authorise federal courts to receive jurisdiction from states. However, it regarded referral of power by the states as a practical way of restoring jurisdiction to federal courts in corporations matters, and therefore it set out to persuade the states, eventually successfully, to enact referral of power legislation.

The reasoning of the High Court in *R v Hughes* (2000) 202 CLR 535 appeared to some commentators to cast additional doubt on the efficacy of the former national scheme, and therefore increased the pressure for referral of power by the

states. Under the national scheme, the Commonwealth, each state and the Northern Territory enacted laws which required courts and others to treat the Corporations Law and other applied laws as if they were laws of the Commonwealth. The object was to "federalise" the corporations legislation, simulating the effect that would have been produced if the Commonwealth had been able unilaterally to pass one law for the whole of Australia. So, for example, in matters calling for a criminal procedure or administrative review, the legislation provided for the application of Commonwealth law to the exclusion of the law of the state where the matter arose. Commonwealth bodies such as the Commonwealth Director of Public Prosecutions and ASIC were invested with power by state application legislation and were authorised by Commonwealth legislation to receive and exercise that power.

In *Bond v R* (2000) 201 CLR 213 it was held that the Commonwealth Director of Public Prosecutions did not have the power to institute an appeal against a sentence for offences against the Corporations Law of Western Australia. When carefully analysed, however, the case did not identify any defect in the "federalising" provisions of the national scheme, but was based on a holding that s 17 of the Director of Public Prosecutions Act 1983 (Cth), which empowered the DPP to institute a prosecution under state law, did not extend on its proper construction to the institution of an appeal.

In the *Hughes* case the High Court held that the Commonwealth Director of Public Prosecutions had the power to prosecute offences against the "prescribed interest" provisions of the Corporations Law of Western Australia (see now Ch 5C), in a case where the offence involved international elements, and the court rejected a claim that the provisions purporting to confer that power were not constitutionally valid. But in doing so, the court took the view that Commonwealth law can impose a duty on a Commonwealth officer to act under state law only if the Commonwealth law is supported by a head of constitutional power, such as (in the present case) the trade and commerce or external affairs power. This reasoning suggested that if the issue were to relate solely to an intra-state activity there may be a question about the power of the Commonwealth DPP to deal with it. The reasoning of the court was thought to raise doubts about the breadth of the powers of all Commonwealth authorities and officers with respect to the administration of the Corporations Law — including the powers of ASIC and even the Takeovers Panel, as well as the DPP. Kirby J was particularly critical of the complexity of the national scheme, which he described as an "almost incomprehensible network of federal, state and territory laws", which employed "fiction piled upon fiction". The problems were partly addressed by the Jurisdiction of Courts Legislation Amendment Act 2000 (Cth), but the more general solution was for the Commonwealth to enact corporations legislation as Commonwealth law after the referral of state legislative power.

Thus, fears about the effects of the *Wakim* and *Hughes* cases were the principal stimuli for the referral of state legislative power and the enactment of the Corporations Act and associated legislation in 2001. The legislation enacted in 2001 did not solve the *Wakim* problem, but it prevents the *Wakim* problem arising in corporations matters, because it conferred jurisdiction on federal courts by a Commonwealth enactment, therefore vesting in the courts the judicial power of the Commonwealth based upon the legislative powers of the Commonwealth Parliament (including the power referred by the states).

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The legislation enacted in 2001 removed the *Hughes* problem prospectively because the Commonwealth's conferral of administrative powers on its officers is supported by the state referral of power, and it is therefore not necessary to rely on more limited heads of power such as the trade and commerce or external affairs power. As regards actions by Commonwealth authorities and officers prior to the commencement of the law on 15 July 2001, each state has enacted a State Validation Act (as defined in s 1372 of the Corporations Act) which has the effect of deeming the actions of Commonwealth authorities and officers to have the same force and effect as if they had been carried out by a duly authorised state authority or officer. Additionally, the transitional provisions of the Corporations Act do not preserve the effects of actions by the Commonwealth authorities and officers under the old law, but instead they provide that things done under the old regime have effect as if they were done under corresponding provisions of the new regime: ss 1383 (court proceedings), 1399, 1400, 1401.

[3.070] The referral of power by the states

Each state has enacted a Corporations (Commonwealth Powers) Act 2001 (the Referral Act), for the purpose of referring certain matters relating to corporations and financial products and services to the Parliament of the Commonwealth under s 51(xxxvii) of the Constitution. Section 51(xxxvii) empowers the Commonwealth Parliament to make laws for the peace, order and good government of the Commonwealth with respect to "matters referred to the Parliament of the Commonwealth by the Parliament or Parliaments of any State or States, but so that the law shall extend only to States by whose Parliaments the matter is referred, or which afterwards adopt the law".

To reflect the limitation in s 51(xxxvii) that the Commonwealth law may extend only to states whose parliaments have referred power, s 4 of the Corporations Act introduces the definition of a "referring State". A state is a "referring State" if its parliament has referred the matters specified by s 4 to the Parliament of the Commonwealth in the circumstances specified by s 4. Section 4 specifies the characteristics of the state referral legislation. The Referral Acts of the states have followed closely the specification in s 4, and since all of the states have enacted that legislation, they are all "referring States". If a state ceases to be a referring state (see below), the Corporations Act ceases to apply territorially to that state: see s 5.

Section 51(xxxvii) speaks of the referral of "matters". The Referral Acts refer two matters to the Parliament of the Commonwealth, which are described in both the Referral Acts and s 4 of the Corporations Act as "the initial reference" and "the amendment reference".

The initial reference relates to the "tabled text" of the bills which became the Corporations Act and ASICA. The text of the bills was tabled in each state parliament and the definition of "tabled text" in the Referral Act of each state identifies the text as tabled. The "referred provisions" are defined to mean the tabled text to the extent to which that text deals with matters that are within the legislative competence of the state.

The initial reference is "the matters to which the referred provisions relate, but only to the extent of making laws with respect to those matters by including the referred provisions in Acts enacted in the terms, or substantially in the terms, of the tabled text (including laws containing provisions that authorise the making of

Corporations instruments that affect the operation of the Corporations legislation, otherwise than by express amendment)": Referral Acts, s 4(1)(a); see also Corporations Act, s 4(4).

The "matters" which are the subject of the Corporations Act and ASICA are numerous and varied, and an unqualified reference of those matters would be extremely broad. However, the reference in s 4(1)(a) is limited to enacting laws substantially in the terms of the tabled text. The intention seems to be to make a static referral of power in terms wide enough to cover the initial enactment of the two bills, but to go no further. On this construction, s 4(1)(a) has already done its work, by virtue of the enactment of the Commonwealth legislation pursuant to the referral of power, and is not available as a source of Commonwealth power to amend the legislation as initially enacted by the Commonwealth.

The Corporations Act, like the previous Corporations Law, authorises ASIC to modify, in writing, certain parts of the legislation, either with particularity or by a general class order. The words in brackets in the initial reference appear to make it clear that the referral encompasses the provisions that confer this authority on ASIC.

The amendment reference is "the matters of the formation of corporations, corporate regulation and the regulation of financial products and services, but only to the extent of the making of laws with respect to those matters by making express amendments of the Corporations legislation (including laws inserting or amending provisions that authorise the making of Corporations instruments that affect the operation of the Corporations legislation, otherwise than by express amendment)": Referral Acts, s 4(1)(b); see also Corporations Act, s 4(5).

The categories of matters set out in the amendment reference are not defined, although "corporation" is defined in s 57A of the Corporations Act and "financial products" and "financial service" are defined in ASICA.

This is the dynamic part of the referral of power, and has become the focus of attention whenever amendments to the Corporations legislation are proposed. It permits amendments to the "Corporations legislation", an expression defined in the Referral Acts to mean Commonwealth Acts enacted in the terms, or substantially in the terms, of the tabled text and as in force from time to time. The words "as in force from time to time" permit successive amendments. Provided that each amendment falls within one or more of the categories stated in s 4(1)(b), the amendment reference will permit successive amendments to be made which take the legislation well away from the tabled text.

Only "express amendments" of the Corporations legislation are permitted by the amendment reference. An "express amendment" is defined in the Referral Acts to mean the direct amendment of the text of the Corporations legislation by Commonwealth Acts: see also Corporations Act, s 4(9). It does not include any enactment that will have a substantive effect otherwise than as part of the text of the Corporations legislation.

Both references have effect only to the extent that the matter referred is not included in the legislative powers of the Parliament of the Commonwealth, otherwise than by referral of power: Referral Acts, s 4(2). It is made clear by the Referral Acts that the Commonwealth Parliament may amend or affect the operation of the Corporations legislation by using the legislative powers it has apart from the references: Referral Acts, s 4(4). Thus, by using its own legislative powers (including such powers as it has with respect to industrial relations) the

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Commonwealth Parliament could insert new provisions in the Corporations legislation falling well outside the tabled text and the categories of the amendment reference.

There are two important limitations contained in the Referral Acts. First, s 1(3) declares that nothing in the Act is intended to enable the making of a law pursuant to the amendment reference with the sole or main underlying purpose or object of regulating industrial relations matters: see also Corporations Act, s 4(2). To the extent that the Commonwealth already has legislative power with respect to industrial relations, the Referral Acts do not purport to interfere with the exercise of that power: s 4(4). But to the extent that the Commonwealth would need to rely on a referral of state legislative power in order to legislate with respect to an industrial relations matter, s 1(3) makes it clear that the Referral Acts cannot be relied upon as a source of referred power to do so.

Second, the references, as originally made, had effect only for a limited period, terminating (unless the Governor made a proclamation) on the fifth anniversary of the day of commencement of the Corporations legislation (15 July 2001): Referral Acts, ss 4(5) and 5. Except in South Australia (where the initial referral was for 10 years), the Referral Acts make provision for termination of the references to be deferred to a later date fixed by the Governor by proclamation. During June 2006 the Governor of each state made a proclamation extending the referral to 15 July 2011. On 24 August 2011, the Parliamentary Secretary to the Treasurer announced that all the states had completed the necessary legal formalities to extend the referral to 2016 and on 15 June 2016, the Minister for Small Business and Assistant Treasurer announced a five year extension of the State referrals of corporations' power to the Commonwealth until 15 July 2021. The Governor also has the power to terminate both references, or only the amendment reference, on a day earlier than the prescribed termination day.

If the references were to be terminated at some future time, their termination would not affect the validity of laws that commenced before the termination. Nor, in the case of termination of the amendment reference before the initial reference, would the termination affect laws made under the amendment reference that had not come into operation before the termination: s 5(4). Termination would prevent the Commonwealth Parliament from relying on the terminated reference for the purpose of enacting new laws after the termination took effect.

If a state ceases to be a referring state, the Corporations Act ceases to apply territorially to that state: Corporations Act, ss 4 and 5. A state ceases to be a referring state if the state's initial reference terminates: s 4(6). The state also ceases to be a referring state if its amendment reference terminates (s 4(7)) otherwise than in the circumstances described in s 4(8). Section 4(8) says the state does not cease to be a referring state because of termination of its amendment reference, if the termination takes place at least six months after the Governor's proclamation of termination and the amendment reference of every other state terminates on the same day. This permits the states unanimously to withdraw their authorisation to the Commonwealth to make further amendments to the Corporations Act, provided that six months notice is given, without causing the Corporations Act (as it then stands) to cease to apply.

[3.080] The inter-governmental agreement

The process of referral of power was governed by an intergovernmental reference agreement made on 21 December 2000. That agreement will eventually be revised

to become a new Corporations Agreement, replacing the Corporations Agreement for the former national scheme. The agreement is between the Commonwealth, each state and the Northern Territory. The Northern Territory has not made a referral of power, since it is not a state for constitutional purposes, but it is a party to the intergovernmental agreement and a participant in the administrative arrangements for the Corporations legislation.

Under the agreement ASIC has sole responsibility for the general administration of the Corporations legislation. ASIC is responsible to the Commonwealth Parliament and the relevant Commonwealth minister, and neither the state parliaments and governments nor the Ministerial Council has any power of control or direction over it.

The agreement continues the previous Ministerial Council, comprising a minister representing each party to the agreement. The Commonwealth has agreed not to legislate to repeal or amend the Corporations legislation, or make a regulation under it, unless the Ministerial Council has first been consulted. In most cases, the Commonwealth is not to proceed unless the Ministerial Council has approved the legislative proposal. The approval of at least three state or territory ministers is required, although the Commonwealth is not obliged to proceed just because the Ministerial Council has given its approval.

The approval of the Ministerial Council is not required for legislation relating to specified matters concerning the regulation of financial products and services, such as provisions regulating managed investment schemes, takeovers, fundraising, the securities and futures industries. Although the Commonwealth does not need to obtain the approval of the Ministerial Council for legislation in these areas, the agreement permits four or more state ministers to convene a meeting of the Ministerial Council to discuss the legislative proposal, and if four or more state ministers vote against the amendment at that meeting, the Commonwealth must not pursue it.

The agreement preserves previously existing arrangements with respect to legislation governing corporations established under state or territory statutes, such as cooperative societies and unincorporated associations (excluding building societies, credit unions and friendly societies which had come to be regulated under the Corporations Law). By the agreement, the Commonwealth undertakes not to introduce any bill that depends, wholly or in part, on a state referral of power, for the purpose of regulating industrial relations, the environment, or any other matter declared unanimously by the Ministerial Council to be a matter to which the Commonwealth's undertaking relates. The Commonwealth also agrees not to introduce a bill that depends wholly or in part on a state referral of power, the purpose of requiring persons or unincorporated bodies to adopt a corporate structure (and so, for example, the Commonwealth cannot legislate to require professions to incorporate), though the Commonwealth is permitted to legislate to prohibit the formation of partnerships or associations consisting of more than 20 members.

[3.090] Some consequences of replacing state Corporations laws with a Commonwealth Corporations Act

The Corporations Act is a single enactment of the Commonwealth Parliament, replacing the eight Corporations Laws of the states and territories. The Corporations Law operated as a national law by virtue of legislative devices of three kinds. In the first place, there were provisions in the Corporations Law of each

jurisdiction which recognised companies incorporated under the Corporations Law of each other jurisdiction (the "corresponding laws"). Companies incorporated under a corresponding law were called "recognised companies", and in general they were treated as equivalent to locally incorporated companies.

Many of the provisions of the Corporations Act apply to or in respect of a "company", defined in s 9 to mean a company registered under the Corporations Act. That will, of course, include companies formed after the commencement of the Act by following the registration procedure set out in Ch 2A. Additionally, companies registered under the Corporations Law fall within the definition of "company" under the Corporations Act because of s 1378(1), which says that the registration of a company registered under the old Corporations Law of a state or territory has effect as if it were a registration of the company under the Corporations Act. This provision is declared by s 1378(3) not to have the effect of creating the company as a new legal entity, but rather to have the effect of continuing the existence of the legal entity that is the company, with the same characteristics and attributes as it had immediately before the commencement. Subsection 1378(3) specifically asserts that the date of the company's first registration remains the same, and a new certificate of registration does not need to be issued. State or territory law may provide that a body is taken to be registered under the Corporations legislation, by following the procedure in s 5H.

For certain purposes (for example, the application of some state revenue laws such as stamp duty laws) it may be important to attribute a domicile or location to a company within a particular state or territory. Section 119A says that companies are incorporated in Australia, but they are taken to be registered in the state or territory specified in the application for registration of the company. Provision is made for a company to change the state or territory in which it is taken to be registered with the consent of the relevant Minister of that state or territory, or in cases where the state in which the company is taken to be registered ceases to be a referring state: s 119A(3). Section 1378(4) says, in the case of companies first registered under the old Corporations Law, that the state or territory in which the company is taken to be registered is the state or territory under whose old Corporations Law the company was registered immediately before the commencement of the Corporations Act. But that state or territory can be changed in the manner specified by s 119A(3).

The second legislative device used to make the Corporations Law operate as a national law, was a set of provisions about offences committed in more than one state or territory. Those provisions dealt with offences partly in one jurisdiction and partly in another, reciprocity in respect of offences committed another jurisdiction, and avoidance of double criminal liability and double recovery: see the old ss 1310A, 1310B, 1313A, 1313B and 1313C. Those provisions are not necessary now that the legislation is a Commonwealth law applying as such in every state and territory.

However, it is still necessary to deal with the geographical jurisdiction of state and territory courts in criminal matters, where federal courts have no jurisdiction. Thus, s 1338B limits the jurisdiction of state and territory courts, in relation to trial and conviction on indictment, to offences against the Corporations legislation committed outside Australia or committed, begun and completed in the relevant state or territory. Jurisdiction in respect of summary conviction is not so limited, but the court may decline to exercise its jurisdiction if the offence is committed in another state or territory.

Third, there were provisions in the Corporations Act 1989 (Cth) and the state application legislation which were intended to "federalise" the administration of the Corporations Law by authorising Commonwealth authorities and officers (such as the Director of Public Prosecutions and ASIC) to administer the system, applying Commonwealth adjectival legislation such as Commonwealth statutory administrative law, and conferring jurisdiction on federal courts. All these legislative devices have become unnecessary by virtue of the simple fact that the Corporations Act now depends for its constitutional validity on the powers of the Commonwealth Parliament (including referred powers), whereas the Corporations Law depended for its constitutional validity on the constitutional powers of the parliaments of the states.

Since the Corporations Act is a Commonwealth statute, the Commonwealth's adjectival laws, including its statutory criminal and administrative laws, have direct application. Thus, the Corporations Act is subject to the Criminal Code and to the constitutional guarantee of jury trial (Constitution, s 80). Various provisions of the Crimes Act 1914 (Cth) have direct application. The Administrative Decisions (Judicial Review) Act 1975, the Freedom of Information Act 1982, the Ombudsman Act 1976 and the Privacy Act 1988 all have potential application to ASIC decisions. For the purposes of the Administrative Appeals Tribunal Act 1975, the Tribunal is authorised by Pt 9.4A of the Corporations Act to review certain decisions of ASIC and other bodies.

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[3.090.3] Interpretation and territorial reach

It is no longer necessary for the Corporations legislation to contain its own interpretation code, because the Corporations Act is a Commonwealth enactment to which the Commonwealth's interpretation legislation, the Acts Interpretation Act 1901, applies directly. Since, however, interpretation provisions may substantially affect the meaning of an enactment, and the Corporations Act depends upon referrals of power by the states, special arrangements are in place to prevent amendments to the Acts Interpretation Act from automatically applying to the Corporations legislation: see s 5C.

Uniform judicial interpretation of the corporations legislation is highly desirable, to deliver legal certainty to the Australian commercial community. Consistent interpretation remains an important goal under the Corporations Act, just as it was under the Corporations Law. Speaking of the former state-based law, the High Court in *ASC v Marlborough Gold Mines Ltd* (1993) 177 CLR 485; 10 ACSR 230 at 232 said:

> Although the considerations applying are somewhat different from those applying in the case of Commonwealth legislation [no longer so, of course], uniformity of decision in the interpretation of uniform national legislation such as the [Corporations] Law is a sufficiently important consideration to require that an intermediate appellate court — and all the more so a single judge — should not depart from an interpretation placed on such legislation by another Australian intermediate appellate court unless convinced that that interpretation is plainly wrong.

See also *Re Kakadu Resources Ltd* [1992] 2 VR 610 at 612.

Since the Federal Court of Australia and the Supreme Courts of the States have concurrent jurisdiction over most matters arising under the Corporations Act, these observations require that in normal circumstances, the Full Federal Court should follow State Court of Appeal/Full Court judgments, and State Courts of Appeal/Full Courts should follow Full Federal Court judgments and the judgments

of other State Courts of Appeal/Full Courts. Single judges of all these courts should follow Appeal Court judgments of any Australian Court of Appeal or Full Court.

When the Corporations legislation was a national scheme of state-based legislation, difficult questions arose as to the competence of each state parliament to enact laws applying in another state or outside Australia. Now that the Corporations Act is a Commonwealth law, the question of legislative power is more straightforward. The Corporations Act relies upon the external affairs power (Constitution, s 51(xxix)) and all other available legislative powers: s 3 (3). The Commonwealth's power when legislating in the exercise of the external affairs power is "not less in scope than the power of the parliament of the United Kingdom with respect to such matters": *Polyukhovich v Commonwealth* (1990) 172 CLR 501 at 530 per Mason CJ. Hence the Commonwealth can constitutionally legislate to apply its law to any acts, matters and things outside Australia regardless of whether they are connected with Australia.

However, having the constitutional power to legislate with extra-territorial effect does not ensure that the Commonwealth Parliament will successfully legislate extra-territorially. There is a question of construction, namely whether the parliament has demonstrated an intention to exercise its plenary legislative power extra-territorially.

Section 5(3) declares that each provision of the Act applies in "this jurisdiction". "This jurisdiction" is defined to consist of the whole of Australia if all of the states are referring states (as they are): s 5(2). Each provision of the Act is also declared to apply, according to its tenor, in relation to acts and omissions outside this jurisdiction: s 5(4). The words "according to its tenor" draw attention to the interpretation of the particular provisions concerned. For example, s 1042B states that the insider trading provisions apply to acts and omissions outside this jurisdiction in relation to financial products issued by entities that carry on business in this jurisdiction, or bodies corporate formed in this jurisdiction. Section 700(4) applies the fund-raising provisions to offers of securities received in Australia regardless of where any resulting issue, sale or transfer occurs.

For more detailed discussion of extra-territorial application of the Corporations Act, see [3.094] in the looseleaf edition of this book.

[3.100] Constitutional aspects of the Corporations Act

[3.100.3] Application to Crown

The Corporations Act purports to bind the Crown in right of the Commonwealth, and to a more limited extent the Crown in right of the states and territories, in the manner stated in s 5A.

Chapter 5 (except Pt 5.8) of the Corporations Act binds the Crown in right of the Commonwealth, and each of the states, of the Australian Capital Territory, of the Northern Territory and of Norfolk Island: s 5A(2). Chapter 5 deals with external administration of companies — schemes of arrangement, receiverships, administration and winding up. Part 5.8 deals with offences. Chapters 6, 6A, 6B, 6C and 6D (takeovers, compulsory acquisitions, information about substantial shareholdings, and fundraising) bind the Crown in right of the Commonwealth but do not bind the Crown in right of any state or territory: s 5A(3). Chapter 7 (the financial services industry) does not bind the Crown in right of the Commonwealth, or of any state or territory: s 5A(4). Nothing in the Corporations Act renders the Crown in any right liable to be prosecuted for an offence: s 5A(5).

Presumably part of the constitutional basis for the Commonwealth legislating to bind the Crown in right of the states is that the state legislatures, which had previously purported to bind the Crown in right of each state to the same extent under the former national scheme, have expressly referred to the Commonwealth Parliament the power to legislate in terms of s 5A.

[3.100.6] Separation of powers

Courts determining matters under the Corporations legislation exercise the judicial power of the Commonwealth, whereas courts acting under the Corporations Law exercised, by and large, judicial power under state law. The doctrine of separation of powers "operates in full vigour" with respect to judicial power, demanding a strict separation between the judicial power of the Commonwealth, on the one hand, and legislative and executive powers, on the other hand: Moens G and Trone J, *Lumb & Moens' The Constitution of the Commonwealth of Australia Annotated* (6th ed), 2001, p 230. This has led to the revision of some provisions in which, it was thought, the distinction was less than clear.

Thus, powers vested in a non-court have been made more clearly administrative. For example, ASIC has the power to disqualify a person from managing corporations for up to five years: s 206F. Section 206F(2)(b) of the Corporations Act differs from its predecessor in the Corporations Law by authorising ASIC to have regard to whether the disqualification would be in the public interest — evidently, a consideration typical of administrative rather than judicial powers. In *Visnic v ASIC* (2007) 231 CLR 381, the High Court held that ASIC does not exercise the judicial power of the Commonwealth when it acts under s 206F.

Conversely, provisions that may have conferred too wide a discretion on the courts, creating a risk that the relevant power may not be a judicial power, have been revised. Thus, in s 422 (which authorises the court to direct a receiver to lodge a report in certain circumstances), the court's power under the Corporations Law to act on its own motion has been removed by the Corporations Act. Similar changes may be found in s 438D(3), dealing with the power of the court to order an administrator to lodge a report, and in s 533(3), dealing with the power of the court to order a liquidator to lodge a report. These changes, small in themselves, seem to imply a revision of the role of the court in the external administration of companies. The court's previously supervisory role has become a strictly judicial one.

Outside the field of external administration of companies, the court's discretion has also been restricted. Section 1322(6) of the Corporations Law required the court to be satisfied that it was in the public interest that the order be made, before it made any order under the section, curing an irregularity in a meeting or procedure. Now s 1322(6) no longer requires the court to be satisfied of the public interest, but insists that the court be satisfied that it is "just and equitable that the order be made".

[3.100.9] Acquisition on just terms

At various points the Corporations Act, like its predecessor, makes provisions which permit property to be compulsorily acquired, directly or indirectly. For example, a compulsory acquisition of property such as company shares may occur under a scheme of arrangement, a selective reduction of capital, or under the statutory provisions providing for compulsory acquisition after a takeover or by a 90% holder: see, generally, Ch 24.

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9 Conflicts of Interest and Special Cases

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Introduction

[9.010] Conflicts of interest: nature of the directors' duties

This is the second of two chapters on directors' duties. In the last chapter the positive or affirmative side of fiduciary responsibilities was explored — the duties to

act in good faith in the best interests of the company, for proper purposes and with care. Many of the duties considered in the last chapter arise for consideration when directors are making a decision as a board, rather than individually.

In this chapter duties which, though cast in negative terms, lie in the heartland of fiduciary responsibility are discussed. Though they sometimes refer affirmatively to the duty of loyalty, Australian courts generally formulate the fiduciary's duties in terms of avoidance of conflicts of interest. The rules concerning conflicts of interest typically arise for consideration when an individual director proposes to exploit an opportunity personally, or for the benefit of someone other than the company.

In the introductory part of this chapter is presented the overall shape of the fiduciary doctrine in its application to corporate matters. In the remainder of the chapter we shall look more closely at the application of the fiduciary rules to corporate circumstances, and explore the key statutory provisions.

The principle about conflicts of interest flows directly from classifying company directors as fiduciaries. The central idea in a fiduciary relationship is service of another's interests. A fiduciary relationship arises where one party is entitled to expect that the other will act in the first party's interests or in their joint interests, to the exclusion of the second party's separate interests.[1] The duty to serve another's interests implies that fiduciaries must avoid placing themselves in a position in which they will be tempted to prefer their own interests or the interests of someone other than their principal.

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The fiduciary is free to proceed so long as he or she has the principal's fully informed consent. Since the fiduciary can obtain exoneration in this way, fiduciary doctrine is sometimes presented as a doctrine about disclosure. In the insider trading context, United States cases talk about the "disclose or abstain" rule: *In the Matter of Cady, Roberts & Co* (1961) 40 SEC 907.

The fiduciary idea is easy enough to explain in general terms but very difficult to apply to concrete facts. There is a sense in which "[t]he fiduciary relationship is a concept in search of a principle".[2] Sir Frederick Jordan's observation, cited by both Deane and Mason JJ in *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41; 55 ALR 417; 4 IPR 291 is still relevant:[3]

> It has often been said that a person who occupies a fiduciary position ought to avoid placing himself in a position in which his duty and his interest, or two different fiduciary duties, conflict. This is rather a counsel of prudence than a rule of equity; the rule being that a fiduciary must not take advantage of such a conflict if it arises.

Notes

1. See P D Finn, "Fiduciary Law and the Modern Commercial World", in E McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations* (1992), p 9.
2. Sir Anthony Mason, "Themes and Prospects", in Finn P D (ed), *Essays in Equity* (1985) p 246.
3. Jordan F, *Chapters on Equity in New South Wales* (6th ed, 1947) p 115; reproduced in *Jordan: Select Legal Papers* (1983).

[9.020] The fiduciary rules

Given the breadth of the fiduciary doctrine,[1] it is necessary to identify the more specific legal principles and sub-rules which bridge the gap between the "counsel of prudence" and the determination of particular cases. Analysis of the case law suggests that equity recognises the following principal rules:[2]

- company directors must not, in any matter falling within the scope of their service, have a personal interest or inconsistent engagement with a third party, except with the company's fully informed consent (*the conflict rule*) (see [9.057]ff);
- company directors must not misuse their position for their own or a third party's possible advantage, except with the company's fully informed consent, and therefore they must account to the company for any gain which they make in connection with their fiduciary office (*the profit rule*) (see [9.220]ff);
- company directors must not misappropriate the company's property for their own or a third party's benefit (*the misappropriation rule*) (see [9.200]ff).[3]

These three rules are conceptually distinct from one another, but they are often applied together and in an overlapping fashion.

[9.020.3] Corporate opportunity doctrine

A director who diverts a business opportunity from the company for personal benefit may be accountable under both the conflict and profit rules. In dealing with this situation, Australian and British Commonwealth courts are moving towards the adoption of a business opportunity doctrine similar in substance to United States case law. This doctrine, which is in effect a special application in the corporate context of the conflict and profit rules, would provide that full-time corporate fiduciaries are accountable if they divert profit-making opportunities, in the same line of business as the corporation's present and prospective business, to themselves or to some other person.[4] Case law on corporate opportunities is considered at [9.230].

[9.020.6] Overlapping of conflict and profit rules

The conflict and profit rules cover a wide range of fiduciary wrongdoing, and very largely overlap with one another.[5] In many of the decided cases it can be said that directors have misused their position and that they have placed themselves in a position of conflict between their personal interest and their duty to the company.

Occasionally, however, one of the rules will apply where the other does not. For example, in *Green v Bestobell Industries Pty Ltd* [1982] WAR 1; (1982) 1 ACLC 1 the manager who tendered for a government contract, when he knew that his company would also tender, was held to be in breach of the conflict rule. However, since tenders were called for by public advertisement and anyone was free to respond, it could probably not be said that his profit as successful tenderer arose in connection with his fiduciary office. Conversely, one can imagine a case where there is no realistic possibility of conflict between interest and duty, but the fiduciary has made a profit which is sufficiently connected with the fiduciary office that an account of the profits is required. It could be argued that *Queensland Mines Ltd v Hudson* (1978) 18 ALR 1; 3 ACLR 176; (1977–78) CLC ¶40-389 is an example of such a case, although there the Privy Council decided that Hudson was not accountable on the facts.

[9.020.9] Consent by company

The conflict and profit rules allow fiduciaries to retain their profit provided that the principal's fully informed consent has been obtained. In the corporate context, the question arises whether profit-taking by a director may be authorised by:

- the company's constitution (see [9.120]);

- the members in general meeting (see [9.330]); or
- the board of directors: see [9.340].

These matters are explored below.

Notes

1. See P D Finn, "The Fiduciary Principle" in T G Youdan (ed), *Equity, Fiduciaries and Trusts*, 1989, Ch 1.
2. P D Finn, *Fiduciary Obligations*, 1977, identifies many more rules, some of which are probably applications of the three rules set out above, while others have no relevance to company directors: see Austin (1979) 8 *Syd LR* 770.
3. See P D Finn, "Fiduciary Law in the Modern Commercial World" in E McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations*, 1992, p 9; R P Austin, "Fiduciary Accountability for Business Opportunities" in PD Finn (ed), *Equity and Commercial Relationships*, 1987, p 146.
4. R P Austin, "Fiduciary Accountability for Business Opportunities" in P D Finn (ed), *Equity and Commercial Relationships*, 1987, p 146.
5. J Kirby, "The history and development of the conflict and profit rules in corporate law — a review" (2004) 22 *C&SLJ* 259.

[9.030] Statutory reinforcement of fiduciary doctrine

The equitable principles regarding fiduciary obligations have been supplemented, though not replaced, by provisions of the Corporations Act, including the following:

- ss 182 and 183, which deal with improper use of position and information (see [9.280]ff);
- s 191, which imposes a statutory disclosure obligation on directors who have a material personal interest in a matter that relates to the affairs of the company (see [9.130]ff);
- s 195, which prohibits a director of a public company who has a material personal interest from participating in the directors' decision (see [9.150]ff);
- Chapter 2E, which deals with a public company or its child entity giving financial benefits to related parties of the public company (see [9.470]ff);
- Part 2D.2 Div 2, which deals with the giving of benefits to directors and officers on retirement or loss of office (see [7.365]);
- Part 7.10 Div 3, which deals with insider trading: see [9.800]ff.

[9.040] Who is subject to fiduciary responsibilities?

The equitable fiduciary principles apply to executive and non-executive company directors, including "shadow" directors, because of the nature of their office. The same principles apply to senior executives of a company (*Canadian Aero Services Ltd v O'Malley* (1973) 40 DLR (3d) 371; [1974] SCR 592) but probably not to ordinary employees.[1]

The statutory provisions affecting fiduciary responsibilities demonstrate a variety of approaches. Thus:

- the statutory duties with respect to improper use of information and position apply to "officers" including directors and officers, and also to ordinary employees (ss 182 and 183);
- the statutory provisions dealing with interested directors apply only to directors and not other officers (ss 191–196);

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- the provisions about giving financial benefits to related parties include directors and their relatives in the definition of "related parties", but not other officers (s 228);
- the provisions about termination payments apply to those who hold or have held a managerial or executive office and their spouses, relatives and associates (Pt 2D.2 Div 2);
- the insider trading provisions are now widely cast, and do not depend upon the existence of any fiduciary, employment or other relationship.

It is therefore strictly inaccurate to refer to the equitable doctrine and its statutory extensions as part of "the law of directors' duties", as if only directors were subject to this part of the law. For the purpose of explaining the law, we shall follow the common practice of referring to directors only, but the reader should bear in mind that the principles which we shall describe will frequently apply to non-director officers.

Notes

1. R P Austin, "Fiduciary Accountability for Business Opportunities" in P D Finn (ed), *Equity and Commercial Relationships*, 1987, p 172.

[9.050] To whom are the duties owed?

[9.050.3] The company

In the last chapter consideration was given to whether the director's positive duties of good faith are owed only to the company or to creditors, beneficiaries, employees and individual members: see [8.070]ff. The general conclusion was that in Australian law directors' duties are owed to the company but, in discharging those duties, the director should have regard to the interests of creditors, employees and others with whom the company deals, to the extent that in doing so, they will indirectly benefit the company.

In the context of directors' conflicts of interest, it is reasonably clear that the duties are owed to the company and not to parties with whom the company deals, such as creditors and employees. Where a breach of any of the fiduciary rules occurs, the director is accountable for profit to the company, and may be a constructive trustee of such profits for the company as beneficiary. Allowing recovery by the company may produce some curious and unsatisfactory results. If, for example, a director wrongly diverts a profit-making opportunity away from the company and exploits it for his or her own benefit, and control of the company subsequently changes hands, the company may recover the director's unauthorised profit. Recovery will benefit the company's new controllers, who have received a windfall; presumably the price which they paid to purchase control did not include any payment for the benefit of recovery from the director. This consequence was recognised but not redressed in *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134n; [1942] 1 All ER 378: see [9.240]. Australian courts have not yet developed a technique for making restitution to the sellers of control: cf *Abbey Glen Property Corp v Strumborg* (1978) 85 DLR (3d) 35.

[9.050.6] Individual members[1]

Percival v Wright [1902] 2 Ch 421 is frequently cited as authority for the proposition that directors do not owe their fiduciary duties to individual members. In that case the company was unlisted and its shares were transferable only with the consent of the board. A shareholder sold his shares to the chairman and two other

directors at an agreed price, after negotiations instigated by the seller. The seller later discovered that at the time of the negotiations the directors were considering a proposal from a third party to buy the company's undertaking at a price which represented more per share than the seller was paid. The proposed purchase of undertaking fell through, but the shareholder sought to have the sale of shares set aside on the ground of non-disclosure. The court held that the directors owed no duty of disclosure to the seller since they were not in a fiduciary relationship to individual shareholders.

However, it is accepted that there may be special circumstances which cause a fiduciary relationship to arise, on the facts, between directors and individual shareholders.

In *Allen v Hyatt* (1914) 30 TLR 444; 26 OWR 215; 17 DLR 7 directors who were negotiating an amalgamation with another company induced individual shareholders to grant them options to buy their shares at par by saying that the options would assist the negotiations. The directors exercised the options and made a substantial profit. It was held that they were accountable for the profit because they had held themselves out to shareholders as being willing to act as their agents in the negotiations. These additional facts created a fiduciary relationship which required a duty of disclosure.

See also *Jones v Dumbrell* [1981] VR 199; (1968) 5 ACLR 417 in which an unsuccessful attempt was made to obtain an award of damages against a director-buyer who had requested the plaintiffs to sell their shares to him.

In *Coleman v Myers* [1977] 2 NZLR 225 the Court of Appeal of New Zealand also held that in a transaction between a shareholder and a director there could be surrounding circumstances which would give rise to a fiduciary duty. A fiduciary relationship was held to arise in that case having regard to the family character of the company, the position of the directors in the family and the company, their high degree of inside knowledge and the way they went about persuading the shareholders to sell.[2]

A fiduciary relationship between a director and an individual shareholder was also held to exist in *Glavanics v Brunninghausen* (1996) 19 ACSR 204; 14 ACLC 345 (on appeal *Brunninghausen v Glavanics* (1999) 46 NSWLR 538; 32 ACSR 294; [1999] NSWCA 199).

G and B were each directors of and shareholders in Skima Imports Australia Pty Ltd, a company which conducted the business of importing ski gear. G held one-sixth of the shares in the company while B held the remainder. Although G was a director he took no active part in the business of the company. The relationship between G and B deteriorated leading to an agreement that G sell his shares to B and that G resign as director. However, prior to this agreement being entered into, B had been approached with an offer to purchase the business of the company. The business was ultimately sold following G's sale of his shares in the company to B. The fact that B had been approached to sell the business was not disclosed to G prior to him selling his shares. At first instance Bryson J held that in the circumstances there was a fiduciary relationship between G and B. He noted that as a matter of law the relationship of shareholder and director, without more, does not give rise to a fiduciary relationship where the director is purchasing shares from the shareholder. However, there were several factors which led his Honour to impose a fiduciary relationship. First, the share transaction was a direct dealing between G and B and was not conducted with the anonymity of transactions on the stock exchange. Second, the company had only two shareholders. According to his

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Honour, "the structure of shareholding in [the company] takes to the verge of the absurd any reasoning in which a distinction is drawn between fiduciary duty owed by a director to the company and fiduciary duty owed to its shareholders" (19 ACSR at 222). Third, a factor which Bryson J described as having "extraordinary significance" was G's entire dependence on B for information and advice about the fact that negotiations were being undertaken in relation to selling the entire business of the company (19 ACSR at 220). In relation to the fact that G was not only a shareholder but also a director of the company, Bryson J held that this was not an impediment in relation to imposing a fiduciary duty "as the directorship had been a dead letter for years": 19 ACSR at 223.

The judgment of Bryson J was upheld on appeal: *Brunninghausen v Glavanics* (1999) 46 NSWLR 538; 32 ACSR 294; [1999] NSWCA 199. The Court of Appeal of New South Wales specifically declined to follow *Percival v Wright*, above, and held that while the general principle that a director's fiduciary duties are owed to the company and not to shareholders remains correct, this does not preclude the recognition of a fiduciary duty owed by directors to shareholders in relation to dealings in their shares where this would not compete with any duty owed to the company (at 304). In limited circumstances, there can be a fiduciary relationship in a proprietary company between a director and shareholders (at 312). In relation to the facts before it, the Court of Appeal applied the reasoning of the High Court in *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41; 55 ALR 417; 4 IPR 291 and held that B was in a fiduciary relationship with G in that B, as the sole effective director, occupied a position of advantage in relation to G and B was in breach of the duty owed to G when he preferred his own interests by not disclosing the negotiations to sell the business.

The judgment of Bryson J in *Glavanics* was followed in *Mesenberg v Cord Industrial Recruiters Pty Ltd (Nos 1 & 2)* (1996) 19 ACSR 483; 14 ACLC 519. See also *Peskin v Anderson* [2001] BCLC 372; (2001) 19 ACLC 3001 (United Kingdom Court of Appeal) in which it was acknowledged that there may exist a special factual relationship between directors and shareholders which gives rise to a fiduciary duty owed by the directors to individual shareholders, although such a fiduciary relationship did not exist on the facts before the court. In *Crawley v Short* (2009) 262 ALR 654; 76 ACSR 286; [2009] NSWCA 410 it was held that a director (who was also a shareholder) owed a fiduciary duty to another shareholder and the court also held that this duty was breached. In *Jones v Jones* [2009] VSC 292, a director (who was also a shareholder) was held to owe a fiduciary duty to another shareholder (and former director) and the court also held that this duty was breached. The court observed (at [36]) that the factual basis for the duty was stronger than in *Brunninghausen v Glavanics* because of representations made by the director.

In summary, pointers towards the existence of a fiduciary obligation include shareholders' dependence upon information and advice, the existence of a relationship of confidence, the significance of some particular transaction for the parties and the extent of any positive action taken by, or on behalf of, the directors to promote the transaction and the structure of shareholdings in the company: *Coleman v Myers* [1977] 2 NZLR 225 at 325; *Chan v Zacharia* (1984) 154 CLR 178 at 198; 53 ALR 417 per Deane J; *Glavanics v Brunninghausen* (1996) 19 ACSR 204; 14 ACLC 345; *Platt v Platt* [1999] 2 BCLC 745 (Ch D) at [29]–[31]; *Thexton v*

Thexton [2001] 1 NZLR 237 HC(NZ) at [83]–[90]. Even if there is no relationship of trust and confidence, as was the case in *Brunninghausen*, a fiduciary relationship can still exist between a director and shareholder where the director occupies a position of particular advantage in relation to the shareholder and special circumstances, such as confidential negotiations to sell the company's business, allow the director to use that advantage to the detriment of the shareholder: *Brunninghausen v Glavanics* (1999) 46 NSWLR 538; 32 ACSR 294; [1999] NSWCA 199.

Fiduciary duties having identical content and relating to the same subject matter cannot be owed by a director both to the company and to one or more of the company's shareholders: *Charlton v Baber* (2003) 47 ACSR 31 at 38; 21 ACLC 1671; [2003] NSWSC 745; *Brunninghausen*, above; *Southern Cross Mine Management Pty Ltd v Ensham Resources Pty Ltd* [2004] 2 Qd R 207; (2004) 22 ACLC 724; [2003] QSC 402.

Where the directors are nominees of a section of shareholders and are appointed to represent their interests on the board, it would seem that a fiduciary obligation to those shareholders ought readily to be found. Similarly directors of a wholly-owned subsidiary could be found to owe fiduciary duties to the parent company. Any such duty to the appointor is subject to the duty of confidentiality to the company of which the person is a director: *Harkness v Commonwealth Bank of Australia Ltd* (1993) 32 NSWLR 543; 12 ACSR 165.

[9.050.9] Management buy-outs by directors

These principles have an obvious application to management buy-outs. In *Glandon Pty Ltd v Strata Consolidated Pty Ltd* (1993) 11 ACSR 543; 11 ACLC 895 Mahony J said, ACSR at 547:

> . . . a director purchasing the shares of a shareholder is in a position of advantage and that advantage is of special kind which, in appropriate circumstances, may give rise to fiduciary obligations.

In *Glandon* a director sought to buy out the non-director members. It was alleged that the director had breached a fiduciary duty owed to the non-director members by failing to disclose certain information regarding asset values at the time of negotiating the buy out. The court held that no fiduciary duty existed, and that there was insufficient evidence to show that confidence and trust were reposed in the director by the plaintiffs, nor was there reliance or expectation that the director would act in the plaintiff's interests: ACSR at 548–9 and 558.

Directors of a wholly-owned subsidiary who propose to buy out the parent are obliged to make full disclosure to the parent of all information affecting the value ofthe shares known to them but unknown to the parent. This obligation could be particularly important where Australian directors of an Australian wholly-owned subsidiary aim to buy out the overseas parent. Directors who propose a management buy-out must also avoid contravening the legislation about improper use of information and position (ss 182 and 183) and insider trading (Pt 7.10 Div 3). Their conduct may also attract the statutory remedy in Pt 2F.1 (discussed in Ch 10) against oppression and unfair prejudice: see *Re a Company (No 008699 of 1985)* [1986] BCLC 382; *Re Posgate & Denby (Agencies) Ltd* [1987] BCLC 8.

Notes

1. Lawrence (1996) 14 *C&SLJ* 428; R Valentine, "The director-shareholder fiduciary relationship: Issues and implications" (2001) 19 *C&SLJ* 92.

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2. Compare *Esplanade Developments Ltd v Dinive Holdings Pty Ltd* [1980] WAR 151; (1980) 4 ACLR 826; (1980) CLC 40-637. But see dicta in *Hurley v BGH Nominees Pty Ltd (No 2)* (1984) 37 SASR 499; 10 ACLR 197; 2 ACLC 497 and *Hooker Investments Pty Ltd v Baring Bros Halkerston & Partners Securities Ltd* (1986) 5 NSWLR 157; 10 ACLR 462 at 463; 4 ACLC 243 aff'd (1986) 10 ACLR 524.

[9.053] Framework for analysis

The various conflicts of interest and special cases will be discussed in the following manner.

[9.053.3] Conflicts of interest

(1) The general conflict rule (see [9.060]ff):
- general equitable considerations of directors' conflict of interest in transactions (see [9.110]ff); and
- statutory provisions regarding interested directors (see [9.130]ff);

(2) The duty not to misappropriate corporate property (see [9.200]ff);
(3) The duty not to profit at the company's expense (see [9.220]ff);
(4) Statutory provisions regarding improper use of information or office (see [9.280]ff);
(5) Consent to breaches of duty (see [9.330]ff); and
(6) Remedies for breaches of duty: see [9.350]ff.

[9.053.6] Special cases

(7) Multiple and nominee directorships (see [9.410]ff);
(8) Financial benefits to related parties (see [9.470]ff); and
(9) Insider trading: see [9.600]ff.

The conflict rule

[9.057] Introduction

The conflict rule outlined below provides a general prohibition on directors placing themselves in a position of conflict whereby a personal interest or duty conflicts with their duty to the company. The scope of the conflict rule is discussed at [9.060]–[9-070]. It is shown that the courts have adopted a pragmatic approach to the scope of the conflict rule by requiring a "real sensible possibility of conflict" before a breach may be established. The requisite extent of a director's conflicting interest is considered at [9.080], and the possibility of the indirect interests of directors giving rise to a conflict is discussed at [9.090]. Finally, the position of directors who have a conflict of duties is discussed at [9.100].

[9.060] Scope of the conflict rule[1]

[9.060.3] Strict formulation

The conflict rule has been formulated in various different ways.

On its strictest formulation, it could mean that where a fiduciary has a loyalty to some other interest than that of the principal, the fiduciary should not act while that other loyalty persists. That high standard would be based on the view that the principal is entitled to the advice of the fiduciary unpolluted by the mere possibility that the advice or decision might have been influenced by the extraneous loyalty.

A strict formulation is supported by high authority. For instance, Lord Herschell said in *Bray v Ford* [1896] AC 44 at 51 that a person ". . . is not allowed to put

himself in a position where his interest and duty conflict": see also *New Zealand Netherlands Society "Oranje" Inc v Kuys* [1973] 2 NZLR 163; [1973] 2 All ER 1222; [1973] 1 WLR 1126 at 1129. In *Boardman v Phipps* [1967] 2 AC 46 at 123; [1966] 3 All ER 721; [1966] 3 WLR 1009 Lord Upjohn referred to "the fundamental rule of equity that a person in a fiduciary capacity must not make a profit out of his trust which is part of the wider rule that a trustee must not place himself in a position where his duty and interest may conflict."

[9.060.6] Practical approach

However, the literal application of this strict principle would give rise to difficulties in various commercial contexts. For instance, the strict formulation could be taken to mean that a director should not hold shares, and would create difficulties where a director occupies board positions in competing companies or holds a board position as a nominee director.

In fact courts have accepted that a director can act with a personal interest even though the director cannot be shown to have freed his or her mind of that personal interest when acting. Directors can own shares in the company and when they make a decision that could affect different classes of shareholders in different ways, the fact that they are conscious that their decision may benefit themselves will not necessarily make their decision unlawful. The decision may only be contested if personal interest was the actuating motive rather than some bona fide concern for the benefit of the company as a whole or for fairness as between members: *Mills v Mills* (1938) 60 CLR 150; 11 ALJ 527.

Indeed, in *Chan v Zacharia* (1984) 154 CLR 178 at 198; 53 ALR 417 at 432ff Deane J denied that Lord Herschell's strict formulation exists as a statement of duty. A similar view was expressed by Mason J in *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41 at 103; 55 ALR 417 at 459.

Notes

1. For possible reforms of this rule see Teele (1994) 22 *ABLR* 99; Farrar, "Reform of Directors' Fiduciary Duties" at *Legal Research Foundation Inc Seminar*, 2, 3 March 1989.

[9.070] "Real sensible possibility of conflict"

The tendency of modern courts to move from a strict formulation to a more practical approach is also evident in their answer to another question: is the fiduciary in breach as soon as an abstract or theoretical conflict between interest and duty arises, or must the possibility of conflict be more real?

In his classic statement in *Aberdeen Railway Co v Blaikie Bros* [1843-60] All ER Rep 249; (1854) 2 Eq Rep 1281; 1 Macq 461 Lord Cranworth LC said that no one, having fiduciary duties to discharge, "shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, *or which possibly may conflict*, with the interests of those whom he is bound to protect".

However, in *Boardman v Phipps* [1967] 2 AC 46 at 124; [1966] 3 All ER 721; [1966] 3 WLR 1009 Lord Upjohn, speaking of the phrase "possibly may conflict", said:

> In my view it means that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict.

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That statement was applied by the Privy Council in *Queensland Mines Ltd v Hudson* (1978) 18 ALR 1; 3 ACLR 176; (1977–78) CLC ¶40-389. In *Chan v Zacharia* (1984) 154 CLR 178 at 199; 53 ALR 417 at 433 Deane J spoke of "significant possibility" of conflict. In *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41 at 103; 55 ALR 417 at 459 Mason J referred to "a real or substantial possibility of a conflict" and in *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 70 ACSR 1; [2008] WASC 239 at [4506] and [4508], Owen J referred to "a real sensible possibility of conflict" and "a real or substantial possibility of conflict." An appeal from the judgment of Owen J was partly allowed and partly dismissed: *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 89 ACSR 1; [2012] WASCA 157. The "real or substantial possibility of conflict" test has been applied by other courts; see, for example, *Australian Careers Institute Pty Ltd v Australian Institute of Fitness Pty Ltd* (2016) 340 ALR 580; 116 ACSR 566; [2016] NSWCA 347 at [3] and [132].

There is disagreement among some courts regarding whether a director has to actually pursue the conflict or prefer their personal interest to be in breach of duty. One view is that the requirement of a real sensible possibility of conflict between the personal interest of the director and their duty to the company means that the director who is in a position of conflict, or possible conflict, does not have to actually pursue or prefer their personal interest. All that is required is the possibility of conflict between the personal interest and duty: *Agricultural Land Management Ltd v Jackson (No 2)* (2014) 285 FLR 121; 98 ACSR 615; [2014] WASC 102 at [263]–[275]. The alternative view is that merely because a director occupies a position or has an interest which results in a conflict or a potential conflict is insufficient for there to be a breach of duty. The director must pursue the personal interest. In other words, the defendant must act in a manner that is inconsistent with the rule preventing the director having a personal interest that conflicts with the director's duty to the company: *Re Colorado Products Pty Ltd (in prov liq)* (2014) 101 ACSR 233; [2014] NSWSC 789 at [351]–[360]. Generally courts do not have to address this issue because the facts usually indicate that the director pursued the conflict or preferred their personal interest.

The two conflicting judgments are examined by R Langford and I Ramsay, "Directors' Conflicts: Must a Conflict be Pursued for there to be a Breach of Duty?" (2015) 9 *Journal of Equity* 281. They argue that the approach in *Agricultural Land Management Ltd v Jackson* is to be preferred for several reasons, including:

- the approach requiring the director to pursue the conflict or prefer their personal interest does not cover some situations in which the conflicts rule should be engaged, bearing in mind that its rationale is preventing fiduciaries from being swayed by considerations of personal interest; and
- the stricter approach in *Agricultural Land Management Ltd v Jackson* is more consistent with the need to maintain high standards and to ensure that directors act in the interests of the company.

[9.070.3] An objective test

We noted above that Lord Upjohn in *Boardman v Phipps* [1967] 2 AC 46 referred to an assessment by the reasonable man as to whether there is a real sensible possibility of conflict. Other courts have confirmed that an objective test is used to determine if there is a real sensible possibility of conflict: see, for example, *Australian Securities and Investments Commission v Adler* (2002) 41 ACSR 72; [2002]

NSWSC 171 at [735]; *Robash Pty Ltd v Gladstone Pacific Nickel Pty Ltd* (2011) 86 ACSR 432; 29 ACLC 11-086; [2011] NSWSC 1235 at [78]; *Australian Careers Institute Pty Ltd v Australian Institute of Fitness Pty Ltd* (2016) 340 ALR 580; (2016) 116 ACSR 566; [2016] NSWCA 347 at [132].

[9.070.6] Relevant factors

Some of the relevant factors that determine whether there is a conflict of interest and duty are the following:

Activities of the company

Whether there is a conflict in any particular case will depend on the type of company and the nature of the extraneous loyalty. Directors, like anybody else, perform their functions subject to many influences and loyalties. The conflict rule applies only to those types of extraneous loyalties that could influence directors when making judgments in the particular company.

In *Canberra Residential Developments Pty Ltd v Brendas* (2010) 188 FCR 140; 273 ALR 601; [2010] FCAFC 125 at [36], in the context of observing the need for a real rather than a theoretical conflict of interest and duty, the Full Federal Court stated that in most cases the duty will be determined in large part by reference to the nature of the activities of the principal (citing *Birtchnell v Equity Trustees, Executors & Agency Co Ltd* (1929) 42 CLR 384 at 407–8). In *Canberra Residential Development*, the company (CRD) commenced proceedings against Brendas, a former director of CRD, for breach of duty on the basis that his personal interest conflicted with his duty to CRD. It was alleged that he formed a joint venture company to acquire and develop a property using information acquired as a director of CRD. The court examined the activities of CRD and found that the company "was not in the business of investing in or developing real estate" (at [38]) and therefore Brendas was not in a position where his personal interest conflicted with his duty to the company.

Functions or responsibilities of the director

As part of determining whether there is a conflict of interest and duty, "it is necessary to identify the functions or responsibilities the director has undertaken in that capacity": *Australian Careers Institute Pty Ltd v Australian Institute of Fitness Pty Ltd* (2016) 340 ALR 580; 116 ACSR 566; [2016] NSWCA 347 at [136]. These functions or responsibilities determine the subject matter over which the director's fiduciary obligations extend for the purpose of deciding if there is a conflict of interest and duty: Ibid at [136]. While the functions or responsibilities of a director are usually framed broadly, it is a question of fact for the court what are the actual functions or responsibilities of the defendant director: Ibid at [136]. In noting the importance of identifying the functions or responsibilities of the director, the court drew upon the judgment of the Full Federal Court in *Grimaldi v Chameleon Mining NL (No 2)* (2012) 287 ALR 22; 87 ACSR 260; [2012] FCAFC 6 at [179].

Expectant or non-pecuniary interest may give rise to a conflict

The interest may be an expectant or contingent interest: *Grimaldi v Chameleon Mining NL (No 2)* (2012) 287 ALR 22; 87 ACSR 260; [2012] FCAFC 6 at [180]. A conflict will normally arise in relation to pecuniary interest. But there could be a breach of duty in not disclosing an outside non-pecuniary interest which is incompatible with the director's duty to act in the interests of the company. In *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 70 ACSR 1;

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[2008] WASC 239 at [4509], Owen J expressed the opinion that an interest of a director that leads to a breach of duty can be a non-pecuniary interest. An appeal from the judgment of Owen J was partly allowed and partly dismissed: *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 89 ACSR 1; [2012] WASCA 157.

[9.080] Extent of interest

One would expect that the application of the conflict rule would be affected by the extent or value of the director's interest. But old cases in this area seem to place little importance on the question of degree of interest. In *Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co* [1914] 2 Ch 488 at 503; [1914] All ER 987; (1914) 31 TLR 1 Swinfen Eady LJ said that:

> the validity or invalidity of a transaction cannot depend upon the extent of the adverse interest of the fiduciary agent any more than upon how far in any particular case the terms of a contract have been the best obtainable for the interest of the cestui que trust, upon which subject no inquiry is permitted.

If this were applied literally to a case in which, say, a director of X Ltd holding 100 $1 shares in Z bank (a large public listed company with issued capital of $2 billion) voted on the board of X Ltd to open an account with the Z bank and did not disclose his holding, he would be in breach of duty.

However, courts now take into account the extent of the interest. In *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 70 ACSR 1; [2008] WASC 239 at [4512], Owen J posed the question whether the interest is such that a reasonable person would think there is a real or substantial possibility of the director being swayed by it. An appeal from the judgment of Owen J was partly allowed and partly dismissed: *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 89 ACSR 1; [2012] WASCA 157.

It does not necessarily follow that there is a conflict giving rise to a breach of duty merely because a director holds shares in a company with which the principal company does business. A shareholder does not owe duties to the company, so there is no conflict of duties, as could be the case where two companies with a common director transact with each other. But a shareholding can be an adverse personal interest. What degree of shareholding will be adverse?

The law of trusts provides some guidance. It has been said that a trustee for sale of realty who sells the land to a large public company in which he along with many others has a small shareholding, cannot have his contract considered in the same light as a trustee for sale who sells to a private company in which he has a substantial but not necessarily a majority shareholding.[1] That statement rests on *Farrar v Farrars Ltd* (1888) 40 Ch D 395, a case considered by the High Court without disapproval in *Australia and New Zealand Banking Group Ltd v Bangadilly Pastoral Co Pty Ltd* (1978) 139 CLR 195; 19 ALR 519. Aickin J looked to see whether the one person is a directing mind on both sides of the transaction. This suggests that if a director has so large a shareholding that in the circumstances he or she has effective control at a general meeting the holding will be an interest adverse to that of the dependent company.

Notes

1. Finn P D, *Fiduciary Obligations*, (1977) p 451.

[9.090] Indirect interest

The conflict rule may apply to indirect forms of conflicting interest. If the company is contracting with another company in which a director of the first company is a director, member or creditor, the director may have a competing interest for the purposes of the conflicts rule: *Walker v Nicolay* (1991) 4 ACSR 309. Another example of indirect interest is where the company contracts with a trustee who holds property on trust for one of its directors and the contract relates to that trust.

However, indirect or ephemeral association between a director and some outside interest is not enough: *Baker v Palm Bay Island Resort Pty Ltd (No 2)* [1970] Qd R 210 at 221. Thus where a provision of the company's constitution provides that an interested director should not vote, the fact that the director is remunerated by a salary from a company with whom the dependent company proposes to contract does not make the director an interested one: *Wilson v London Midland and Scottish Railway Co* [1940] Ch 169, aff'd [1940] Ch 393; see also *Buttonwood Nominees Pty Ltd v Sundowner Minerals NL* (1986) 10 ACLR 360.

[9.100] Conflict of duties

The conflict rule applies to an actual or possible conflict between the director's duty to the company and his or her personal interest. It also applies where a conflict arises between the director's duty to the company and his or her duty to someone else — for example, to another company of which he or she is a director, or to a trust of which he or she is a trustee: *Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co* [1914] 2 Ch 488; [1914] All ER 987; (1914) 31 TLR 1. However, the mere acceptance of more than one fiduciary position cannot be allowed to trigger the prohibition automatically, since it is generally accepted that company directors may act as trustees or as directors of other companies or in some other fiduciary role, such as the role of solicitor. It appears that the prohibition is attracted only when there is an actual conflict between the duties owed in each relationship.[1]

For example, in *Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co* [1914] 2 Ch 488; [1914] All ER 987; (1914) 31 TLR 1 Harvey was a director of T, and was a trustee of shares in B for his wife. T purchased shares in X from B. Harvey failed to disclose his trust shareholding in B to the board or general meeting of T. Astbury J found that Harvey was in a position of conflict, the conflict being between his duty as trustee to act in the interests of the beneficiary, and his duty as director to act in the interests of the company.

Where a director of company A is engaged in a transaction with company B of which he or she is also a director, the director must make full disclosure of his or her interest and, in some cases, may be obliged to abstain from taking part in the negotiations or voting on the transaction: *Jenkins v Enterprise Gold Mines NL* (1992) 6 ACSR 539; 10 ACLC 136. In *R v Byrnes* (1995) 130 ALR 529; 17 ACSR 551 at 562; 13 ACLC 1488, the High Court stated:

> A company is entitled to the unbiased and independent judgment of each of its directors. A director of a company who is also a director of another company may owe conflicting fiduciary duties. Being a fiduciary, the director of the first company must not exercise his or her powers for the benefit or gain of the second company without clearly disclosing the second company's interest to the first company and obtaining the first company's consent.

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See also *South Australia v Marcus Clark* (1996) 19 ACSR 606 at 630–2; 14 ACLC 1019.

A conflict of duties may arise where a director owes a duty of honesty to one company and a duty of confidentiality to another company, in a situation where the two companies are engaged in a transaction. In *Fitzsimmons v R* (1997) 23 ACSR 355; 15 ACLC 666,[2] the applicant was a director of Duke Holdings Ltd. The financial position of this company was precarious. Duke entered into a transaction with Kia Ora Gold whereby Kia Ora was to provide funds to Duke and Duke would acquire shares in Kia Ora. The applicant became a director of Kia Ora on the day the agreements were signed and he participated in a board meeting of Kia Ora at which the directors resolved to enter into the transaction. The applicant was held to have breached his duty to act honestly under s 229(1) of the Companies (SA) Code (see now s 181) in that he failed to disclose to the board of Kia Ora what he knew of the true financial position of Duke. On appeal, the Court of Criminal Appeal of the Supreme Court of Western Australia rejected an argument of the applicant that, because the applicant was a director of both Kia Ora and Duke, he was not required to disclose to Kia Ora information about Duke because this would have required the applicant to act contrary to his obligation to Duke not to reveal confidential information about the financial position of Duke. The court stated (at ACSR 363) that at all times and regardless of conflicting duties, a director of a company is required to act honestly and that, in this case, what was required was disclosure of information material to issues being decided by the other directors of Kia Ora.

What precisely should the applicant have disclosed to the other directors of Kia Ora? The Court of Appeal was not required to provide a specific answer. Parker J stated (at ACSR 363–4) that the applicant was required to disclose to the other directors of Kia Ora that he was in a position of conflict in respect of the matter being considered and that, as a consequence, he could neither participate in the deliberations nor vote. His Honour rejected the applicant's submission that his duty to Kia Ora to act honestly was "rolled back" by his duty of confidentiality to Duke and there could have been no breach of his duty to act honestly had the applicant merely remained silent during the board's deliberations or the applicant had absented himself from the meeting because of the conflict but without disclosing any reason for absenting himself. However, Parker J stated that in addition to disclosing the conflict of interest, the applicant "may well have [been] required [to] identify what he knew to be the risk to Kia Ora": at ACSR 364.

Another situation of conflict of duties involving a director of Kia Ora arose in *Duke Group Ltd (in liq) v Pilmer* (1999) 73 SASR 64; 31 ACSR 213; [1999] SASC 97. One of the appellants in this case, S, was a director of both Kia Ora and Western United. In addition, he held options in Kia Ora and shares in Western United. Kia Ora completed a successful takeover of Western United which became a wholly-owned subsidiary of Kia Ora. However, it did so at a price which was excessive and directors of Kia Ora, including S, profited substantially from selling their shares in Western United. Kia Ora subsequently commenced proceedings against a firm of accountants who had been retained by Kia Ora to prepare an independent expert's report on the proposed takeover price for Western United. Kia Ora also commenced proceedings against certain of its directors, including S, claiming that they had breached their duties owed to Kia Ora.

The trial judge (see *Duke Group Ltd (in liq) v Pilmer* (1998) 27 ACSR 1; 16 ACLC 567; [1998] SASC 6529) held that there had been breaches of duty by both the accountants and Kia Ora's directors. In relation to S, the trial judge found that

S knew that it was not in the best interests of Kia Ora to proceed with the takeover and that the report prepared by the accountants could not be relied upon by shareholders of Kia Ora. S should have opposed the takeover of Western United and counselled the independent directors of Kia Ora to the same view.

On appeal, it was argued on behalf of S that because he was a director of both Kia Ora and Western United he owed fiduciary duties to both companies. All that was required of him was to make disclosure of his conflict and refrain from taking part in discussions by Kia Ora's directors on the decision to proceed with the takeover. This argument was rejected by the Full Court. If there had been no suggestion of Kia Ora entering into an improvident transaction, the court stated that the proper course for S would have been to declare his interest and take no further part in the implementation of the takeover of Western United. However, different considerations applied because the takeover was contrary to Kia Ora's interests as S was well aware. In the circumstances, S could not avoid his duty to Kia Ora and remain silent. The Full Court held that there had been a breach of duty because there was no record of S declaring any conflict of interest. Rather, despite knowing that the takeover was not in the best interests of Kia Ora and should have been rejected, S participated in a series of decisions which progressed the plans for the takeover of Western United: at 31 ACSR 341–2. There was an appeal to the High Court: *Pilmer v Duke Group Ltd (in liq)* (2001) 180 ALR 249; 38 ACSR 122; [2001] HCA 31. However, the appellants were members of a firm of accountants who had been held to be liable for loss caused by a report they prepared in relation to the takeover. Issues of directors' duties were not relevant to the appeal.

What should S have done in these circumstances? S should of course have declared the nature of his conflict of interest to the directors of Kia Ora. However, this would not have been sufficient. Because of the clear knowledge S had of the fact that the takeover was not in the best interests of Kia Ora, the Full Court observed that S and another director should have informed the shareholders of Kia Ora of the fact that it was not in the best interests of the company to proceed with the takeover at the extraordinary general meeting of Kia Ora's shareholders called to consider the takeover: ACSR at 342.

Notes

1. Finn P D, *Fiduciary Obligations* (1977), p 253.
2. Noted Barrett (1997) 71 *ALJ* 677.

[9.105] The conflict rule and alternate directors

The conflict rule applies to alternate directors. Where an alternate director is appointed to act in his or her own right in place of a particular director and that absent director is disqualified from voting because of a conflict of interest, that disqualification does not preclude the alternate director from voting. However, the alternate directors may have their own conflict of interest which disqualifies them. These principles are discussed in [7.300].

Conflicts of interest in transactions with the company

[9.110] Director dealing with company

The conflict rule has its most obvious application in cases where a director enters into a transaction, directly or indirectly, to which the company is a party. The

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