MONASH University

# *The contemporary role of shareholder ratification and authorisation of breaches of director's duties*

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**ABSTRACT**

This Thesis considers to what extent does the doctrine of ratification remain relevant and appropriate to companies governed by the Corporations Act.

The primary criticism of the operation of the doctrine focuses on the right of a director/shareholder to vote to approve a ratification resolution in relation to their own breach of duty. The criticism of the conduct of self-interested directors extends to the right of family members and associates to vote because the combined voting power of those shareholders may be a majority.

Case law developments and corporate law reforms have diminished the role of the doctrine and increased minority shareholder protections including the introduction of the statutory derivative action and the statutory oppression remedy. However the reforms to the Corporations Act have left open much of the academic and judicial criticism of the operation of the doctrine.

The United Kingdom, the United States of America and Canada have adopted statutory reforms which limit a director/shareholder from voting to approve their own breach of duty. Those reforms, whilst generally effective, have introduced some new legal issues of statutory interpretation. Going against the grain of law reform in other common law countries, New Zealand is the only jurisdiction under review which has sought to allow a director/shareholder the right to vote. There does not appear to have been any economic analysis in any of these jurisdictions which supported the law reforms.

There are no jurisdictions identified by this Thesis which have considered the risk of the shareholders attenuating a director's duty and the legal possibility is unresolved in Australia. Given that statutory duties have a public aspect to them, any law reforms should consider how the risk of attenuation of duties should be best addressed.

The doctrine continues to be beneficial to companies governed by the Corporations Act. For example, the shareholders can forgive a breach which was beneficial to the company, it may protect honest directors, the company can preserve its relationship with a director and a court has a greater discretion to prevent vexatious proceedings following ratification. An analysis of those and other benefits demonstrates that any reform to the operation of the doctrine would need to be carefully considered to avoid unintentional changes to the identified beneficial aspects of the doctrine.

The corporate law policy arguments for and against limited law reform are also evaluated in this Thesis by considering the extent to which shareholder primacy theory is consistent with the operation of the doctrine.

This Thesis recommends limited statutory reform to the operation of the doctrine by limiting the right of a director/shareholder and their related parties to vote on a ratification or authorisation resolution for (i) conduct amounting to negligence, default, breach of trust or duty (ii) the exercise of a director's power, (iii) the attenuation of a director's duty or (iv) any release, forbearance to sue or settlement of a claim of matters (i) and (ii). Similar recommendations for limited statutory reform in 1990 have not been implemented by the Commonwealth Parliament.

## DECLARATION

This thesis is an original work of my research and contains no material which has been accepted for the award of any other degree or diploma at any university or equivalent institution and that, to the best of my knowledge and belief, this thesis contains no material previously published or written by another person, except where due reference is made in the text of the thesis.

Signature: ……

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# Contents

## CHAPTER 1 - INTRODUCTION

Company law in Australia with respect to members' remedies has evolved over a long period of time and arose originally from the *Companies Act 1862* (UK). Victoria was the first State to introduce a director's statutory duty in 1896.[1] The evolution of company law saw the enactment of uniform companies legislation during the period from 1961 to 1963 by each of the States and Territories with the Commonwealth Parliament twenty years later enacting the *Companies Act 1981* (Cth) and later the *Corporations Act 1989* (Cth). From 15 July 2001, following the referral of powers by the States, the Commonwealth Parliament gained responsibility for company law which resulted in the enactment of the *Corporations Act 2001* (Cth) ('**Corporations Act**'). This evolution of Australian company law from State and Territory based statutory schemes to a uniform set of Commonwealth laws included the continuous strengthening of members' remedies and the broadening of directors' statutory duties to address many forms of conduct by directors which included conduct with was unethical or immoral and generally 'sharp' business practices.

One area of the general law which is relevant to both members' remedies and directors' fiduciary and statutory duties which has not been reformed in relation to companies governed by the Corporations Act is the doctrine of ratification.[2] The doctrine of ratification continues to raise legal and public policy issues and is uncertain in its operation. The doctrine has the potential for a disadvantage to arise for minority shareholders when ratification is not in the best interests of the company and ultimately serves to protects the relevant directors from their breach of duty.[3] In other cases, the ratification is beneficial to the company, for example when the company obtained a benefit, or if the breach was of a technical nature causing no loss to the company.

[1] See *Companies Act 1896* (Vic).

[2] The doctrine emerged from customary Roman law prior to 449 BC and was applied broadly in the United Kingdom to fiduciary relationships, including director and company, in connection with the laws of agency, trusts, contract and torts.

[3] See eg, Elizabeth Bennett, 'Shareholder Ratification: The "nice question" of Corporations Law' (2005) 23 *Company & Securities Law Journal* 538, 540.

Ratification in relation to companies governed by the Corporations Act is primarily concerned with (i) the conduct of agents acting without the lawful authority of the board of directors in relation to contracts of the company and (ii) the conduct by a director for and on behalf of the company which is in breach of the director's fiduciary and/or statutory duties. This Thesis concerns the second point. The decision by a majority of shareholders in general meeting to approve a ratification resolution was first considered by a court of the United Kingdom in 1887 in *North-West Transportation Co v Beatty*[4] ('***Beatty***'). In *Beatty*, it was held that a director was entitled to exercise his voting power as a shareholder in general meeting to ratify the company's contract entered into by the authority of the board of directors in which that director held a direct financial interest.

Ratification is not always permissible, including because of equitable limitations on the application of the doctrine. Provided that the conduct of a director is capable of being ratified, the shareholders in general meeting may approve a ratification resolution (and thereby elect to take the benefit of the director's conduct with *retrospective* effect). Under the common law, the election to ratify the director's conduct results in the company's cause of action against the director for a breach of fiduciary duty being extinguished. If they do not ratify the director's conduct, the company could pursue a claim against a director for the breach of fiduciary duty.

In 2004, the case of *Angas Law Services Pty Ltd (in liq) v Carabelas*[5] ('***Angas Law Services***') came before the High Court of Australia. The proceedings concerned a compensation claim of the appellant company brought by the liquidator against the two directors arising from alleged contraventions of sections 229(2) and 229(4) of the *Companies (South Australia) Code* which occurred in 1989. The two directors, who were the only shareholders of the company, unanimously voted at a general meeting of the shareholders to ratify their *own* breaches of fiduciary duties owed to the company for the purpose of releasing themselves from any liability to the company arising from those breaches.

[4] (1887) 12 App Cas 589 ('*Beatty*').
[5] [2005] HCA 23 ('*Angas Law Services*').

The *obiter* statements of Gleeson CJ and Heydon J (Gummow, Kirby and Hayne JJ agreeing) in applying *Bamford v Bamford*[6] ('***Bamford***') and *Winthrop Investments Ltd v Winns Ltd*[7] ('***Winthrop Investments***') confirmed that unless an exception applies, a majority of shareholders may lawfully ratify a director's breach of fiduciary duty. Ratification was permitted in the circumstances of the directors in *Angas Law Services*' case and the directors were not liable to the company.

The High Court's decision in *Angas Law Services* was consistent with the existing case law and it raised no new legal principle. The case did again draw attention to the availability of the doctrine for directors who had acted in breach of their duties. This remains a current legal problem in Australia because (i) there has not been any change to the applicability of the doctrine and (ii) there has not been any statutory law reform to the doctrine.

The issue addressed by this Thesis in light of the decisions from *Beatty* to *Angas Law Services* is whether a director/shareholder should be permitted to vote on a ratification resolution concerning their own conduct which was in breach of duty and whether there should be statutory law reform to the Corporations Act to address the operation of the doctrine. Partly that issue concerns when an exception applies to the doctrine of ratification (and thereby the exception excludes the operation of the doctrine). Overwhelmingly however, this Thesis considers the legal and policy issues which are relevant to when a breach of a director's duty is ratifiable.

## A. *The research question*

This Thesis will consider to what extent the doctrine of ratification remains relevant and appropriate to companies governed by the Corporations Act.

For the reason that directors may also be shareholders of the same company, there is an inherent tension between the application of the following principles:

(i) a director must act in the best interests of and avoid conflicts of interest to the company;

[6] [1970] Ch 212 ('*Bamford*').
[7] [1975] 2 NSWLR 666.

(ii) with limited exceptions on the principles explained in *Peter's American Delicacy Co Ltd v Heath*,[8] there are no fiduciary duties owed by a director to a shareholder;

(iii) generally, a shareholder does not owe any fiduciary duties to the company, or to any other shareholder;

(iv) corporate property must be used for corporate purposes;[9]

(v) a person shall not derive advantage from their own wrong;[10]

(vi) a director/shareholder may vote to prospectively authorise or to retrospectively ratify their own breach of fiduciary duties provided that the director's breach of duty was not unlawful (including because of fraud, an abuse of power or a breach or threatened breach of the Corporations Act or a breach of a director's duties), not a fraud on the minority, not contrary to section 232[11] of the Corporations Act or to expropriate the property of the company;

(vii) the shareholders cannot validly vote to prospectively authorise or to retrospectively ratify any breach of statutory directors' duties;[12] and

(viii) a director who is a shareholder may, subject to certain limited exceptions referred to in point (vi) above, vote at a meeting of shareholders in their own interests.

The objective of this Thesis is to critically examine the doctrine of ratification in the context of companies governed by the Corporations Act by considering six separate issues. Firstly, the beneficial aspects of the doctrine. Secondly, the legal uncertainty and the most significant criticisms of the doctrine. Thirdly, the legal issues arising from the possible attenuation of a director's fiduciary or statutory duties. Fourthly, the common law and statutory reforms in other common law jurisdictions. Fifthly, the problems which have or may emerge following statutory reform to the doctrine in other common law countries; and finally, the corporate law policy arguments in favour and against limited law reforms to the doctrine in Australia.

[8] [1939] HCA 2.

[9] *Hutton v West Cork Ry Co* (1883) 23 Ch D 654; *ANZ Executors & Trustee Company Limited v Qintex Australia Limited (Receivers and Managers appointed)* [1991] 2 Qd R 360.

[10] See, eg, *Tsoukaris v Royal Motor Yacht Club of New South Wales Limited* [2012] NSWSC 1190.

[11] *Corporations Act 2001* (Cth) s 232. Statutory oppression is particular to companies governed by the Corporations Act.

[12] *Angas Law Services* (n 5); *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52.

Shareholder primacy theory has been selected as the theoretical lens for the analysis of the doctrine for a number of reasons. Firstly, shareholder primacy theory arising from the work of Adolf Berle and Gardiner Means in 'The modern corporation and private property' published in 1933 has strongly influenced the development of Australian company law.[13] Secondly, shareholder primacy theory has been described as a central tenet of corporate governance[14] and ratification is inexorably linked to corporate governance issues. Thirdly, this Thesis considers the limits of shareholder powers in the context of ratification. The analysis of shareholder primacy theory thereby provides a proper basis for considering the corporate law policy issues which relate to ratification.

The Chapter outline below sets out how the research question will be addressed.

## B. *The literature review*

There have been a plethora of journal articles and parliamentary reports written in Australia and internationally concerning the topic of the doctrine of ratification. The seminal Australian paper written by the late Professor Robert Baxt published in 1978 titled *'Judges in their own cause: The ratification of directors' breaches of duty'*[15] considered the state of the law in Australia following the decision in *Winthrop Investments*.[16] Professor Baxt raised important questions about the underlying principles of law and how the doctrine of ratification works in practice.

[13] Adolf Berle and Gardiner Means, *The modern corporations and private property* (The MacMillan Company, 1933).
[14] Robert Rhee, 'A Legal Theory of Shareholder Primacy' (2018) *Minnesota Law Review* 122, 124.
[15] Robert Baxt, 'Judges in their own cause: The ratification of directors' breaches of duty' (1978) 5 *Monash University Law Review* 16.
[16] *Winthrop Investments* (n 7).

The case law concerning when a director's conduct is ratifiable is in an unsatisfactory state.[17] Academics have attempted to explain the difference between a ratifiable and non-ratifiable wrong, however, this has not resulted in a clear distillation of the legal basis for the difference.[18]

The academic analysis of the cases applying the doctrine has not yielded a clear explanation as to why different reasoning applies in similar factual situations such as, for example, the difference between a director taking a corporate opportunity from a company and a director appropriating the company's property.[19] The doctrine was aptly described by Karen Yeung as a *'tangled skein'*[20] and by Alice Ashbolt as *'a troublesome, arguably unworkable body of law'*.[21] Prior to the enactment of the statutory derivative action,[22] Saul Fridman described the doctrine in combination with rule of *Foss v Harbottle*[23] as a *'legal regime that perpetuates injustice towards minority shareholders'*.[24]

[17] Compare *Cook v Deeks* [1916] 1 AC 554, *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 and *Furs Ltd v Tomkies* (1936) 54 CLR 583

[18] See eg, Paul Davies and Sarah Worthington, *Gower: Principles of Modern Company Law* (Sweet & Maxwell, 11th ed, 2021); Baxt (n 15); David Bakibinga, 'Ratification: Reconciling Cook v Deeks and Regal (Hastings Ltd) v Gulliver' (1986) 13 Nigerian Law Journal 121; Say Goo, *Minority Shareholders' Protection* (Cavendish Publishing Ltd, 1994).

[19] Saul Fridman, 'Ratification of Directors' Breaches' (1992) 10 *Company and Securities Law Journal* 252, 262-263. See also Davies and Worthington (n 18) 617; Robert Austin, 'Fiduciary Accountability for Business Opportunities' in Paul Finn (ed) *Equity and Commercial Relationships* (Law Book Company Ltd, 1987), 183.

[20] Karen Yeung, 'Disentangling the Tangled Skein: The Ratification of Directors' Actions (1992) 66 *Australian Law Journal* 343.

[21] Alice Ashbolt, 'Legislated and reasoned away: Death of the doctrine of shareholder ratification' (2009) 83(8) *Australian Law Journal* 525, 536.

[22] *Corporations Act 2001* (Cth) s 232.

[23] (1843) 2 Hare 461.

[24] Fridman (n 19) 255.

The most criticised aspect of the doctrine is the right of a director/shareholder to vote on a ratification resolution concerning their own breach of duty.[25] The academic criticism of the doctrine of ratification has been ongoing.[26]

There was an Australian law review over 30 years ago. The Companies and Securities Law Review Committee in its report dated 21 May 1990, titled '*Company Directors and Officers: Indemnification, Relief and Insurance'*, recommended an amendment to the Corporations Act to allow a company by resolution of a properly informed and disinterested general meeting, to release a director or officer from liability to pay damages or compensation to the company in respect of wrongdoing that did not involve intent to deceive or defraud. These proposed reforms were never enacted by the Commonwealth Parliament. Since the enactment of the statutory derivative action in March 2000, the doctrine has not arisen for further contemplation by the Commonwealth Parliament.

Academics in the United Kingdom[27] have similarly considered the principles underlying the doctrine of ratification, however, there was subsequent statutory law reform in the United Kingdom in 2006.

Academic writing in the United States of America has considered the doctrine of ratification in its unique context because the law developed independently from other common law countries. An important paper written by Professor Earl Sneed titled *'The stockholder may vote as he pleases: Theory and Fact'*[28] considered the legal and equitable rights of shareholders

[25] See, eg, Baxt (n 15); Hugh Mason, 'Ratification of the Directors' Acts: An Anglo-Australian Comparison' (1978) 41(2) *Modern Law Review* 161; Fridman (n 19) 260; Rosemary Teele Langford, 'Statutory duties and ratification: Untangling the maze' (2021) 15 *Journal of Equity* 126, 150.

[26] See generally, Paul Finn, *Fiduciary Obligations* (The Law Book Company Ltd, 1977), 73; Bakibinga (n 18); John Farrar et al, *Farrar's Company Law* (Butterworths, 2nd ed, 1988), 388; See Robert Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (LexisNexis 17th ed, 2018), [8.390].

[27] See, eg. Sarah Worthington, 'Corporate Governance: remedying and ratifying directors' breaches' (2000) *Law Quarterly Review* 116; David Chivers et al, *The Law of Majority Shareholder Power Use and Abuse*, (Oxford University Press, 2008), [7.33].

[28] Earl Sneed, 'The stockholder may vote as he pleases: Theory and fact' (1960) 22 *University of Pittsburgh Law Review* 23.

to vote on a ratification resolution in the context of the law in the United States of America. There was statutory law reform in 1967 to require a 'disinterested majority of shareholders' to approve a ratification resolution in Delaware, United States of America. The current law in Delaware, is more complex than the law in Australia because ratification can result in four different legal outcomes.[29] As discussed in Chapter 6, those effects are to either; have no effect whatsoever, fully extinguish a legal claim, shift the burden of proof to the plaintiff of whether there was 'entire fairness', or maintain the business judgment rule's presumptions.[30]

Greater attention was given to this corporate law issue following the release of the Companies and Securities Law Review Committee report titled *Company Directors and Officers: Indemnification, Relief and Insurance* in 1990, the Cadbury Report[31] in the United Kingdom in 1992, the Royal Commission report into HIH Insurance in 2001[32] following its collapse and the academic analysis of the corporate governance lessons learnt from the James Hardie Industries saga.[33]

Academic perspectives on the doctrine applying corporate governance principles are diverse. The academic literature concerning the overarching principles of leadership, effectiveness, ethics, openness, integrity and accountability adopt on the one hand a 'narrow' view by considering the conduct of directors in the context of shareholders and there is a competing 'broader approach' by considering other stakeholders including creditors and employees.[34] The

[29] *Solomon v Armstrong* 747 A 2d 1098 (Del, 1999); Krystal Scott, 'A Catch-22 or a catch-all: Delaware and Texas Grasp for certainty in shareholder ratification' (2006) 8 *Duquesne Business Law Journal* 117, 118.

[30] *Solomon v Armstrong* 747 A 2d 1098 (Del, 1999); Krystal Scott, 'A Catch-22 or a catch-all: Delaware and Texas Grasp for certainty in shareholder ratification' (2006) 8 *Duquesne Business Law Journal* 117, 118.

[31] Adrian Cadbury, Report of the Committee on the Financial Aspects of Corporate Governance (1992), paragraph 2.5.

[32] *Royal Commission into HIH Insurance* (May 2003).

[33] Anil Hargovan, 'Australian Securities and Investments Commission v McDonald [No 11] – Corporate governance lessons from James Hardie' (2009) 33(3) *Melbourne University Law Review* 984.

[34] Jill Solomon and Aris Solomon, *Corporate Governance and Accountability* (John Wiley & Sons, Ltd, 2004), 14.

commentary has not added any significant contribution to the ongoing criticisms of the doctrine.

Whilst the published literature concerning the doctrine has considered its operation, effect and the principles it is based upon,[35] the academic papers do not consider in a collective and systematic way the issues raised by the research question of this Thesis. Two examples are apt to demonstrate the concern. A significant and unresolved legal question is whether there are differences between retrospective ratification and prospective authorisation of a breach of a director's duty.[36] There also remains a significant gap in the literature with respect to the attenuation of a director's fiduciary and statutory duties.[37] This was a point left open by the High Court in *Angas Law Services*. A novel aspect of this Thesis is the analysis of the possibility of the attenuation of a director's fiduciary and statutory duties.

Since the introduction of the statutory derivative action into the Corporations Act in Australia in March 2000, there has not been a reassessment of the effect of the doctrine of ratification in relation to the interests of companies and minority shareholders by any published Thesis or by any Commonwealth report. This Thesis brings the discussion up-to-date and it provides a contemporary review and a detailed analysis of the relevant laws in New Zealand, the United Kingdom, Canada and Delaware in the United States of America. The Thesis argues for limited statutory law reform to the doctrine and applies that analysis by proposing the draft legislative amendments to the Corporations Act.

[35] See eg, Ashbolt (n 21).

[36] See, eg Ross Cranston, 'Limiting directors' liability: ratification, exemption and indemnification' (1992) *Journal of Business Law* 197, 199-200; R Partridge, 'Ratification and the Release of Directors from Personal Liability' (1987) 45 *Cambridge Law Journal* 12, 143-147.

[37] See Dierdre Ahern, ' 'Nominee directors' duty to promote the success of the company: Commercial pragmatism and legal orthodoxy' (2011) 127 *Law Quarterly Review* 118; Matthew Conaglen, 'Interaction Between Statutory and General Law Duties Concerning Company Director Conflicts (2013) 31(7) *Company and Securities Law Journal* 403, 413 and 421 discussing Companies and Securities Law Review Committee, Takeovers Panel, *Indemnification, Relief and Insurance in Relation to Company Directors and Officers* (Report, May 1990), [54] and John Langbein, 'Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?' (2005) 114 Yale Law Journal 929.

## C. *Uses of a director's powers and ratification*

The intersection of the doctrine of ratification and the limits of shareholders' powers under the Corporations Act provides a context for the legal analysis because it assists to explain the limits of shareholders' powers and the extent to which shareholder primacy theory is implemented by the Corporations Act.

It is useful at this point to reflect on the position of minority shareholders in the context of companies. The relationship between each shareholder and the company is largely contractual[38] and no shareholder has any right to absolute protection if their interests are affected.[39] Further, unless the company is listed on a securities exchange, there may be no liquid market for its shares and in ordinary circumstances in the absence of a shareholders agreement or orders being made under sections 233 or 461 of the Corporations Act, there is no mechanism for a shareholder to compel a buyout of their shares.

A shareholder may choose to seek to protect their interests by the enforcement of their rights under the Corporations Act or under the company's constitution, and this choice will turn on two main considerations. Firstly, whether the legal and factual matrix provides the shareholder with a remedy and, secondly, the economics of commencing proceedings because of the high costs involved in commercial litigation in Australia.[40] A minority shareholder may seek to reduce any economic damage and seek orders (for example) for the buyout of their shares by a majority shareholder,[41] seek the grant of an injunction,[42] or seek leave to commence derivative proceedings arising from a breach of duty to the company.[43] In some cases, a shareholder may have a claim to a suitable remedy, but the likely legal costs negate any expected benefit for the

[38] *Corporations Act 2001* (Cth) s 140.

[39] See generally, Janet Dine, 'Rights of Minority Shareholders' (Conference Paper, XVIth Congress of the International Academy of Comparative Law, 2002), 781.

[40] See, eg, Schedule 3 of the *Federal Court Rules 2011* (Cth) which provides an allowance for a lawyer's professional fees. As an example, in *Sandalwood Properties Ltd (Subject to a Deed of Company Arrangement) v Huntley Management Ltd (No 2)* [2019] FCA 647 which concerned invalidly approved resolutions at a company meeting. Colvin J in this case allowed $130,500 (exclusive of GST) where the hearing last approximately half a day. Colvin J at [28] described the amounts claimed by two practitioners as 'confronting amounts'.

[41] See, eg, The court's discretion pursuant to section 233(1)(d) of the *Corporations Act 2001* extends to the purchase of shares.

[42] *Corporations Act 2001* (Cth) s 1324.

[43] *Corporations Act 2001* (Cth) s 237.

shareholder and make it uneconomical to pursue the claim. This highlights the vulnerable position of minority shareholders where the directors of a company use their powers in their own interests or for their own benefit (or the benefit of a related party).

A ratification resolution approved by a majority of shareholders may establish grounds to seek relief under section 232[44] and/or section 461 of the Corporations Act and, accordingly, there is an important connection between ratification and the limitation of the shareholders' powers.[45] The doctrine of ratification therefore does not operate free from constraints under the Corporations Act and the general law which impose some limitations on the rights of shareholders to vote in their own interests.

Unless the company is a public company, a director who has the personal interest in a related party transaction[46] is permitted to vote on the approval of the transaction and this aligns with the right of a director/shareholder to approve a ratification resolution in respect of their own breach of statutory and fiduciary duty. The shareholders of private companies are not subject to the requirements of section 224 of the Corporations Act which limit some shareholder's right to vote on related party transactions. In relation to public companies, transactions which involve a director's material personal interest are required to be approved by the shareholders in general meeting.[47] Save for this statutory prohibition against certain shareholders voting on related party transactions,[48] the right of a director and their associates to vote on a transaction where a director will obtain a financial benefit from the approval of the resolution highlights the prejudice which arises from the largely unconstrained right of a shareholder to vote in their own interests and contrary to the interests of the company.

The doctrine of ratification can operate in the context of an abuse of power by one or more of the directors. A typical example of this problem arises in relation to the sale of a company's assets.[49] An abuse by the directors of their powers which created rights in a third party is voidable and, subject to any limits imposed by equitable principles, the ratification of the breach of duty by the shareholders in general meeting ratifies the breach to regularise the

[44] See especially *HNA Irish Nominee Ltd v Kinghorn (No 2)* [2012] FCA 228 ('*HNA Irish Nominee*').

[45] See, eg. *Gambotto v WCP Ltd* [1995] HCA 12 which concerns the duties on controlling shareholders.
[46] See *Corporations Act 2001* (Cth) Chapter 2E.
[47] *Corporations Act 2001* (Cth) s 195(4).
[48] *Corporations Act 2001* (Cth) s 224.
[49] See for example, *Bamford v Bamford* [1970] Ch 212; *Hogg v Cramphorn Ltd* [1967] Ch 254.

directors' conduct. Even if the shareholders do not approve the ratification resolution, the company may be bound by the directors conduct because of the assumptions which may be made by a third party under section 129 of the Corporations Act. There is evident prejudice to the company and its minority shareholders in these circumstances since the minority shareholders will be largely unable to limit the majority's power to approve a ratification resolution which concerns the misuse of the company's property.

The enforcement of third party securities such as guarantees and security interests registered over land or pursuant to the *Personal Property Securities Act 2009* (Cth) may involve considerations of (i) the assumptions the third party is entitled to make under section 129 of the Corporations Act[50] (ii) the protection of irregularities which arise in shareholders' meetings under section 1322 (iii) whether the shareholders approved (and were legally entitled to approve) the creation of the rights in the third party[51] and (iv) whether the shareholders in general meeting may ratify the directors' conduct which was an abuse of power.[52]

In the absence of a ratification resolution which remedies a breach of duty by a director, a third party may be limited to reliance on the assumptions in section 129 of the Corporations Act, but that will depend upon whether the third party knew or suspected that the assumptions relied upon were incorrect.[53] Ratification therefore has a role in resolving questions of the enforceability of third party securities as it relates to a company's property, however, whether there has been a ratification of a director's conduct is not a complete answer to the legal controversy surrounding the enforcement of third party securities.

The introduction of the statutory derivative action into the Corporations Act significantly changed the operation of the doctrine of ratification. The statutory cause of action improved the position of minority shareholders where a company was unwilling or unable to act against a wrongdoing director. The introduction of section 239 of the Corporations Act ensured that the ratification of a breach of a director's duty did not have the effect of extinguishing the right of a shareholder to commence or intervene in proceedings with leave granted pursuant to

[50] See, eg, *Northside Developments v Registrar-General* (1990) 170 CLR 146.

[51] See eg, *ANZ Executors & Trustee Company Limited v Qintex Australia Limited (Receivers and Managers appointed)* [1991] 2 Qd R 360.

[52] See generally Bryan Horrigan, 'Third Party Securities – Theory, law and Practice' in John Greig and Bryan Horrigan (eds), *Enforcing Securities* (The Law Book Company Limited, 1994).

[53] Horrigan (n 52) 242.

section 237. This section resulted however in new legal problems for minority shareholders. Whilst section 239 of the Corporations Act permits shareholders to commence derivative actions even when a director's conduct was ratified, the approval of a ratification resolution remains relevant to whether leave is granted under section 237 of the Corporations Act, the ultimate orders made by a court in derivative proceedings[54] and in respect of applications for relief from liability made under section 1318 of the Corporations Act.

Ratification does not operate in the context of pre-insolvency and insolvency situations. In an insolvency context where the company has acted to the prejudice of creditors, even the shareholders' reserve powers are curtailed in favour of creditors' rights. A line of authority following *Kinsella v Russell Kinsella Pty Ltd (in liq)*[55] ('***Kinsella***') explains that creditors in these circumstances have rights in respect of a company's property and not the shareholders.[56]

## D. *The problems arising from the operation and effect of the doctrine*

Based upon the literature review discussed above, there are a number of significant problems evident with the operation and effect of the doctrine of ratification with respect to companies governed by the Corporations Act which are set out below:

(i) save for public companies or entities controlled by a public company,[57] a director/shareholder and their associates (including close relatives) are permitted to vote to approve a ratification resolution;

(ii) integrity, accountability and ethics, all contemporary good corporate governance principles, are not principles which underpin the doctrine of ratification;

(iii) the best interests of a corporation are not required to be objectively assessed prior to the approval of a ratification resolution by the shareholders in general meeting;

(iv) a ratification resolution approved by the shareholders in general meeting cannot be later treated as a voidable transaction[58] under the Corporations Act;

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[54] *Corporations Act 2001* (Cth) s 239.

[55] (1986) 4 NSWLR 722 ('*Kinsella*'). See eg., *Australasian Annuities Pty Ltd (in liq) (Recs and Mgrs Apptd) v Rowley Super Fund Pty Ltd* (2015) [2015] VSCA 9.

[56] Horrigan (n 52) 246.

[57] Pursuant to section 208(1) of the *Corporations Act, 2001* (Cth) approval by a company's is required. Voting restrictions apply to a related party (see s 228) and an associate of a related party of the relevant public company pursuant to s 224(1).

[58] *Corporations Act 2001* (Cth) s 588FE.

(v) shareholder ratification of a breach of duty is relevant to whether a shareholder may be granted leave to commence derivative proceedings[59] whereas ratification of a breach of duty cannot prevent a shareholder commencing proceedings pursuant to section 232 of the Corporations Act (the statutory oppression remedy). The divergence of the right to commence proceedings may indicate that a legislative lacuna has emerged; and

(vi) ratification of a breach of duty is relevant to the court's discretion to grant relief to a director from a liability owed to the company.[60] The granting of relief can occur when the director/shareholder is the major shareholder of the company.

A re-examination of the doctrine of ratification drawing on reforms made to the doctrine in other common law countries is of important contemporary legal significance to future law reforms to the Corporations Act.

## E. ***Chapter outline***

This Thesis concludes that the doctrine of ratification is beneficial to companies governed by the Corporations Act but its availability should be narrowed from its present form. An argument is presented for significant but limited statutory reform to the Corporations Act which prohibits a director/shareholder, their family members and associates from voting on a ratification resolution.

Legislative amendments are necessary to limit the operation of the doctrine of ratification, as distinct from a general prohibition, because of the benefit it provides with respect to each of following four matters:

1. ratification avoids a situation where a director would be liable for a breach of duty to the company that had no negative consequences for the company or even may have been beneficial to the company (eg. issuance of shares during a hostile takeover bid);
2. ratification protects directors who have acted honestly consistent with the policy intent of section 1318 of the Corporations Act;

[59] *Corporations Act 2001* (Cth) ss 237, 239.
[60] *Corporations Act 2001* (Cth) s 1318.

3. ratification allows shareholders to have a say in certain aspects of the company's governance and this is consistent with the general approach of courts to not interfere in the internal decision-making processes of companies; and
4. a ratification resolution is relevant to the enforcement of third party securities including security interests under the *Personal Property Securities Act 2009* (Cth), mortgages and guarantees.[61]

Each of the above legal issues would need to be readdressed if the doctrine of ratification did not apply to companies governed by the Corporations Act.

The chapter outline below summarises the key matters to be considered in each of the nine Chapters of this Thesis which support the six principal issues discussed in this Thesis in support of limited statutory law reform to the Corporations Act which are:

1. the benefits of the application of the doctrine to companies governed by the Corporations Act;
2. the criticisms and uncertainties of the operation and effect of the doctrine;
3. whether ratification is permissive of the attenuation of a fiduciary or statutory duty and the legal consequences arising from the attenuation of a director's duty;
4. the limited statutory reforms to the doctrine in comparable common law countries;
5. the problems identified by this Thesis with the statutory law reforms in the other common law countries; and
6. the Australian corporate law policy arguments for and against limited law reform to the doctrine.

Chapter 2 discusses the doctrine of ratification, its current scope and application to companies governed by the Corporations Act. The doctrine of ratification which developed in customary Roman law has been applied widely to fiduciary relationships, including director and company. This analysis of the current law in Australia also explores the difference between retrospective ratification and prospective authorisation. This analysis of the current law lays the foundation for the critical reassessment of the doctrine in this Thesis.

[61] See generally Horrigan (n 52).

Chapter 3 considers the benefits of the doctrine of ratification in its application to companies governed by the Corporations Act. This Chapter considers the policy basis of the doctrine which was discussed in *Keighley, Maxsted & Co v Durant*.[62]

There are benefits of the application of the doctrine to companies which include; when ratification arises in relation to a payment made on a company's behalf, this will result in a discharge of the company's debt to a creditor (and this may be relevant in an insolvency context) and the protection of honest directors following a ratification resolution under section 1318 of the Corporations Act.

Chapter 4 picks up on the discussion of the current law in Chapter 2 and discusses the criticisms and uncertainties inherent in the application of the doctrine to companies governed by the Corporations Act.

The most significant criticism of the doctrine is the problem which arises from self-interested directors/shareholders voting to ratify their own breach of duty to the company arising from, for example, some related party transaction with the company. A review of the academic and judicial criticism of the operation of the doctrine indicates that the Corporations Act needs to be reformed to address this specific problem for the benefit of companies and their minority shareholders. The analysis of the criticisms and uncertainties provides a persuasive reason for limited statutory reform to the doctrine.

Chapter 5 considers whether statutory duties can be attenuated resulting in the changed content of a director's duties as a separate issue from earlier Chapters. This question was only partly considered by the High Court in *Angas Law Services*[63] and there is limited other authority in Australia considering the legal issues, including in respect of incorporated associations, strata companies and trade unions. Consideration is given to the *obiter* remarks of Edelman J in

[62] [1901] AC 240.
[63] *Angas Law Services* (n 5).

*Australian Securities and Investments Commission v Cassimatis (No 8),*[64] ('***Cassimatis (No 8)***') and *Cassimatis v Australian Securities and Investments Commission*[65] which discussed the public nature of directors' duties. There remain legal and policy issues which have not been addressed by the academic literature and the judiciary in Australia. The analysis provided in this Thesis is therefore a novel part of the reassessment of the doctrine of ratification.

Pursuant to the doctrine of attenuation of fiduciary duties, the fiduciary duties owed by directors may be narrowed by the unanimous agreement of the shareholders and as discussed in *Angas Law Services*, the shareholders' acquiescence to a course of conduct can affect the practical content of a director's fiduciary duties.

The question whether statutory duties may be attenuated is addressed to provide a separate criterion for assessing whether the doctrine of ratification remains relevant and appropriate to companies governed by the Corporations Act. The legal analysis presented in Chapter 5 confirms that the law concerning attenuation of directors' duties remains under development in Australia and that there are conflicting policy arguments. This Thesis argues that attenuation of duties by shareholders should be limited in the same way as proposed for limiting ratification.

Chapter 6 considers whether and how the issues raised in earlier Chapters have been addressed in other common law countries, specifically, the United Kingdom, Delaware in the United States of America, Canada and New Zealand. It is significant for this analysis to consider whether the law has developed in the same way as Australia and what reforms were made to corporate law to deal with the problems evident from the operation of the doctrine in each jurisdiction. A further question is then whether the enacted reforms are, or are predicted to be, effective to resolve the problems with the doctrine. Significantly, many law reforms to the doctrine were ineffective or introduced new problems of statutory interpretation.

[64] [2016] FCA 1023 ('*Cassimatis (No 8)*').
[65] [2020] FCAFC 52.

Chapter 7 evaluates the Australian corporate law policy arguments for and against law reform to the doctrine. The extent to which shareholder primacy theory is implemented into the Corporations Act is discussed in this Chapter and this review provides a specific context for analysing the policy considerations in the context of the doctrine. Having considered the theoretical aspects of corporations, this Thesis consider the risks of retaining the doctrine in its current form. The analysis of the policy issues identified that the risks to retaining the doctrine are outweighed by the benefits and this is a substantial reason to reform the operation of the doctrine.

Based upon the analysis discussed in earlier Chapters, this Thesis in Chapter 8 argues for a limited number of reforms to the Corporations Act which will have the effect of eliminating or reducing (as far as possible) the problem of a director/shareholder, their associates and close family members voting to approve a ratification or authorisation resolution. These proposed legislative reforms address key problems with international law reforms identified by this Thesis and accordingly draw on the analysis of the international jurisprudence from the United Kingdom, the United States of America and Canada. There are no reported cases which have considered the statutory interpretation of the statutory reforms to ratification in New Zealand.

The proposed legislative reforms to the doctrine of ratification include the following key measures. Firstly, to ensure a director/shareholder who acted in breach of their duties, their associates and family members are prohibited from voting to approve a ratification, authorisation or attenuation resolution in connection with (i) conduct of a director which amounts to negligence, default, breach of trust, breach of duty or an exercise of power of a director, (ii) the attenuation of a director's duty, or (iii) a release, forbearance to sue or settlement of a claim in relation to the matters in point (i) above. The statutory definition of the persons excluded from voting will draw on existing definitions in the Corporations Act.

Secondly, to retain the benefits of the doctrine by preserving all the existing common law, general law and extant powers of a court. Thirdly, to ensure that shareholders and companies can provide for stricter constitutional requirements in relation to the doctrine of ratification. Finally, to create a new civil penalty provision for a contravention of the new provision and create an offence if a contravention involves dishonesty.

Chapter 9 draws together the conclusions of this Thesis with respect to the identified legal and corporate law policy issues, uncertainty in the operation of the law and the development of the law in other jurisdictions. This Chapter concludes this Thesis by highlighting the proposed statutory reforms to the Corporations Act for the purpose of considering future law reforms to State and Territory laws and in relation to Managed Investment Schemes regulated under Chapter 5C of the Corporations Act.

## F. *The scope of the Thesis*

A number of matters which concern the doctrine of ratification are outside of the scope of this Thesis which are referred to below.

This Thesis will not examine the extent to which countries with a civil law legal system have adopted or reformed the doctrine of ratification. The distinctions between common law countries and civil law countries with respect to the reliance on equitable principles must be recognised as a barrier to any comparative analysis. Further, various definitions of corporate governance may differ significantly in their scope and focus because of social, cultural, economic and political influences in countries which have followed the civil law tradition,[66] making their consideration less beneficial.

Separate to companies governed by the Corporations Act, the operation of the doctrine of ratification is of significance to body corporates incorporated under State and Territory legislation which include; strata companies,[67] trade unions,[68] co-operatives, not-for-profit organisations, and other incorporated associations.[69] In Australian in 2020, there were over

[66] Jeswald Salacuse, 'The Cultural roots of Corporate Governance' in Joseph Norton, Jonathan Rickford and Jan Kleineman (eds), *Corporate Governance Post-Enron: Comparative and International Perspectives* (British Institute of International and Comparative Law, 2006).

[67] See, eg, *Owners Corporations Act 2006* (Vic).
[68] See, eg, *Trade Unions Act 1958* (Vic).
[69] See, eg, *Associations Incorporation Reform Act 2012* (Vic).

340,000 strata companies with a total insured value of over $1.1 trillion[70] and approximately 14.3% of all employees were members of a trade union.[71]

This Thesis does not consider the specific legislative reforms which may be required to reform State and Territory legislation in relation to body corporates in the context of the doctrine. The scope of such a review is enormous because of the number of different Acts which regulate strata companies, trade unions, co-operatives and not-for-profit organisations. A review of managed investment schemes which are regulated by Chapter 5C of the Corporations Act is also not considered by this Thesis because there are statutory duties which are more extensive than the statutory duties which apply to directors of companies.[72] The legislative reforms to the Corporations Act proposed by this Thesis will however provide general guidance for future reforms to State and Territory legislation.

It is also outside of the scope of this Thesis to consider the consequences of any limited law reform to the doctrine on statutory corporations. There are a myriad of Acts enacted by the Commonwealth, the States and the Territories which rely upon the Corporations Act. Accordingly, a review of each Act would be necessary to determine the impact of the legislative reforms proposed by this Thesis upon a particular statutory corporation. There could therefore be unintended consequences which flow from the law reform recommendations in this Thesis for many statutory corporations.

[70] Hazel Easthope et al, *Australasian Strata Insights 2020* (PDF, March 2021) <https://cityfutures.be.unsw.edu.au/documents/612/Australasian_Strata_Insights_2020_Final.pdf>.

[71] Australian Bureau of Statistics, 'Trade Union Membership' (Webpage, 11 December 2020) <https://www.abs.gov.au/statistics/labour/earnings-and-work-hours/trade-union-membership/latest-release#:~:text=There%20were%201.5%20million%20trade,worked%20in%20full%2Dtime%20jobs.&text=Trade%20union%20membership%20tends%20to,24%20were%20trade%20union%20members>.

[72] See *Corporations Act 2001* (Cth) s 601FD.

## CHAPTER 2 – THE DOCTRINE OF RATIFICATION: ITS CURRENT SCOPE AND APPLICATION IN THE CONTEXT OF COMPANIES GOVERNED BY THE *CORPORATIONS ACT 2001*

### A. *Introduction*

Pursuant to the doctrine of ratification, a shareholder who is also a director of the company may vote at a general meeting of the shareholders to approve a ratification resolution in respect of their *own* breach of fiduciary and/or statutory duty as a director of the company. In both Australia and the United Kingdom, a remedy has not been granted to a company for any detriment caused to a company because of a ratification of a breach of duty. Specifically, the director/shareholder voting does not amount to a conflict of interest, give rise to any breach of fiduciary duty to any other shareholder, or unjust enrichment.

The current law is dominated by two questions. Firstly, whether a director's conduct is ratifiable. Secondly if the conduct is ratified and a shareholders' resolution is valid, the proper interpretation of that resolution to determine the effect, if any, the resolution has in connection with the company.

This Chapter begins with outlining the different legal contexts in which the word 'ratification' is used, and how this applies to companies governed by the Corporations Act.

The doctrine of ratification can have a negative effect on minority shareholders. To address these problems, the common law developed exceptions to the availability of ratification on a case by case basis. The scope of the operation of the doctrine was thereby reduced and this Chapter will discuss the limits of the doctrine in this context.

It is significant to note that, if a director's conduct is ratified, that ratification operates retrospectively, ie. the conduct was authorised *ab initio*. The consequences of the ratification may be far broader than simply to protect a director from liability for a breach of duty. They could include that the company may be bound by a transaction under section 128 of the Corporations Act, which could have a separate adverse financial impact on the company.

In this Chapter, the legal requirements for a valid ratification are discussed before considering the legal effect of a ratification resolution. Since the word 'ratification' is used in different legal contexts, ratification can have different legal effects which vary between (i) the extinguishment of a company's cause of action for breach of a director's duty, (ii) a promise not to sue a director for breach of duty, (iii) preventing the current controllers of the company from commencing legal proceedings or (iv) a release to the director in breach of their duties which may be pleaded as a defence to a claim for breach of duty.

## B. *Statutory duties of directors*

Before embarking upon a discussion about the meaning of ratification, it is necessary to briefly consider the statutory duties owed by a director of a company.

The nature of the duties imposed upon directors under the *Companies Act 1862* (UK) as developed by the Courts of Equity was not always clear arising from differing judicial views as to whether directors were to be regarded as agents, trustees, managing partners, or some combination of these.

Under the Corporations Act, the duties owed by a director includes duties to:

(i) exercise their powers and discharge their duties with the degree of care and diligence of a reasonable person (section 180(1) of the Corporations Act);

(ii) exercise their powers and discharge their duties act in good faith in the best interests of the company and for proper purposes (section 181(1) of the Corporations Act);

(iii) not improperly use their position to gain an advantage for themselves or someone else, or cause detriment to the company (section 182(1) of the Corporations Act); and

(iv) not improperly use information gained from being a director to gain an advantage for themselves or someone else, or cause detriment to the company (section 183(1) of the Corporations Act).

## C. *What is the meaning of 'ratification'?*

Ratification, which developed from the law of agency, is concerned with the performance of acts without authority by an agent in the name of a named or ascertainable principal.[73] In connection with the doctrine of the undisclosed principal, if the agent does not act or purport to act as agent for the principal,[74] *ergo* the agent acts for themselves and the doctrine of ratification cannot operate.[75] The effect of the doctrine of ratification is to bind a principal retrospectively to the acts of an agent so that the principal becomes liable for the agent's acts. A principal may at times make an election to ratify the agent's conduct to become bound, such as will be the case when the principal wishes to enforce the terms of a contract on a third party.

Ratification must be unambiguous[76] and may be by express words, or implied from conduct[77] including silence[78] and acquiescence.[79] This is the case even with respect to a matter where statute requires the agreement to be in writing.[80]

In *Beatty*[81] the doctrine was applied in the United Kingdom to allow shareholders in general meeting to ratify a breach of a director's fiduciary duties owed to the company.

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[73] *Imperial Bank of Canada v Begley* [1936] 2 All ER 367 citing with authority Viscount Hailsham et al, *Halsbury's Laws of England*, Vol 1 (Butterworths, 1907), 231; *Heath v Chilton* (1844) 12 M & W 632, 638; *Eastern Construction Co v National Trust Co* [1914] AC 197, 213.

[74] In the context of an undisclosed principal, a party cannot become the undisclosed principal to a contract by subsequent ratification of the contract (see *Keighley Maxsted & Co v Durant* [1901] AC 240, 251; *Howard Smith and Company Ltd v Varawa* [1907] HCA 38; *Maynegrain Pty Ltd v Compafina Bank* [1982] 2 NSWLR 141 (NSW CA), 150 (Hope JA); *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1987) 8 NSWLR 270 (NSW CA), 276 (McHugh JA)). The foundation of liability of an agent to the other contracting party lies in the non-disclosure of the existence of a principal (see *Marsh & McLennan Pty Ltd v Stanyers Transport Pty Ltd* [1994] 2 VR 232, 244; *Citi Nominees Pty Ltd v Fenny* [2006] WASC 97). An undisclosed principal arises only where the agent was in truth their agent at the time of the transaction and this arises from not disclosing the identity of the principal (*Keighley, Maxsted & Co v Durant* [1901] AC 240; *Marsh & McLennan Pty Ltd v Stanyers Transport Pty Ltd* [1994] 2 VR 232, 244; *Citi Nominees Pty Ltd v Fenny* [2006] WASC 97; *McNally v Jackson Spanney* (1938) 42 WALR 27).

[75] *Imperial Bank of Canada v Begley* [1936] 2 All ER 367.

[76] *The Bonita* (1861) Lusb 252.

[77] See, eg. *Hagler v Parker* (1846) 7 M & W 322; *Cornwall v Wilson* (1789) 1 Ves 569.

[78] *Yona International Ltd v La reunion Francaise SA* [1996] 2 Lloyd's Rep 84.

[79] *Kent v Thomas* (1836) 1 H & N 473; *French v Backhouse* (1771) 5 Bar 2728. See generally E Wright, *The law of principal and agent* (Stevens and Sons, Ltd, 2nd ed, 1901), 58.

[80] For example, under the *Statute of Frauds 1677* (UK). See *McLean v Dunn* (1828) 4 Bing 722.

[81] *Beatty* (n 4).

It is for the principal to decide whether or not to ratify an act of an agent. The strong weight of authority[82] indicates that when the principal has elected to ratify an act, the maxim *omnis ratihabitio retrotrahitur et mandato priori aequiparatur*[83] applies. Subject to the exceptions developed to prevent unfairness to third parties, the ratification is deemed by the law to be retrospective to the time of the agent's conduct as though the principal had authorised the act *ab initio*.[84] The position is different from the situation where the agent's acceptance was expressly conditional upon the ratification by the principal.[85] In such circumstances, the ratification will not be retrospective.

## D. *The legal requirements for ratification*

In the context of companies governed by the Corporations Act, the legal requirements discussed in *Firth v Stainer*[86] for a valid ratification are as follows and considered in detail below:

(i) the ratification must take place within a reasonable time;
(ii) the principal (company) must have knowledge of the agent's (director's) conduct; and
(iii) there must be full and frank disclosure.

There is some uncertainty as to whether the provision of a release by a company to the director in breach is a further requirement for a valid ratification. The decision of Santow J in *Miller v Miller*[87] ('***Miller***') held that '[r]atification of a past breach, though within the permitted scope

[82] There have been expressions of disapproval of the application of the principle for which *Bolton Partners v Lambert* (1889) 41 Ch D 295 is authority for in *Fleming v Bank of New Zealand* (1900) AC 577, 587, in Isaacs J's dissenting judgment in *Davison v Vickery's Motors Ltd* (1925) 37 CLR 1, 20 and *Adams v Elphinstone* [1993] TASSC 67.
[83] Every ratification is dragged back and treated as equivalent to a prior authority (*Bolton Partners v Lambert* (1889) 41 Ch D 295).
[84] *Koenigsblatt v Sweet* [1923] 2 Ch 314. See generally Roderick Munday, *Agency law and principles* (Oxford University Press, 2010), 105.
[85] See, eg, *Watson v Davies* [1931] 1 Ch 455.
[86] [1897] 2 QB 70.
[87] (1995) 16 ACSR 73 ('*Miller*').

for ratification, would not, of itself, generally speaking, extinguish a claim.'[88] Subsequent cases in Australia have not overruled the decision.

**The reasonable time requirement**

The ratification by the shareholders in general meeting of a breach of duty must take place within a reasonable time, after which the conduct cannot be ratified to the prejudice of a third person.[89]

It was held in *In re Portugese Consolidated Copper Mines Ltd*[90] that the standard of reasonableness must depend upon the circumstances of the case.[91] In this case, it was considered that the question was one which must be decided on the true construction of the articles of association of the company.[92] The Court did not set out what it considered to be the relevant factors, or the principles upon which a reasonable time may be determined and accordingly, there is legal uncertainty about what is a reasonable time.

This Thesis does not seek to address the legal uncertainty about the reasonable time requirement. The cases have been determined on a case by case basis. Any statutory law reform to establish a time limit by which a ratification resolution must be approved would be based on subjective criteria and in this regard the time limit would be arbitrary. The imposition of a time limit which has the effect of barring the right of a director to seek a ratification resolution could have an adverse effect on directors who seek the protection of a ratification resolution to avoid the requirement to apply for relief from a court pursuant to section 1318 of the Corporations Act.

**The full and frank disclosure requirement**

[88] *Miller* (n 88), 87 (Santow J).
[89] *Re Portugese Consolidated Copper Mines Ltd* [1891] 3 Ch 28.
[90] (1889) 42 Ch D 160.
[91] *Re Portugese Consolidated Copper Mines Ltd* [1891] 3 Ch 28, 37 (Bowen LJ).
[92] *Re Portugese Consolidated Copper Mines Ltd* [1891] 3 Ch 28, 37 (Bowen LJ).

In order to satisfy the requirement that there be fully informed consent[93] of the shareholders in general meeting, the director in breach of their fiduciary and/or statutory duties to the company must provide 'full and frank' disclosure of the material facts to the general meeting.[94] The requirement is analogous to a trustee seeking the informed consent of each of the beneficiaries.[95]

The extent of disclosure required to ensure that consent is fully informed is a matter of fact to be determined in the circumstances of each case[96] or there must be an intention to adopt the conduct regardless of what the material circumstances might be.[97] It has been described as ensuring that the fiduciary's principal is 'fully informed of the real state of things'.[98] In *Forge v Australian Securities & Investments Commission*,[99] the Court held that full and frank disclosure required that the directors admit to breaches of their statutory duties under the Corporations Act.

**How ratification must be evidenced**

A ratification resolution can only be valid if it was approved by the shareholders in general meeting. Ratification may be approved at an informal meeting of the shareholders under the

[93] *Maguire v Makaronis* (1997) 188 CLR 449, 466.
[94] *Forge v Australian Securities & Investments Commission* (2004) 213 ALR 574; *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* [2008] WASC 239, [9393].
[95] See, eg, *Holyoake Industries (Vic) Pty Ltd v V-Flow Pty Ltd* [2011] FCA 1154, [131].
[96] *Holyoake Industries (Vic) Pty Ltd v V-Flow Pty Ltd* [2011] FCA 1154,[133]; *SEB Trygg Holding Aktiebolag v Manches Sprecher Grier Halberstam* [2005] 2 Lloyd's Rep 129; *Bremner v Sinclair* (NSWCA, unreported 3 November 1998). See also Munday (n 84) 116.
[97] *McKand v Thomas* [2006] NSWSC 1028, [72] (Campbell J). See also *The Phosphate of Lime Company, Limited v Green* (1871) 7 CP 43, 56-57; *Taylor v Smith* (1926) 38 CLR 48, 54-55, 59, 60, 62; *Marsh v Joseph* [1897] 1 Ch 213, 246-7 (Lord Russell of Killowen CJ, Lindley and AL Smith LJJ); *Bank of Montreal v Dominion Gresham Guarantee and Casualty Company, Limited* [1930] AC 659, 666; *Australian Blue Metal Ltd v Hughes* (1961) 79 WN (NSW) 498, 515; *Wilton v Commonwealth Trading Bank of Australia; Model Investments Pty Ltd (Third Party)* [1973] 2 NSWLR 644, 674; *Brockway v Pando* (2000) 22 WAR 405, 433. See also *Suncorp Insurance and Finance v Milane Assicurazioni SpA* [1993] 2 Lloyd's Rep 225.
[98] *Gray v New Augarita Porcupine Mines Ltd* [1952] 3 DLR 1, 14 (Lord Radcliffe).
[99] [2004] NSWCA 448.

*Duomatic* principle,[100] or arising from the acquiescence by the shareholders to a course of conduct by the directors.[101]

## E. *What conduct cannot be ratified by shareholders?*

Some conduct of the directors is not able to be ratified. A breach of statutory duty has been held to not be ratifiable, whereas the law on ratifiability of a breach of a fiduciary duty is more complex.

The High Court held in *Angas Law Services*[102] that a ratification of a breach of a statutory duty imposed by sections 180, 182 or 184 of the Corporations Act could not release a director from those statutory duties. The reasoning of the High Court's in *Angas Law Services*[103] provides a strong basis for concluding that a ratification of a breach of the statutory duties imposed by section 183 of the Corporations Act will not result in any relief from the requirements of that statutory duty.

There is a separate legal possibility that a statutory duty imposed on a director by the Corporations Act may be attenuated and thereby the content of the statutory duty is narrowed which could consequently have the effect that the statutory duty was not breached by the director. This possibility is discussed in Chapter 5.

Under the current law in Australia, the shareholders in general meeting cannot ratify a breach of a director's fiduciary duties in these circumstances:

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[100] *Re Duomatic Ltd* [1969] 2 Ch 365.

[101] *Angas Law Services* (n 5). See generally *Japan Abrasive Materials Pty Ltd v Australian Fused Materials Pty Ltd* [1998] WASC 60; *Grand Enterprises Pty Ltd v Aurium Resources Limited* [2009] FCA 513; *Western Areas Exploration Pty Ltd v Streeter (No. 3)* [2009] WASC 213; *Eastland Technology Australia Pty Ltd v Whisson* [2005] WASCA 144; *Barkley v Barkley Brown* [2009] NSWSC 76; *Guinness Plc v Saunders* [1990] 2 AC 663.

[102] *Angas Law Services* (n 5). See also *Miller* (n 87); *Macleod v The Queen* (2003) 214 CLR 230*; Forge v Australian Securities and Investments Commission* [2004] NSWCA 448*; Australian Securities and Investments Commission v Australian Investors Forum Pty Ltd (No 2)* [2005] NSWSC 267; *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52.

[103] *Angas Law Services* (n 5).

(i) the act is contrary to statute[104] or a criminal act;[105]

(ii) where the conduct is a fraud[106] or constructive fraud, on account of its being opposed to some positive law, or public policy;[107]

(iii) the act is beyond the power of the company, because for example, there is a limitation in the company's constitution (noting the *ultra vires* doctrine no longer applies in Australia);[108]

(iv) the act is void *ab initio*[109] and the maxim *quod ab initio non valet, in tractu temporis non convalescit*[110] applies;[111]

(v) the act was beyond the purposes of the company for which it was created under the relevant statute[112];[113]

(vi) where the ratification would constitute a fraud on the minority;[114]

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[104] *Angus v R. Angus Alberta Limited* [1988] ABCA 54, [42] (Belzil J, Stevenson and Hetherington JJ agreeing) citing with authority *Re Sharpe* [1892] 1 Ch 155 (CA), *Hope v International Finance Society* (1876) 4 Ch App 327 (CA), *Hoole v Great Western Railway Company* (1867) 3 Ch App 262 and *Estate of Thibault* (1962) 33 DLR (2d) 317.

[105] *Banque Janques Cortiev v La Banque d'Epergue* (1888) 13 Ap Cas 111.

[106] *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258.

[107] John Cotterell, *A collection of latin maxims & phrases* (Stevens and Haynes, 3rd ed, 1913).

[108] *The Ashbury Railway Carriage Co. v Riche* (1874) LR 7 H of L 659; *Hutton v West Cork Ry Co* (1883) 23 ChD 654; *Parke v The Daily News Ltd* [1962] 2 All ER 929; *United Australia Ltd v Barclays Bank Ltd* [1940] 4 All ER 20. See generally Austin and Ramsay (n 26) 'The limits to the general meeting's power to ratify' [8.390] and 'Ratification of excess of power' [8.375].

[109] *The Ashbury Railway Carriage Co. v Riche* (1874) LR 7 H of L 659.

[110] That which was void from its commencement, does not improve by lapse of time.

[111] An example is the exercise of an option by an unauthorised person (see *Holland v King* (1848) 6 CB 727; *Dibbins v Dibbins* (1856) 2 CH 348).

[112] *Baroness Wenlock v River Dee Co* (1883) 36 Ch D 675n. The doctrine of *ultra vires* is no longer applicable in Australia to companies governed by the *Corporations Act 2001* but may apply to other incorporated bodies.

[113] See *Hutton v West Cork Ry Co* (1883) 23 ChD 654; *Parke v The Daily News Ltd* [1962] 2 All ER 929; *United Australia Ltd v Barclays Bank Ltd* [1940] 4 All ER 20. See generally Austin and Ramsay (n 26) 'The limits to the general meeting's power to ratify' [8.390].

[114] See *Cook v Deeks* [1916] 1 AC 554; *Ngurli Ltd v McCann* (1953) 90 CLR 425, 438 and 447; *Whitehouse v Carlton Hotel Pty Limited* (1987) 162 CLR 285; *Permanent Building Society v Wheeler* (1994) 14 ACSR 109, 137; *Gambotto v WCP Ltd* [1995] HCA 12. See also *Miller* (n 87), 89 followed in *Gray Eisdell Timms Pty Ltd v Combined Auctions Pty Ltd* (1995) 17 ACSR 303, 312–13 (on appeal *Combined Auctions Pty Ltd v Gray Eisdell Timms Pty Ltd* (1998) 16 ACLC 252). See generally Austin and Ramsay (n 26) 'The limits to the general meeting's power to ratify' [8.390].

(vii) where the ratification would constitute a misappropriation of company resources[115] or an appropriation to the majority of the shareholders, of property advantages which belong to the company;[116]

(viii) where the ratification was entered into by an insolvent company to the prejudice of creditors[117] or a company nearing the point of insolvency;[118]

(ix) where the ratification defeated a member's personal right;[119]

(x) where the ratification was contrary to section 232 of the Corporations Act;[120]

(xi) where the majority of shareholders in general meeting acted for the same improper purpose as directors;[121] and

(xii) where ratification would constitute bad faith.[122]

The above limits on the doctrine of ratification developed on a case by case basis and there remains the possibility of further limitations being imposed on the operation of the doctrine.

Commentary by Robert Austin and Ian Ramsay suggests that, "[t]he clearest case is where the directors have acted irregularly and they control the general meeting."[123]

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[115] See *Cook v Deeks* [1916] 1 AC 554; *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* [2008] WASC 239, [9396] (Owen J) stated that the creation and disposal of security interests over the assets of the company brought about in breach of duty would constitute misappropriation of company resources.

[116] *Ngurli v McCann* (1953) 90 CLR 425.

[117] *Miller* (n 87), 89 followed in *Gray Eisdell Timms Pty Ltd v Combined Auctions Pty Ltd* (1995) 17 ACSR 303, 312–13 (on appeal *Combined Auctions Pty Ltd v Gray Eisdell Timms Pty Ltd* (1998) 16 ACLC 252). See generally Austin and Ramsay (n 26) 'The limits to the general meeting's power to ratify' [8.390]. In *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722 it was held that a transaction entered into by directors for an improper purpose while the company was insolvent could not be validated by even unanimous approval of the members in disregard of the interests of creditors. Compare John Heydon, 'Directors' Duties and the Company's Interests' in Paul Finn (ed), *Equity and Commercial Relationships* (Law Book Company, 1987), 130.

[118] *Spies v The Queen* [2000] HCA 43.

[119] See generally Finn (n 26) 74. For example, where it is taken so as to deprive that shareholder of the enjoyment of their existing rights (eg. the right to vote at a meeting: *Canon v Trask* (1875) LR 20 Eq 669).

[120] *Miller* (n 87), 89 followed in *Gray Eisdell Timms Pty Ltd v Combined Auctions Pty Ltd* (1995) 17 ACSR 303, 312–13 (on appeal *Combined Auctions Pty Ltd v Gray Eisdell Timms Pty Ltd* (1998) 16 ACLC 252); *HNA Irish Nominee* (n 44). See generally Austin and Ramsay (n 26) 'The limits to the general meeting's power to ratify' [8.390].

[121] *Miller* (n 87), 89 followed in *Gray Eisdell Timms Pty Ltd v Combined Auctions Pty Ltd* (1995) 17 ACSR 303, 312–13 (on appeal *Combined Auctions Pty Ltd v Gray Eisdell Timms Pty Ltd* (1998) 16 ACLC 252); *HNA Irish Nominee* (n 44). See generally Austin and Ramsay (n 26) 'The limits to the general meeting's power to ratify' [8.390].

[122] *Pascoe Ltd (in liq) v Lucas* (1999) 33 ACSR 357, 384–88.

[123] Austin and Ramsay (n 26) 'The limits to the general meeting's power to ratify' [8.390].

## F. *What is the legal effect of ratification?*

Following on from the above discussion which concerned the requirements for a valid ratification, this Chapter will now consider the legal effect of the ratification.

As a general rule, ratification is considered 'equivalent to an antecedent authority'[124] and therefore the ratification acts retrospectively. However, the effect of a ratification will depend upon what is meant by the ratification, since the word 'ratification' is used in the following different contexts:

(i) ratification as exoneration or affirmation;
(ii) ratification as a mere promise not to sue; and
(iii) ratification as a release.

Each of the legal effects of ratification arising from the different contexts of the use of the word are considered below.

**Ratification as exoneration or affirmation**

Ratification as exoneration (also sometimes referred to as exculpation or absolution) or affirmation has the same effect as if the person whose conduct is ratified had an original lawful authority. The position is reflected by the Latin maxim *omnis ratihabitio retro trahitur et mandato aequiparatur*.[125]

In *Bamford,*[126] ratification was described as the directors seeking 'absolution and forgiveness of their sins'.[127] The term 'absolution' means 'a remission of sins pronounced by a priest (as in the sacrament of reconciliation)'[128] and is accordingly a term used in connection with religion, but applied in the context of the doctrine of ratification in the judgment of this case.

[124] *Koernigrblatt v Sweet* [1923] 2 Ch 314, 325 (Lord Sterndale MR).
[125] Every consent given to what has already been done, has a retrospective effect and equals a command.
[126] *Bamford* (n 6).
[127] *Bamford* (n 6) 238 (Harman J).
[128] *Merriam-Webster Dictionary* (27 January 2014).

Ratification arises in circumstances whereby a director has breached a fiduciary or statutory duty.[129] It is useful to provide some specific examples to elucidate the distinction between the other possible legal effects of a ratification resolution.

In *Hogg v Cramphorn Ltd*,[130] the board of directors devised a scheme to issue shares to a trust controlled by the directors, the beneficiaries of which were the employees of the company. The power to issue shares is a fiduciary power and if that power was exercised for an improper motive, the issue of the shares is liable to be set aside, notwithstanding that the directors held a *bona fide* belief that the issue of the shares was in the best interests of the company.[131] The court found that the primary purpose of the issue of the shares was to ensure the control of the company by the directors. The Court relevantly held that the conduct of the directors was *ultra vires* unless the conduct of the directors was ratified by the shareholders (as they were on the register of members prior to the issue and allotment of the shares in dispute) in general meeting. It appears from the judgment that ratification in respect of an issue of shares was not treated differently in effect to the shareholders approving an issue of shares since the issue of shares is a residual power of the company.[132] Consequently, the effect of one of a number of ratification resolutions was to validate the issue of the shares.

In *Bamford*,[133] the board of directors issued and allotted shares to a third party for the purpose of thwarting a takeover bid. The Court approved the decision in *Hogg v Cramphorn Ltd*[134] and the Court held the ratification of the issuance of the shares was within the powers of the company.

[129] An example of ratification of this type of conduct is a circumstance whereby a director has acted for an improper purpose (see *Hogg v Cramphorn Ltd* [1967] Ch 254; *Bamford* (n 6)).
[130] [1967] Ch 254.
[131] See *Hogg v Cramphorn Ltd* [1967] Ch 254.
[132] *Hogg v Cramphorn Ltd* [1967] Ch 254; *Bamford* (n 6).
[133] *Bamford* (n 6).
[134] [1967] Ch 254.

Prospective authorisation is not treated differently to retrospective ratification. In *Pascoe Ltd (in liq) v Lucas*,[135] a sole director of a solvent wholly owned subsidiary company acted on the authority of the sole shareholder (the holding company). It was alleged that the defendant had acted dishonestly or for an improper purpose when the defendant as sole director of the plaintiff authorised a loan. The conduct of the sole director was within the powers of the company, the sole shareholder had obtained full disclosure about the proposed transaction and there was no evidence that the sole director had acted in bad faith. The Court in its *obiter* remarks concluded that there was a valid prospective authorisation for the director to enter into the loan and accordingly, there was no breach of fiduciary duty.[136] The prospective authorisation by the sole shareholder would have had the effect of preventing the conduct of the director from being regarded as a breach of duty.

The effect of the ratification (or authorisation) may therefore be to exonerate the directors for breach of fiduciary duty.[137] In those circumstances, the director has no liability to the company.

**Ratification as a promise not to sue**

Ratification may be no more than a covenant or promise not to sue.[138] The relevant test has been stated to be 'what is the meaning and effect of the agreement having regard to the surrounding circumstances and taking into account not only the express words used in the document but also any terms which can properly be implied'.[139] In such circumstances, the covenant is merely a contract (or deed) between the parties and it does not affect the liability of the party in breach of their fiduciary duties.[140]

If the ratification resolution is interpreted to be no more than a promise not to sue by certain shareholders, this firstly does not have the effect of binding the company, or secondly prevent

[135] [1999] SASC 519.
[136] *Pascoe Ltd (in liq) v Lucas* [1999] SASC 519, [273] (Lander J, Millhouse and Duggan JJ agreeing).
[137] See *Foss v Harbottle* (1843) 2 Hare 461.
[138] *Apley Estates Co v De Bernales* [1947] 1 All ER 213.
[139] *Johnson v Davies* [1998] 2 All ER 649, 655 (Chadwick LJ approving the statement of Neill LJ in *Watts v Aldington* (EWCA Civ, Steyn J, 16 December 1993).
[140] See generally *Watts v Aldington* (EWCA Civ, Steyn J, 16 December 1993).

another shareholder from commencing proceedings in the future. The interpretation means the ratification resolution does not have the effect of being a ratification of a breach of duty. Future proceedings can arise for example when there is a new controller (such as an administrator or liquidator).[141]

**Ratification as a release**

Ratification as a release may arise from a director being released for valuable consideration, or by deed without consideration, from their breach of fiduciary duty given by the board of directors following valid ratification by the shareholders in general meeting.[142] Such a release is not contrary to section 199A of the Corporations Act[143] (formerly section 241 of the Corporations Law).[144]

In *Miller*,[145] Santow J considered that such a release would exonerate a director. It was stated that,

> [r]atification of a past breach, …, would not, of itself, generally speaking, extinguish a claim ... In truth what ratification achieves, generally speaking, is to block action by the minority shareholders, leaving vulnerability still to new controllers in the event of a future change of control ... That is why one would expect the director relying on ratification would also want a documented formal deed of release, from the board.

It is not doubted that the release given in the circumstances of *Miller*[146] is a complete defence to firstly a claim under the general law and secondly a claim for statutory relief.[147] In such circumstances, it is not necessary for the company to also indemnify a director against any

[141] See eg., *Angas Law Services* (n 5).
[142] See *Miller* (n 87); *Forge v Australian Securities and Investments Commission* [2004] NSWCA 448; *Pascoe Ltd (in liq) v Lucas* (1998) 27 ACSR 737; *Eastland Technology Australia Pty Ltd v Whisson* [2005] WASCA 144.
[143] Section 199A of the *Corporations Act 2001* concerns the indemnification and exemption of an officer or an auditor of the company.
[144] *Eastland Technology Australia Pty Ltd v Whisson* [2005] WASCA 144.
[145] *Miller* (n 87).
[146] *Miller* (n 87).
[147] *Eastland Technology Australia Pty Ltd v Whisson* [2005] WASCA 144.

claims (albeit, indemnification against any costs incurred in defending proceedings in respect of the claim would be a different matter).

## G. *Conclusion*

The doctrine of ratification has been applied widely to fiduciary relationships including to companies governed by the Corporations Act. A ratification resolution can give rise to exoneration for a breach of a director's duty, but not in all instances. What precisely is meant by ratification is dependent upon the context in which the term is being used. In relation to companies, the meaning of ratification may turn on the proper construction of the resolution which is approved by the shareholders as was shown by the cases of *Apley Estates Co v De Bernales*[148] and *Cutler v McPhail.*[149] This has a consequent implication for the legal effect of the ratification, which may be no more than a promise not to sue by those persons approving the ratification resolution.

The doctrine of ratification will have its greatest effects on a company when a ratification resolution gives rise to the exoneration of a director's conduct. This Thesis therefore considers the significant implications of the doctrine on companies governed by the Corporations Act when a director's conduct is exonerated. Specific law reforms are considered by this Thesis to limit the effect of ratification when the consequence is the exoneration of a director's conduct.

The doctrine has a less significant effect on companies when the effect of the ratification resolution is limited to it being no more than a promise not to sue. In that instance, rights are retained by the company to commence proceedings against a director who has acted in breach of their statutory or fiduciary duties. By reason of the very limited effect of ratification in this instance, this Thesis accordingly does not consider whether there ought to be any law reform to the Corporations Act to further address ratification in this context.

[148] [1947] 1 All ER 213.
[149] [1962] 2 All ER 474.

This Thesis will now consider the benefits of the doctrine of ratification in Chapter 3 before considering the criticisms and uncertainties of the doctrine in Chapter 4.

## CHAPTER 3 – THE BENEFITS OF THE RATIFICATION DOCTRINE

This Chapter considers the benefits of the doctrine of ratification to companies governed by the Corporations Act as the doctrine remains relevant even following the introduction of the statutory derivative action.

Before considering the principal benefits, the application of the doctrine to companies is first discussed.

### A. *The application of the doctrine of ratification to companies*

The decision in *Beatty*[150] is the commencement of an unbroken line of authority which confirmed that the doctrine of ratification could be utilised by the shareholders in general meeting to excuse a breach of a director's fiduciary duty. The application of the doctrine to companies was consistent with the existing laws of agency, contract law and trust law and therefore the extension of the doctrine to the relationship of director/company was a small step by way of analogy from other fiduciary relationships of agent/principal and trustee/beneficiary recognised by the common law.

By way of example, the general law permitted people to hold real and personal property on trust for ascertainable beneficiaries. The law recognised that a beneficiary of a trust could give informed consent to a trustee in relation to a breach of their fiduciary duties and if informed consent were given, the trustee's conduct was ratified by the beneficiary.[151] The right to give informed consent is generally consistent with the application of the doctrine of ratification to the relationship of director/company. In Chapter 2, this Thesis discussed ratification in the context of the law of agency which provides a further analogous relationship to that of a director/company.

There is a different approach to considering the application of the doctrine to companies which demonstrates the consistency of principles between different areas of law. Consistent with the common law approach to upholding contracts between parties which have reached agreement,

[150] *Beatty* (n 4).
[151] *Boardman v Phipps* [1967] 2 AC 46.

the common law adopted the doctrine of ratification to permit a company to become bound by the conduct of a director from the time of the director's conduct.[152] This common-sense approach was therefore consistent with settled principles of contract law by upholding the director's earlier conduct following ratification. It avoided the costs associated with the company, for example, renegotiating the contract, which may include new or amended terms.

The application of the doctrine to the relationship of director/company is consistent with other recognised common law relationships, however it is the shareholders in general meeting, not each individual shareholder who consider whether to ratify a breach of a director's duty and only a majority vote of the shareholders can approve the ratification resolution. To consider that issue, this Thesis now considers the shareholders' power of ratification.

## B. *Shareholder regulation of a company's affairs*

The shareholders in general meeting or informally pursuant to the *Duomatic* principle[153] may approve an authorisation or ratification resolution with respect to the proposed or actual conduct of the directors. A resolution for the attenuation of directors' duties, or the ratification of conduct of the directors is thereby within the control of the current shareholders of the company.

The right of the shareholders to vote on a ratification resolution provides a range of benefits which are now discussed.

Firstly, shareholder authorisation or ratification permits a decision to be made efficiently and inexpensively when compared to seeking a decision of a court. Court proceedings may take months to years to resolve and are regularly expensive. They are an inefficient way to resolve disputes that can be addressed in a shareholders' meeting.

[152] *Beatty* (n 4).
[153] *Re Duomatic Ltd* [1969] 2 Ch 365.

Secondly, if the majority of shareholders refuse to authorise or ratify the director's prospective or actual breach of fiduciary duty, the company retains the benefit of a cause of action against the directors and can thereby seek a remedy against the directors for any loss and damage caused by the breach.

Thirdly, the operation of the doctrine of ratification in this way avoids a situation where a director would be liable for *every* breach of duty to the company. By way of example, a director can be liable for a breach of duty even in circumstances where the breach was beneficial to the company and thereby a majority of shareholders may approve a ratification resolution in those circumstances.

Fourthly, by maintaining the doctrine in its current form, companies benefit from the use of the *Duomatic* principle[154] for the purpose of approving a ratification resolution. Small companies are likely to be the primary beneficiaries of the use of the *Duomatic* principle because they have small numbers of shareholders and consequently, it is possible that those shareholders will be in unanimous agreement about ratification of a breach of duty by a director.

Given the *Duomatic* principle require unanimous approval, there are no minority shareholders which are losing any legal rights following the approval of a ratification resolution. Accordingly, a major criticism of the operation of the doctrine against the interests of minority shareholders does not arise in these limited circumstances.

The holding of informal meetings is quick and inexpensive compared to the requirements for the holding of a formal meeting. Importantly, the full and frank disclosure obligations for the directors in breach of duty do not change. If in the event there was insufficient disclosure by a director seeking ratification of a breach of duty, the ratification resolution is invalid.

[154] *Re Duomatic Ltd* [1969] 2 Ch 365.

Arising from the above matters, there is a clear benefit for shareholders to maintain the power of ratification.

### C. *The protection of honest directors*

With respect to statutory duties, by reason that the shareholders in general meeting cannot exonerate a director by ratifying a breach of statutory duty, the director may only seek relief from a court pursuant to section 1318 of the Corporations Act.

In the context of fiduciary duties and in contrast to statutory duties, it remains open to a director in breach of a fiduciary duty to seek both ratification by the shareholders and relief from liability under section 1318. Notably, there is no requirement under the doctrine of ratification that the director acted honestly, whereas honesty is a requirement to obtain relief pursuant to section 1318 of the Corporations Act.

The existence of the judicial power to relieve a director from liability pursuant to section 1318 elucidates two matters which concern the current scope of the doctrine of ratification with respect to companies governed by the Corporations Act. Firstly, the power of ratification is not exclusively a power to be exercised by the shareholders in general meeting, even where the shareholders do not approve a ratification resolution. Secondly, the powers of the shareholders and a court are different because section 1318 establishes statutory pre-conditions to the exercise of the power. Accordingly, section 1318 does not limit the rights of the shareholders with respect to the exercise of the power ratification. Neither of these matters gives rise to any further narrowing of the powers of the shareholders in general meeting.

If the shareholders ratify a breach of fiduciary duty, there is no need for a director to seek relief from a court since the effect of the ratification is to exonerate the director from all liability to the company for the breach of fiduciary duty, unless there is an interpretation question about the effect of the resolution.

Although exoneration of a director's breach of statutory duty is not permissible, a purported ratification of a breach of statutory duty remains relevant to whether a court may relieve an honest director wholly or partly from a liability to a company pursuant to section 1318 of the Corporations Act. The fact that a ratification resolution was approved does not of itself mean that the director will be relieved of a liability by a court, its one of a wide range of criteria relevant to the question. The criteria is discussed below in the next section.

Ratification for directors who have acted in breach of their duties is a beneficial aspect of the doctrine, although the grant of relief is a discretionary matter having regard to the circumstances of the case. Relief cannot be granted to a director who has not acted honestly.

The meaning of honesty for the purposes of section 1318 is first considered before considering the role of ratification in respect of section 1318 of the Corporations Act.

**What is honesty?**

A review of the relevant case law reveals that the words 'honest', 'dishonest', 'honesty' and 'honestly' appear in different contexts. The cases however which consider the meaning of those words provide a suitable context for a discussion about the relevant criteria to determine whether a director may be excused from a liability pursuant to section 1318 of the Corporations Act.

The definition of 'dishonest' is objective and means 'dishonest according to the standards of ordinary people'.[155] As a corollary, 'honesty' is also measured by reference to an objective standard. In *Barlow Clowes International Ltd (in liq) v Eurotrust International Ltd*,[156] the Privy Council found it necessary to clarify the test which was applied in *Twinsectra Limited v Yardley*[157] and confirmed that the test for dishonesty is an objective one as held by Lord Millett.

[155] *Corporations Act 2001* (Cth) s 9.
[156] [2005] UKPC 37.
[157] [2002] UKHL 12.

In *Hasler v Singtel Optus Pty Ltd*[158] (which concerned former employees of Singtel Optus) and *Simmons v New South Wales Trustee and Guardian*,[159] (which concerned whether the plaintiff was defrauded by certain defendants) the New South Wales Court of Appeal cited with approval the test for dishonesty in *Barlow Clowes International Ltd (in liq) v Eurotrust International Ltd*.[160] Whilst both *Hasler v Singtel Optus Pty Ltd*[161] and *Simmons v New South Wales Trustee and Guardian*[162] are not cases concerned with section 1318 of the Corporations Act, the cases are authoritative with respect to the proper construction of section 1318.

In the context of section 1318 of the Corporations Act, the meaning of 'honesty' and 'honestly' was considered in *Hall v Poolman*[163] and *Australian Securities & Investments Commission v Healey (No 2)*[164] respectively to mean (a) without deceit or conscious impropriety; (b) without intent to gain an improper benefit or advantage; and (c) without carelessness or imprudence that negates the performance of the duty in question.[165] Section 1318 is not limited to considering whether the person obtained a financial advantage or whether the person intended to engage in dishonesty.[166]

More recently in *Re ICandy Interactive Limited*,[167] the Court distilled a number of matters from the relevant case law with respect to section 1318 and provided an expanded analysis of the relevant criteria. Firstly, in assessing whether a director has acted honestly, the court looks to an absence of evidence of dishonesty.[168] Secondly, the Court also takes into account whether the director has taken prompt action to remedy the error.[169] Thirdly, the Court stated that the concept of acting honestly can embrace (a) inadvertence or a failure to turn their mind to the

[158] [2014] NSWCA 266.
[159] [2014] NSWCA 405, [124] (Beazley P, Barett and Gleeson JJA agreeing).
[160] [2005] UKPC 37.
[161] [2014] NSWCA 266.
[162] [2014] NSWCA 405, [124] (Beazley P, Barett and Gleeson JJA agreeing).
[163] [2007] NSWSC 1330.
[164] [2011] FCA 1003.
[165] *Hall v Poolman* [2007] NSWSC 1330, [325] (Palmer J); *Australian Securities & Investments Commission v Healey (No. 2)* [2011] FCA 1003, [88] (Middleton J).
[166] *Hall v Poolman* [2007] NSWSC 1330, [316] (Palmer J)
[167] [2018] FCA 533.
[168] *G8 Communications Ltd, in the matter of G8 Communications Ltd* [2016] FCA 297 [35].
[169] *Re Sprint Energy Ltd* [2012] FCA 1354; *Re Golden Gate Petroleum Ltd* [2010] FCA 40.

relevant issue,[170] (b) an active, but incorrect, consideration of a legal issue as well as failure to consider the issue at all,[171] and (c) a failure to understand or appreciate the significance of non-compliance.[172] Fourthly, the obtaining of advice does not conclusively establish that a director was acting honestly, however, it is however an important consideration in determining whether proper competent and expert advice was sought and obtained.[173]

It is also relevant to consider any evidence of a director's conduct which may be described as dishonest which has been described as *'a transgression of ordinary standards of honest behaviour. It is not necessary to say anything else by way of elaboration, save to confirm that it is not necessary to demonstrate that the person thought about what those standards were'*.[174] It has been held that a state of wilful blindness may be dishonest.[175] For example, wilful blindness, by deliberately ignoring factual information which a person knows may be material to a decision, is akin to fraud.[176]

Whilst the test for dishonesty may be simple to state, there will be cases where it is difficult to distinguish between what is honest and dishonest conduct of directors.

**When is relief for honest directors granted?**

Section 1318 of the Corporations Act permits a court to exercise its discretion if two conditions are satisfied, *'first, the court is affirmatively satisfied the person acted honestly; second, the*

[170] *Re QBiotics Limited* [2016] FCA 873, [38].
[171] *Primelife Corporation Ltd v Aevum Ltd* [2005] NSWSC 269; *Re Sprint Energy Ltd* [2012] FCA 1354; *Re Golden Gate Petroleum Ltd* [2010] FCA 40.
[172] *Re Sprint Energy Ltd* [2012] FCA 1354.
[173] *Clarke v Great Southern Finance Pty Ltd* [2014] VSC 516, [1960].
[174] *Hasler v Singtel Optus Pty Ltd* [2014] NSWCA 266, [124] (Barrett, Gleeson and Leeming JJA)) citing with approval Barlow Clowes International Ltd (in liq) v Eurotrust International Ltd [2006] 1 All ER 333, [16] (Lord Hoffman).
[175] *Macquarie Bank v Sixty-Fourth Throne Pty Ltd* (1998) 3 VR 133, 143.
[176] *Lego Australia Pty Ltd v Paraggio* [1993] FCA 575; 44 FCR 151 at 171

*court forms a value judgment that in all the circumstances, the person should be excused.'*[177] Relief may be granted to a director for breach of a fiduciary or a statutory duty in anticipation of proceedings.[178]

A section related to Section 1317JA of the former Corporations Law (now section 1317S of the Corporations Act) was considered in *Forge v Australian Securities & Investments Commission*.[179] The only relief available to avoid or reduce liability is that for which the legislature provided and for the purposes of this section,[180] the question will be whether the director acted honestly on the principles referred to in *Hall v Poolman*[181] and *Re ICandy Interactive Limited*.[182]

A director's honest breach of their statutory duties is not a bar to a liability being imposed under a civil penalty provision. Pursuant to section 1318 of the Corporations Act, the Court must have regard to all the circumstances of the case to determine whether the person ought fairly to be excused from the contravention, in whole or in part. It will be recalled that under the general law there is no requirement under the Corporations Act for a ratification resolution to be approved by a majority of shareholders which are independent of the directors and accordingly, a director (and their fellow directors and any associates of the directors) may vote as shareholders to ratify a breach of a director's duty.

The protection of honest directors does recognise that there are very few prohibitions against a person being appointed as a director. In relation to proprietary companies, provided that the person is over the age of eighteen years,[183] has consented to the appointment as a director under section 201D of the Corporations Act and is not otherwise barred from acting as a director

[177] *Resource Equities Ltd (subject to Deed of Company Arrangement) v Garrett* [2009] NSWSC 1385, [119] cited with approval in *Robert Allan Jacobs as liquidator of Necessary Holdings P/L (in liq) v Lenton Brae Ltd Partnership (A Firm)* [2021] WASC 10, [73] (Hill J)

[178] *Corporations Act 2001* (Cth) s 1318(2).

[179] [2004] NSWCA 448.

[180] *Forge v Australian Securities & Investments Commission* [2004] NSWCA 448, [382] (McColl J, Handley and Santow JJA agreeing).

[181] (2007) 65 ACSR 123.

[182] [2018] FCA 533.

[183] *Corporations Act 2001* (Cth) s 201B.

under Part 2D.6 of the Corporations Act, the person, or persons can conduct the business of the company. There are no educational, knowledge or skill requirements to meet before being appointed as a director. Accordingly, a director may be entirely dependent upon the professional advisers engaged by a company to ensure, as far as possible, that the director does not breach any of their fiduciary or statutory duties.

It should be noted that the policy approach adopted for the protection of honest directors is consistent with, but not identical to, the power of a court to relieve a trustee of a breach of duty where the trustee and acted reasonably and honestly.[184]

It should also be noted that the protection of honest directors extends to persons who fall within the definition of 'director' under section 9 of the Corporations Act, commonly referred to as 'shadow' directors and 'de facto' directors.[185]

Cases considering section 1318 of the Corporations Act have not addressed what weight should be attributed to the shareholder approval of a ratification resolution when it was approved because a director/shareholder voted in support of the resolution.

Separate from the requirements under section 1318 of the Corporations Act, in light of the general law, it is very likely that a court would disregard which of the shareholders voted to approve a ratification resolution in exercising its discretion to relieve a director from all or part of the liability to the company because there is no statutory requirement that an independent majority of shareholders approve a ratification resolution.

The doctrine of ratification remains beneficial for directors because a ratification resolution can be taken into account for the purposes of section 1318 of the Corporations Act. The judicial discretion to relieve a director from a liability to a company is broad and those

[184] See, eg., *Trustees Act 1962* (WA) s 75.
[185] See generally, *Corporate Affairs Commission v Drysdale* [1978] HCA 52; *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6.

judicial powers do not exclude the possibility that a ratification resolution will be relevant to whether a court should exercise its powers, having regard to all of the circumstances of a particular case.

### D. *Economic benefits of the doctrine*

The doctrine of ratification has direct economic benefits. In this part, the discussion concerns the economic benefit to the company, its directors and its shareholders.

The economic benefits of the doctrine do not appear to have been considered in Australia. In particular, the Explanatory Memorandum to the *Corporate Law Economic Program Bill 1998* (Cth) does not consider the economic benefits associated with the introduction of section 239 of the Corporations Act. Further, the report titled "Enforcement of the duties of directors and officers of a company by means of a statutory derivative action"[186] in November 1990, House of Representatives Standing Committee on Legal and Constitutional Affairs report titled "Corporate practices and the rights of shareholders"[187] in November 1991, the Government response to the November 1991 report[188] in December 1992 and the report titled "Report on a Statutory Derivative Action" in July 1993[189] do not consider economic benefits arising from the doctrine.

It is noted that the reforms to the doctrine of ratification in the United Kingdom in 2007 did not consider whether there was any economic benefit to retaining or modifying the doctrine.[190] The fact that there was no evidence of an economic benefit in connection with the 2006 United

[186] Companies and Securities Law Review Committee, Takeovers Panel, *Discussion Paper No. 11 Enforcement of the Duties of Directors and Officers of a Company by Means of a Statutory Derivative Action* (Report, July 1990).

[187] House Standing Committee on Legal and Constitutional Affairs, House of Representatives, Parliament of Australia, *Corporate practices and the rights of shareholders* (Report, November 1991).

[188] Ibid.

[189] Companies and Securities Advisory Committee, *Report on A Statutory Derivative Action* (Report, July 1993).

[190] *Explanatory Notes, Companies Act 2006* (UK).

Kingdom law reforms was clearly not a significant issue for the United Kingdom Parliament when it approved the amending legislation to the *Companies Act 2006* (UK).

The discussion below is focussed on the economic benefits which relate to breaches of a director's duty.

Firstly, the board of directors as a part of the process of giving notice of a general meeting will include all the matters which they believe are relevant to any ratification or authorisation resolution as a part of the notice of the general meeting. Such a notice may require the assistance of the company's solicitors to ensure that the notice complies with the requirements of the Corporations Act. The costs to the company of preparing the notice of meeting may be substantial based upon rates for competent private counsel pursuant to Schedule 3 of the *Federal Court Rules 2011* from 2 May 2019 which allowed for up to $650 per hour. There are a wide range of factors which influence legal costs including; the facts relevant to any transaction and the breach of duty and the overall complexity of the disclosures required to be made by the director(s).

The company's expense in giving notice of the general meeting to shareholders needs to be put in context. Hypothetically, if the doctrine of ratification did not operate with respect to companies and a company was required to seek an order of a court to approve a ratification or authorisation resolution pursuant to section 1318, the necessary steps would include; the preparation of an originating process, the preparation of supporting affidavits, the payment of Court filing fees and the expense of solicitors attend to the preparation of the documents and attending a hearing. It is clear from those steps that ratification by a general meeting of shareholders will be a more cost effective that the hypothetical court application. In some cases the company would be indemnified for the costs by the director, but there is no prohibition on the company indemnifying the director for their costs of the application.

In such a process, a shareholder may seek leave to intervene in the proceedings.[191] This may occur for example when the company is controlled by the director who acted in breach of their duties to the company and the shareholder is a minority shareholder. In these circumstances, the intervening shareholder would likely be represented by counsel with the attendant costs of that representation. It would be expected on average that an intervener's legal costs would be lower than the applicant's (director's) legal costs because any evidence would likely be limited to responsive affidavits, submissions and attendance at a limited number of directions hearings and the final hearing. In any event, the economic costs to the applicant and the intervener will vary significantly exceed the estimated costs of the company convening a general meeting.

Secondly, the doctrine allows the shareholders of a company to vote on a ratification or authorisation resolution. A shareholder or representative of a shareholder need not attend a general meeting to cast that vote if a proxy is appointed. There is therefore minimal expense for each shareholder, or each director to participate in a shareholders' meeting.

Thirdly, any approval by the shareholders in general meeting of a ratification resolution for a breach of fiduciary duty limits the need of a director to make an application under section 1318 of the Corporations Act and thereby reduces the overall costs to the company and the directors.

Finally, since the power of ratification is exercisable by the shareholders in general meeting, there is likely to be an overall economic benefit to companies and their shareholders. The benefit is obtainable as a financial advantage for a company because of the relatively low costs of holding a general meeting of the shareholders. By allowing the shareholders to determine whether a ratification or authorisation resolution is approved, this decision can (and should) include a cost/benefit analysis for the company of the economic consequences of a decision by the shareholders.

The economic benefit is to be weighed against the risk of low rates of shareholder participation in general meetings. This is because the approval of a ratification resolution only requires a

[191] *Federal Court Rules 2011* (Cth) r 9.12.

majority of votes cast on the resolution by the shareholders in attendance or represented by an appointed proxy. Public policy concerns about shareholder activism are not addressed as a part of the proposed statutory law reforms to the doctrine in this Thesis because it is not related to the problem of a director/shareholder voting to approve a ratification resolution of their own breach of duty. The statutory law reforms proposed by this Thesis however will be an overall advantage for the company even if there are low rates of shareholder participation because a director/shareholder (and their associates) are excluded from voting on a ratification resolution.

In support of this point, it has been argued by Andrew Keay that shareholders have an incentive to maximise profits so they are likely to foster economic efficiency.[192]

Further it was argued by Michael Whincop that "We may therefore expect the constitution of a corporation to pursue an objective analogous to the organisation of states, namely, minimising the costs of future collective action."[193] This is a basis for an argument that there is an economic benefit to the collective decision-making process of the shareholders in general meeting because of the shareholders' decision at least at a theoretical level should be focussed on the costs (and benefits) of any future action.

Each of the above matters demonstrates that there are direct economic benefits to the operation of the doctrine in relation to companies governed by the Corporations Act.

## E. ***Conclusion***

The above discussion reveals that the doctrine of ratification remains beneficial to companies governed by the Corporations Act.

[192] Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach' (2007) 29(4) *Sydney Law Review* 577.

[193] Michael Whincop, The Role of the Shareholders in Corporate Governance: A Theoretical Approach (2001) 25(2) *Melbourne University Law Review* 418, 425.

The continued operation of the doctrine following the introduction of the statutory derivative action counterbalances the strictness of the statutory duties established under the Corporations Act in favour of directors of companies. However, where a director seeks to avoid or reduce liability for their conduct, the director can seek that a ratification resolution be approved, or otherwise must apply to a court for a determination of any reduction of their liability arising from their conduct.

In principle, the benefits discussed above in this Chapter provide a policy and legal basis for the retention of the operation of the doctrine. The beneficial aspects of the doctrine are however to be contrasted with the criticisms and uncertainty inherent in the operation of the doctrine which is discussed in Chapter 4.

It can be seen from the discussion in this Chapter that if the doctrine of ratification were abolished, there would need to be other reforms to the Corporations Act which deal with how the common law and general law would operate to ensure the continuance of the beneficial aspects of the doctrine of ratification discussed above. Such an endeavour would be complex and there would likely be unintended consequences of such an approach.

This Thesis therefore does not advocate the abolition of doctrine of ratification. However, this Thesis proposes limited law reform to the doctrine to ensure it only operates where it provides sufficient benefit. This proposed approach to law reform of the doctrine of ratification by amendments to the Corporations Act is consistent with the recommendations made in the report titled “Enforcement of the duties of directors and officers of a company by means of a statutory derivative action”[194] and the recommendations made in the report titled "Report on a Statutory Derivative Action" in July 1993[195].

[194] Companies and Securities Law Review Committee (n 186).

[195] Companies and Securities Advisory Committee (n 189).

This Thesis will now consider both the criticisms of the doctrine and the legal uncertainty in relation to the doctrine to assess to what extent its availability needs to be refined.

## CHAPTER 4 – THE MOST SIGNIFICANT CRITICISMS OF THE DOCTRINE OF RATIFICATION

### A. *Introduction*

Statutory law reform to the Corporations Act has significantly decreased the problems evident from the operation and effect of the doctrine of ratification for minority shareholders. Further, following the decision in *Angas Law Services*,[196] the shareholders in general meeting are unable to ratify a breach of a director's statutory duty. Despite the introduction of the statutory derivative action from March 2000, for the reasons discussed in this Chapter and Chapter 5, the doctrine of ratification continues to be problematic for minority shareholders and it has attracted broad criticism from the judiciary, academics and in government reports for this reason.

This Chapter firstly considers the criticisms of the doctrine. The primary criticism by academics and the judiciary focusses upon the problem of a director/shareholder voting to ratify a breach of a director's duty with respect to their own conduct. The criticism also extends to circumstances where there are family members and associates of a director/shareholder who vote to ratify a breach of duty. The issues discussed in this Chapter particularly focus on this primary criticism. Without statutory law reform, this criticism will not be resolved.

Section 224 of the Corporations Act imposes requirements for the approval of a related party transaction by prohibiting voting by related parties to a public company (but not a proprietary limited company). Ratification also has a limited effect in the context of the statutory derivative action because section 239 ensures that a shareholder is not prevented from seeking leave to commence or intervene in derivative proceedings in the event a director's conduct is ratified. It is argued however in this Chapter that the existing protections under Chapter 2E (including section 224) and section 232 of the Corporations Act do not go far enough to protect companies and minority shareholders and consequently this is a strong reason for statutory law reform to the Corporations Act, separate from the clear reasons for law reform which are required to address the criticisms and uncertainties of the doctrine.

[196] *Angas Law Services* (n 5).

There are other significant problems addressed in this Chapter which consider whether the same standard of disclosure applies to prospective authorisation as retrospective ratification and whether Chapter 2E and section 239 of the Corporations Act are effective statutory limits on the doctrine of ratification.

Following a discussion of the criticisms, the uncertainty in the operation of the doctrine is considered. One significant question is the scope of the categories of non-ratifiable wrongs. This is not a trivial issue since ratification can have the effect of extinguishing a company's cause of action for breach of fiduciary duty against any relevant directors.

It is argued by this Thesis that the ongoing academic and judicial criticisms of the doctrine and uncertainty in the operation of the law discussed in this Chapter below strongly indicate that the inherent problems with the doctrine should be resolved by limited statutory law reform to the Corporations Act. As addressed later in Chapter 8 of this Thesis, the objective of this law reform is to ensure that directors who are also shareholders and any associated shareholders cannot vote on a ratification resolution while retaining the benefits of the doctrine discussed in Chapter 3.

## B. *The criticisms of the doctrine of ratification*

The following discussion considers a number of criticisms of the doctrine of ratification. They relate to the issues of when ratification is not required, which shareholders are entitled to vote on a ratification resolution, what constitutes full and frank disclosure to the shareholders, the standard of disclosure which relates to authorisation and ratification resolutions, as well as how the doctrine applies to directors of wholly owned subsidiaries. The amendment of the Corporations Act to include Part 2F.1A (Proceedings on behalf of a company by members and others) has been effective to limit the operation of the doctrine. However this Chapter also considers how effective law reform to the Corporations Act has been to limit the problems caused by ratification since the introduction of Chapter 2E (Related party transactions) and section 239 (Effect of ratification by members) of the Corporations Act.

**Voting by a self-interested director/shareholder, family members and associates**

In relation to proprietary limited companies, under the current law in Australia, any shareholder who is entitled to vote on a resolution concerning ratification or authorisation of a breach of a director's duty may vote to approve that resolution. This includes, in principle, directors/shareholders who breached their duties to the company.

In relation to public companies or entities controlled by public companies, sections 224(1) and 228 of the Corporations Act restrict related parties, including directors and associates of directors, from voting on resolutions where a financial benefit is given to a related party within the meaning of section 228 of the Corporations Act. Accordingly, the concerns raised in this Thesis with the doctrine of ratification primarily concern proprietary limited companies and not public companies.

The right of a director/shareholder to vote at a general meeting of shareholders to approve their own breach of fiduciary duty has been widely criticised[197] and described as 'a troubling aspect' of the doctrine.[198] There is no requirement that a resolution be approved by an independent majority of shareholders. The family members and associates of a director could vote to approve a ratification resolution for the benefit of the director who acted in breach of their duties to the company. Collectively, these shareholders could form a majority and in that event, the director has voting control at a general meeting of the shareholders.

In the context of voting restrictions, a special situation is when there has been an improper issuance of shares. In such a case, the shareholder(s) holding those newly issued shares will not be permitted to vote on a ratification resolution using those newly issued shares in respect of the issuance of the shares.[199] If this were not the case, there would be no internal corporate

[197] Baxt (n 15); Bakibinga (n 18); Fridman (n 19); Yeung (n 20); Ashbolt (n 21); Mason (n 25); Farrar (n 26), 388; Finn (n 26); Austin and Ramsay (n 26); Cadbury (n 31); Cranston (n 36); Langford (n 25), 150.
[198] Companies and Securities Advisory Committee (n 189) 21.

[199] *Hogg v Cramphorn* [1967] 1 Ch 254.

mechanism by which a new majority could be prevented from ratifying the directors' breach of duty. This is a recognised exception to the general rule that all shareholders are entitled to vote.

The current law in Australia permits a company to issue one or more classes of shares which do not have voting rights attached to them. Accordingly, only shareholders with voting rights will be permitted to vote upon an approval or ratification resolution. For example, consider a newly formed company which has Class A voting shares issued to the directors/shareholders and Class B non-voting shares issued to all other shareholders. This is not an uncommon arrangement for proprietary companies. There is unfairness to the Class B shareholders which do not have a right to vote against a ratification resolution because the directors who are shareholders can ensure from the date of incorporation of the company that they have the voting power to pass a ratification resolution, possibly unanimously in the future. Given that the Class B shareholders knew of the non-voting status of their shares when they acquired them, what legal protection does a Class B shareholder have if a breach of duty is ratified by the Class A shareholders?

There is no particular answer to whether the doctrine of ratification is limited in the circumstances described above by, for example, an equitable principle or whether the circumstances are contrary to section 232 of the Corporations Act. Consequently, a remedy may not be available to a Class B shareholder. This Thesis does not identify a concern with the right of a company to issue non-voting shares to shareholders. The example highlights the primary criticism of a director/shareholder voting to ratify their own breach of duty and accordingly, resolving the primary criticism of the doctrine by restricting the voting rights of self-interest directors to ensure that a majority of independent shareholders approve a ratification resolution.

**Can a unanimous vote of all shareholders rectify the problems with ratification?**

A unanimous vote of all shareholders, irrespective of the class of share owned, is a potential solution to the problems addressed in this Chapter and later in this Thesis. The benefit of such

an approach is to ensure that there is no minority. However this approach has significant difficulties as follows.

Firstly, it would introduce significant practical difficulties for companies with large shareholder bases and accordingly such a rule would be more appropriate, but not very practical, for small closely held companies.

Secondly, the rule may potentially bring about a situation where directors seek to obtain proxy votes from shareholders for valuable consideration and this accordingly may create, for example, a false market price for the shares in the company.

Finally, any shareholder could withhold their approval. That could result in a shareholder profiting from an agreement with a director to vote to approve a ratification resolution.

Shareholders may ratify a breach of fiduciary duty by unanimous informal assent[200] and accordingly without the need for a formal meeting of which notice has been given. There is a question of law whether the *Duomatic* principle may not operate where there is a statutory requirement for a meeting.[201] Therefore, a law reform which establishes a requirement that there be a formal meeting to approve a ratification resolution would have the effect of limiting the role of the *Duomatic* principle. It is not suggested for the reasons discussed in Chapter 8 of this Thesis to limit the role of the *Duomatic* principle in connection with the doctrine. This is primarily because there are no minority shareholders which opposed the approval of a ratification resolution.

Whilst this Thesis identifies concerns with the operation of the *Duomatic* principle in connection with the doctrine of ratification, those concerns can be addressed by establishing a

[200] *Re Duomatic Ltd* [1969] 2 Ch 365.

[201] Elizabeth Boros, 'Virtual shareholder meetings: Who decides how companies make decisions?' (2004) 28 *Melbourne University Law Review* 265, 278. See also Ross Grantham, 'The Unanimous Consent Rule in Company Law' (1993) 52 *Cambridge Law Journal* 245, 254–5.

requirement that a majority of independent shareholders vote to approve a ratification resolution.

**The standard of disclosure for authorisation of a breach of fiduciary and/or statutory duties and the consequences**

The Australian case law imposes an obligation to make 'full and frank' disclosure to the shareholders when a ratification resolution is proposed.[202] A failure to give full and frank disclosure will result in a ratification resolution being void.[203]

This section of the Thesis considers whether the same standard of disclosure is applicable to a prospective authorisation resolution as is the case for a retrospective ratification resolution and the consequences of that applicable standard.

The leading case in Australia on the validity of a prospective authorisation resolution is *Winthrop Investments*.[204] *Winthrop Investments*[205] was a case concerning whether an interlocutory injunction should be continued and accordingly, the decision should be treated with caution as to whether the issues under consideration were fully argued.

In *Winthrop Investments*[206], the decision in *Bamford*[207] (a case concerning a ratification resolution) was followed confirming that the doctrine of ratification could be generally applied to prospective conduct of a director. The NSW Court of Appeal held in *Winthrop Investments*[208] that a general meeting of the shareholders to whom a proper and full disclosure of all relevant facts has been made, may ratify an exercise of power by the directors which

[202] See especially *Bamford* (n 6); *Peters American Delicacy Co Ltd v Heath* (1939) 61 CLR 457.
[203] *Forge v Australian Securities & Investments Commission* [2004] NSWCA 448.
[204] *Winthrop Investments* (n 7).
[205] *Winthrop Investments* (n 7).
[206] *Winthrop Investments* (n 7).
[207] *Bamford* (n 6).
[208] *Winthrop Investments* (n 7).

constitutes a breach of their fiduciary duty to the company and may give advance authority for an exercise of power which would otherwise involve such a breach.

Mahoney JA in *Winthrop Investments* considered *obiter* that "inadequacy of disclosure by directors is not, of itself, sufficient to render a resolution ineffective; the matter must be determined in the light of the material, whether provided by the directors or their opponents, which was before the shareholders."[209] Mahoney JA held that there was a requirement for proper and full disclosure of all relevant facts when ratification is sought for breach of a director's duty.

The decision in *Winthrop Investments*[210] did not elaborate whether the full and frank disclosure obligation for an authorisation resolution was in any sense different from the disclosure obligations for a ratification resolution and accordingly the case did not determine whether the same standard of disclosure applies to both authorisation and ratification.

Authorisation of breaches of directors' duties differs from ratification because authorisation relates to future conduct, whereas ratification is directed to past conduct in breach of a director's duties. Examples of when authorisation for a breach of duty may be sought from the shareholders include; authorisation for steps to thwart a hostile takeover bid,[211] or before the purchase (or sale) of an asset by the company in connection with a director. It is not clear if authorisation is required to permit a management (director) buyout where for example the directors are purchasing the company's shares from the other shareholders.[212] There is no authority on the question in Australia.

In relation to the requirements for disclosure to shareholders, Samuels JA held relevantly that it would have been necessary for the notice of meeting to have set out clearly the nature of the

[209] *Winthrop Investments* (n 7) 705 (Mahoney JA).
[210] *Winthrop Investments* (n 7).
[211] See eg. *Winthrop Investments* (n 7).
[212] Martin Bennett, 'Alinta Ltd: Unlocking Shareholder Wealth in the Role of Management' (2007) *AMPLA Year Book*, 521.

contemplated breach of the directors' duty and that the meeting would be asked to authorise the breach and waive its consequences.[213] Glass JA (in dissent) found that full and proper disclosure had been made by the directors. Mahoney JA did not express a view on the requirements for full and frank disclosure.[214] The decision shows that there may be a different standard for disclosure for prospective authorisation of a breach of duty when compared to ratification.

Arising from trust law, the fiduciary bears the onus of proof that there was fully informed consent after full and frank disclosure of all the material facts.[215] The same principle which applies to ratification of prior conduct[216] can be easily applied to the authorisation for a prospective breach of a director's duty. Whilst it is consistent to apply the legal principle to cases concerning prospective authorisation, the issue will be whether the same standard of disclosure is required for the approval of an authorisation resolution as is required for a ratification resolution. Clearly, it is not possible for the full and frank disclosure to set out the future events. All that is possible, consistent with the statements by Samuels JA and Mahoney JA in *Winthrop Investments*,[217] is to disclose the relevant facts known at the time of the disclosure,[218] including for example, the steps intended to be taken by the directors and the breach(es) which are said to arise from the intended steps. An example of the disclosure would be the defensive steps proposed to be taken to thwart a takeover of a company.

A consequence of a valid authorisation resolution for a breach of a director's duty is that minority shareholders and the company would need to consider the issues arising under section 239(2) of the Corporations Act in the context of the relief sought in any proceedings for the relevant breach. That consequence is not different from the consequences arising from a ratification resolution. Separately, as discussed in Chapter 5, if the shareholders can lawfully attenuate the statutory duties of directors, the company will not have a right to sue with respect

[213] *Winthrop Investments* (n 7) 684 (Samuels JA).
[214] *Winthrop Investments* (n 7) 686 (Mahoney JA).
[215] *Warman International Ltd v Dwyer* [1994] QCA 012, page 21 citing with approval *Phipps v Boardman* [1967] 2 AC 46 and *New Zealand Netherlands Society "Oranje" Inc. v Ruys* [1973] 1 WLR 1126.
[216] *Bamford* (n 6); *Peters American Delicacy Co Ltd v Heath* (1939) 61 CLR 457; *Forge v Australian Securities & Investments Commission* (2004) 213 ALR 574; *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* [2008] WASC 239, [9393].
[217] *Winthrop Investments* (n 7).
[218] *Winthrop Investments* (n 7) 684 (Samuels JA); *Winthrop Investments* (n 7) 705 (Mahoney JA).

to the proposed conduct because the resolution was effective to narrow the scope of the director's fiduciary and statutory duties.

Importantly, common to both ratification and authorisation resolutions, the interests of a director in giving disclosure may be of a self-serving nature. By way of example, a director can give disclosure of the proposed purpose of the breach of duty, however there may be a collateral purpose which is the motivation for the proposed breach of duty which is not disclosed to all shareholders. The fact that the conduct will be in the future amplifies the risk that the shareholders may not receive full and frank disclosure because the shareholders cannot independently obtain information to satisfy themselves or indeed oppose the proposal by circulating additional information to the other shareholders.

The decision in *Winthrop Investments* was not doubted in *Angas Law Services*. In both cases, the decision in *Bamford* was followed. Although both *Angas Law Services* and *Bamford* were concerned with retrospective ratification, there is no clear reason why all of the current law concerning the ratification of a breach of fiduciary or statutory duty would not be accepted as correct, including that all of the legal principles apply with equal force to a prospective authorisation of a director's proposed breach of duty.

From the discussion above about the relevant cases, there is no difference identified on the question of the standard of disclosure between a situation where the directors have breached their duties and one where the directors propose to breach their duties. The difficulty in applying the same standard of disclosure to future events is the inherent problem of a director being able to disclose the facts relevant to the proposed breach of duty.

***What are the implications and consequences for applying the same standard of disclosure?***

Future conduct, by its very nature is uncertain. Historical conduct on the other hand can be described and evidenced by the parties involved. This difference may be narrow where future conduct is able to be established by a specific course of action in a document, or the difference

could be very stark where the directors only have a high-level plan which they can disclose to shareholders and the directors seek a general mandate from the shareholders in general meeting to implement that plan.

If the same standard of disclosure for ratification is to be applied to authorisation for future conduct, this would make it difficult for a director to seek authorisation for high level plan because, for example, the director would be unable to advise the shareholders on the exact circumstances of the contemplated breaches of fiduciary and statutory duties. It is clearly better for the company if specific disclosure is made by the director because the shareholders in general meeting are entitled to consider the benefits and the risks to the company which could result in loss or damage to the company. A shareholder should be able to determine from a specific proposal what financial, legal and other consequences may flow from the proposed conduct which the directors seeks to be authorised.

***Summary***

A director/shareholder has a self-serving interest to give full and frank disclosure to the shareholders to ensure that the authorisation resolution is valid. The principle arising from trust law and applied to the doctrine of ratification that there must be full and frank disclosure indicates that the same standard of disclosure will be applicable to a director seeking the authorisation of their proposed conduct. There would be inconsistencies between retrospective ratification and prospective authorisation unless the same standard of disclosure applied and accordingly, the same standard of disclosure must apply.

The applicability of the same standard of disclosure to authorisation as ratification can be criticised on the basis that there will always be differences between the nature and content of the information disclosed to the shareholders. For example, in the case of authorisation, generalised information may only be available to shareholders about the proposed breach of duty and therefore the director's full and frank disclosure will fall short of what disclosure would have been made for retrospective ratification. There is therefore a quantifiable difference for the shareholders which could either result in on the one hand a limiting of the

company's or a shareholder's right to obtain any relief against a director who acted in breach of their duties or an invalid ratification resolution because full and frank disclosure was not made to the shareholders.

The criticism of applying the same standard of disclosure overlooks two issues. Firstly, there is the need for the consistent application of legal principles between retrospective ratification and prospective authorisation. Secondly, the relevant facts including the proposed breach of duty must be disclosed before any authorisation could be valid. Whilst the facts of a proposed breach of duty will be different from the facts of a prior breach of duty, whether the standard of disclosure has been reached is a matter for a court to consider since the issue concerns a question of law. Further, the common law of Australia determines the applicable standard of disclosure.[219] It is not thereby permissible for the shareholders to determine the applicable standard of disclosure, or whether that standard was achieved in the circumstances.

It is proposed by this Thesis to address the legal uncertainty by requiring that an authorisation resolution be approved in the same manner as a ratification resolution.

**Is chapter 2E of the Corporations Act an effective statutory limit on the doctrine of ratification?**

Chapter 2E of the Corporations Act imposes a requirement for shareholder approval before a financial benefit can be given to a related party of a public company unless an exception applies pursuant to sections 210 to 216. A financial benefit includes the releasing of an obligation[220] and section 229(1) of the Corporations Act expressly gives a broad interpretation to financial benefits.

[219] See especially, *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22, [135] (Gleeson CJ, Gummow, Callinan, Heydon and Crennan JJ).
[220] *Corporations Act 2001* (Cth) s 229(3)(f).

It is clearly the intention of section 229 of the Corporations Act to include a ratification of a director's conduct in breach of a director's duties because, at least in the instance of a breach of fiduciary duty, the ratification results in the release of the director's obligations to the company.

Whether section 229 extends to authorisation of a breach of a director's duty would turn on a question of whether a financial benefit includes a *future* financial benefit. There is circularity in the question for an authorisation resolution since at the time of the resolution, the director does not have any liability to the company and following the resolution, the director will not be liable for a breach of duty and thereby the director will not have a liability to the company. There is no authority on these questions in Australia.

Notably, section 224 of the Corporations Act imposes a voting restriction on shareholders who are a related party of the public company. This section therefore provides a mechanism for a majority of the shareholders who are not related parties to determine whether to give a financial benefit (eg. approve a ratification resolution) to a director in breach of their director's duties. This requirement is an effective statutory limit on the doctrine of ratification for all public companies.

Section 230 of the Corporations Act makes clear that a director is not relieved from any of their statutory or fiduciary duties in connection with a transaction which is approved for the purpose of compliance with Chapter 2E of the Corporations Act by a resolution of the members. Accordingly, the approval of a transaction by the shareholders is not equivalent to the authorisation or ratification of a breach of a director's duties. This is effective to ensure that full and frank disclosure is made at the meeting where authorisation or ratification is sought by one or more directors.

The requirements of Chapter 2E of the Corporations Act do not however extend to proprietary companies governed by the Corporations Act. Accordingly, the approval requirements of section 224 of the Corporations Act do not apply and only the equitable and the other statutory limits of the power of ratification apply.

In connection with the possible attenuation of statutory duties, it is not clear from the definition of 'giving a financial benefit' pursuant to section 229 of the Corporations Act whether a director would be restricted from voting on a resolution which would have the effect of attenuating their own statutory duties to a public company since the attenuation of a duty does not of itself result in the director obtaining a financial (or other economic) benefit. The question has not arisen for consideration in Australia and the question whether it is possible to attenuate a statutory duty is addressed in Chapter 5.

In summary, Chapter 2E of the Corporations Act provides an effective statutory limit on the doctrine of ratification for public companies because of the effect of sections 224 and 230 of the Corporations Act. However, Chapter 2E does not apply to proprietary companies and it may not apply to the attenuation of a public company's duties.

**What is the purpose of section 239?**

Pursuant to section 239(2)(b) of the Corporations Act, the Court must have regard to "whether the members who ratified or approved the conduct were acting for proper purposes.". This reference to 'proper purposes' may simply be interpreted to be consistent with the phrase 'proper purposes' in sections 181 and 184. This interpretation would be to ensure that a court aligns decisions with respect to section 239 with the statutory duties established by section 181(1) and section 184(1) especially since any decision pursuant to section 239 is contextual to ratification or approval of some conduct of a director who acted in breach of a duty. The cases concerning 'proper purposes' in connection with sections 181 and 184 have developed from the equitable doctrine of fraud on a power.[221]

A majority of shareholders in general meeting cannot act for the same improper purpose as the directors.[222] If it is held the shareholders acted for the same improper purpose as the directors,

[221] See generally *Mills v Mills* (1938) 60 CLR 150.
[222] *Miller* (n 87), 89 followed in *Gray Eisdell Timms Pty Ltd v Combined Auctions Pty Ltd* (1995) 17 ACSR 303, 312–13 (on appeal *Combined Auctions Pty Ltd v Gray Eisdell Timms Pty Ltd* (1998) 16 ACLC 252); *HNA Irish Nominee* (n 44). See generally Austin and Ramsay (n 26) 'The limits to the general meeting's power to ratify' [8.390].

the ratification resolution would be invalid.[223] In the event that there was a finding that there was an improper purpose by the shareholders in connection with the approval of the ratification resolution, a court would not be required to consider section 239 because the ratification resolution was invalid. This Thesis has not identified any authority on this point or academic discussion of the issue.

**Is section 239 of the Corporations Act an effective statutory limit on ratification?**

It is important to set out the terms of section 239 of the Corporations Act for the purpose of the following analysis. Section 239 of the Corporations Act states as follows:

> (1) If the members of a company ratify or approve conduct, the ratification or approval:
>
> (a) does not prevent a person from bringing or intervening in proceedings with leave under section 237 or from applying for leave under that section; and
>
> (b) does not have the effect that proceedings brought or intervened in with leave under section 237 must be determined in favour of the defendant, or that an application for leave under that section must be refused.
>
> (2) If members of a company ratify or approve conduct, the Court may take the ratification or approval into account in deciding what order or judgment (including as to damages) to make in proceedings brought or intervened in with leave under section 237 or in relation to an application for leave under that section. In doing this, it must have regard to:
>
> (a) how well-informed about the conduct the members were when deciding whether to ratify or approve the conduct; and
>
> (b) whether the members who ratified or approved the conduct were acting for proper purposes.

[223] *Miller* (n 87), 89 followed in *Gray Eisdell Timms Pty Ltd v Combined Auctions Pty Ltd* (1995) 17 ACSR 303, 312–13 (on appeal *Combined Auctions Pty Ltd v Gray Eisdell Timms Pty Ltd* (1998) 16 ACLC 252); *HNA Irish Nominee* (n 44). See generally Austin and Ramsay (n 26) 'The limits to the general meeting's power to ratify' [8.390].

Section 239(2) establishes matters in addition to section 237 that the Court must have regard to in relation to an application for leave to commence or intervene in derivative proceedings under section 237 in cases where shareholders have ratified or approved of the director's conduct in question.

Importantly, section 239 of the Corporations Act allows a court to take into account a ratification resolution, but it is no bar to leave being granted to commence a derivative proceeding or to prevent relief being granted in favour of a company. Section 239 has the effect of at least preventing a company's cause of action from being extinguished following approval of a ratification resolution and thereby has modified the common law.

Chapter 2F.1A, of which is section 239(2) is a part, commenced on 13 March 2000 following the enactment of the *Corporate Law Economic Reform Program Act 1999* (Cth). The Explanatory Memorandum to the *Corporate Law Economic Reform Program Bill 1998* (Cth) which concerned the proposed introduction of section 239(2), explained as follows:

> Proposed subsection 239(2) will provide that the Court may take into account a ratification or approval of conduct in deciding what order or judgment (including as to damages) to make. However, the provision will make it clear that the Court may only have regard to ratification if it is satisfied that the ratification was effected by the company's fully informed independent members. (*emphasis added*)[224]

The Explanatory Memorandum indicates that the intention of section 239(2) was to ensure that if the Court exercises its discretion to take a ratification or approval resolution into account in relation to an application for leave under section 237, the Court must be satisfied that the shareholders who approved the resolution were both fully informed and were independent shareholders from the affected director(s). Section 239(2) of the Corporations Act makes no reference to independent shareholders and has not been interpreted to require that the

[224] *Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998* (Cth) para 6.8 on page 24.

shareholders be independent.[225] Section 239 of the Corporations Act has therefore not been effective to limit the voting rights of a director/shareholder, or their family members and associates.

The Explanatory Memorandum explained that Part 2F.1A was introduced to overcome the practical and legal difficulties faced by litigants arising from the limited exceptions to the rule in *Foss v Harbottle*.[226] The three main difficulties associated with the common law derivative action were explained as follows:

1. the effect of ratification of the impugned conduct by the general meeting of shareholders (if effective, the ratification by a majority of shareholders could deny the company as a whole, and hence minority shareholders, any right of action against the directors);
2. the lack of access to company funds by shareholders to finance legal proceedings (where a shareholder seeks to enforce a right on behalf of a company, they are likely to be disinclined to risk having costs awarded against them in a case which will ultimately benefit the company as a whole, not just individual shareholders); and
3. the strict criteria which needed to be established before a court may grant leave.[227]

The Explanatory Memorandum also explained that there would be appropriate checks and balances to prevent abuse of the statutory derivative action to ensure that vexatious proceedings were not commenced and that company funds are not expended unnecessarily.[228] Those checks and balances are set out in section 237 which establishes specific mandatory requirements which a court must be satisfied about before leave is granted to a shareholder.[229]

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[225] See especially, *Forge v Australian Securities & Investments Commission* [2004] NSWCA 448; *Massey v Wales* [2003] NSWCA 212; *Chahwan v Euphoric Pty Ltd trading as Clay & Michel* [2008] NSWCA 52; *Ehsman v Nutectime International* [2006] NSWSC 887.

[226] (1843) 2 Hare 461.

[227] *Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998* (Cth) para 6.15 on page 19.

[228] *Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998* (Cth) para 6.16 on page 19.

[229] *Corporations Act 2001* (Cth) s 237(2); 237(3).

Evidence that a shareholder was independent of a director who acted in breach of duty carries an implication that the shareholder's vote was not connected with the same purpose as the director. For example, where the shareholder is not a family member or associate of the director, without contrary evidence, the shareholder's purpose is not connected with the director's purpose. By extending this proposition to all independent shareholders, there is some force in the argument that section 239(2) is permissive of a court taking into account a ratification which was approved by the independent shareholders because in the absence of contrary evidence, there is nothing to suggest that the independent shareholders acted for the same improper purpose.

The difficulty in the proposition that it will be permissible to take into account a ratification resolution approved by independent shareholders is that there is no equivalence between "independent shareholders" and "a majority acting for the same improper purpose". This means that section 239(2) cannot be interpreted to impose any requirement that a ratification resolution must be approved by independent shareholders.

If the Commonwealth Parliament intended the meaning of ‘members’ to be ‘independent members’ the word ‘independent’ would have been inserted into section 239(2). Under the general law, there is no requirement for an independent majority of shareholders to approve a ratification resolution. It would therefore be expected that a change to the general law would have been expressly stated in section 239 if there was an intention to change the general law. A further significant difficulty with reading the word ‘independent’ into section 239(2) is that the word ‘member’ or ‘members’ is used extensively throughout the Corporations Act and the word ‘member’ pursuant to sections 9 and 231 of the Corporations Act means persons who become members upon registration of a company or their name is entered into the register of members after registration. This is a reference to all shareholders of a company.

The Explanatory Memorandum does not explain why, firstly, there ought to be *any* relevance of a ratification resolution to a shareholder commencing proceedings pursuant to section 236 of the Corporations Act or, secondly, why a court should take into consideration the fact that a ratification resolution was approved. One reason would be that a ratification resolution may

be in certain circumstances relevant to an assessment of what is in the best interests of the company that leave be granted pursuant to section 237(2)(c) of the Corporations Act. Further, since the Explanatory Memorandum refers to independent members, it may have been considered that the relevance of the ratification resolution was inexorably linked with its approval by only independent shareholders.

The Corporations Act therefore provides a basis for a ratification resolution to be taken into account under section 237, notwithstanding that a ratification resolution approved by a self-interested director is the most criticised aspect of the doctrine. It is a proposal of this Thesis to address the problem by requiring that all ratification resolutions be approved by independent shareholders. This proposal will ensure that section 239 is not utilised by a self-interested director for the purpose of limiting a shareholder's rights under section 236.

A court as a part of the exercise of its discretion could potentially take into account the votes cast in favour and against a ratification resolution. It would be a matter for a court to determine whether the evidence was relevant to the exercise of its discretion under section 239. However the court's enquiry under section 239(2) may be restricted to identifying whether the shareholders who ratified the conduct were acting for proper purposes.[230] There are no reported cases which have addressed this issue.

The strongest argument of a practical significance for taking into account a ratification resolution is if the company was unable to obtain any substantial damages as a result of the ratification resolution. The granting of leave to commence proceedings would likely be refused at least on the basis that the proceedings would be otiose and only result in the parties and the court devoting unnecessary resources to the resolution of the dispute. The refusal of leave in those circumstances is entirely appropriate.

At the time of the commencement of section 239(2) of the Corporations Law, the law in Australia with respect to the doctrine of ratification was in a more uncertain state. However,

[230] *Corporations Act 2001* (Cth) s 239(2)(b).

since that time, it is now clear, separate from the effect of section 239 that the shareholders in general meeting cannot ratify a breach of statutory duty. A court would be unable to deny a shareholder leave to commence proceedings with respect to a breach of a director's statutory duties on the basis of a ratification resolution being approved by the shareholders since that resolution could not be legally effective to relieve a director of liability to the company.

The absence of the words 'independent' in section 239 in relation to shareholders supports an interpretation that there is no requirement that a ratification resolution be approved by independent shareholders. Since it is a requirement of statutory interpretation pursuant to section 15AA of the *Acts Interpretation Act 1901* (Cth) that in interpreting a provision of an Act, the interpretation that would best achieve the purpose or object of the Act (whether or not that purpose or object is expressly stated in the Act) is to be preferred to any other interpretation.[231] A court may consider extrinsic material where a provision is ambiguous or obscure,[232] however, on the face of section 239(2), there is nothing ambiguous or obscure about the words used in the section.

In light of the interpretation of section 239 it is concluded by this Thesis that section 239 is not an effective limit on the doctrine of ratification because there is no requirement that a ratification resolution be approved by independent shareholders. This Thesis proposes to address the interpretation of section 239 by requiring that ratification resolutions be approved by independent shareholders, which is consistent with the proposed scope of section 239 described in the Explanatory Memorandum.

### C. *Uncertainty in determining whether a wrong is ratifiable*

A significant area of uncertainty of the doctrine are the categories of non-ratifiable wrongs, or more aptly the exceptions to the doctrine of ratification[233] which were briefly discussed in

[231] *Acts Interpretation Act 1901* (Cth) s 15AB.
[232] *Acts Interpretation Act 1901* (Cth) s 15AB(1)(b)(i).
[233] Hans Hirt, *The enforcement of director's duties in Britain and Germany: A comparative study with particular reference to large companies* (European Academic Publishers, 2004), 230; John Kluver, 'Derivative actions and the rule in Foss v Harbottle: Do we need a statutory remedy?' (1993) 11 *Companies and Securities Law Journal*

Chapter 2. The distinction between a ratifiable and non-ratifiable wrong is of great significance since the effect of allowing a majority to approve a ratification resolution, may deprive the minority of their legal rights to commence derivative proceedings[234] and could result in the company's cause of action against the director in breach of their fiduciary duties being extinguished.

In the context of minority shareholder rights, Professor Paul Finn criticised the guidance given by the courts in respect of ratification as 'neither conclusive nor satisfactory'.[235] In particular, Professor Finn suggested that the approach taken by the courts to distinguish between a situation where (i) shareholders are in hostile camps and (ii) one where they are not was a logical distinction which was *'a little difficult to discover'* and opined that *'the directors are entitled to interfere improperly with a threatening minority, but not a threatening majority'*.[236] Professor Finn's critical observations in 1977 about the state of the law in connection with the doctrine drew attention to the ability of a majority of shareholders to approve a ratification resolution resulting, at that time, in the extinguishment of a company's right to sue a director for a breach of duty.

The concern raised by the Companies and Securities Advisory Committee in the report titled "Report on a Statutory Derivative Action" in July 1993[237] was that *'the distinction in law between ratifiable and non-ratifiable matters is unclear and uncertain'*[238] and the academic literature has drawn attention to a number of conflicting authorities which cannot be reconciled to determine what types of acts and omissions by directors are ratifiable by the shareholders in general meeting.[239] The reforms to the Corporations Law which implemented the statutory

7, 8; Anil Hargovan, 'Under judicial and legislative attack: The rule in Foss v Harbottle' (1996) 113 *South African Law Journal* 631, 634, 636-7.

[234] Cf Fridman (n 19), 266.
[235] Finn (n 26) 73.
[236] Ibid.
[237] Companies and Securities Advisory Committee (n 189).

[238] Companies and Securities Advisory Committee (n 189) 6. See also Fridman (n 19); Yeung (n 20); Stanley Beck, 'The Shareholders' Derivative Action' (1974) 52 *Canadian Bar Review* 159, 207.

[239] Lynne Taylor, 'Ratification and the Statutory Derivative Action in the Companies Act 1993' (1998) 16 *Company and Securities law Journal* 221, 223; Bruce McPherson, 'Duties of directors and the powers of shareholders' (1977) 51 *Australian Law Journal* 460, 468-9; Ian Ramsay and Benjamin Saunders, 'Litigation by

derivative action did diminish the significance of ratification but those reforms did not resolve the uncertainty related to the distinction between a ratifiable and a non-ratifiable wrong.

One such category of non-ratifiable wrongs which has been criticised for being in an uncertain state is a fraud on the minority in relation to a breach of a fiduciary duty. Two areas have been highlighted by the academic literature. Firstly, a distinction is drawn between negligence of the directors (a ratifiable wrong) and negligence which results in the directors' making a profit (which *may* be within the fraud on the minority exception).[240] Secondly there is conflicting authority that a shareholder is subject to an implied limitation that their power is to be exercised in good faith in the best interests of the company.[241]

It may be thought that the criteria for a non-ratifiable wrong would be able to be clearly stated, if not easily applied in practice. However, Professor Robert Baxt and other academics[242] have highlighted the difficulties in reconciling the cases of *Cook v Deeks*,[243] *Regal (Hastings) Ltd v Gulliver*[244] and *Furs Ltd v Tomkies*.[245,246]

In *Cook v Deeks*,[247] the three defendants were each directors of a company and held seventy five percent of its issued shares. They negotiated for themselves a contract to the exclusion of the company. The resolution of the shareholders in general meeting ratifying the conduct of the three directors was invalid because the use of the voting power was oppressive to the minority and accordingly, the conduct was not ratifiable.

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shareholders and directors: An empirical study of the statutory derivative action' (Centre for Corporate Law and Securities Regulation, 2006), 13.

[240] Companies and Securities Advisory Committee (n 189) 22. See especially *Pavlides v Jensen* [1956] Ch 565; *Daniels v Daniels* [1978] Ch 406.
[241] Compare *Ngurli Ltd v McCann* (1953) 90 CLR 425 and *Bamford* (n 6). See Austin and Ramsay (n 26) 'The limits to the general meeting's power to ratify' [8.390].
[242] See, eg, Davies and Worthington (n 18); Bakibinga (n 18).
[243] [1916] 1 AC 554.
[244] [1967] 2 AC 134.
[245] (1936) 54 CLR 583.
[246] Baxt (n 15).
[247] [1916] 1 AC 554.

In *Regal (Hastings) Ltd v Gulliver*,[248] the plaintiff company had an opportunity, but financial difficulty in acquiring leases for two cinemas. A new company was formed, however under a scheme devised by the directors, only 40% of the shares were owned by the plaintiff, the remaining 60% by the directors and the plaintiff's solicitor. The shares in the new company were later sold for a substantial profit which was not disclosed to the company. The defendant directors were held to be in breach of their directors' duties to the company because the acquisition of the shares in the new company only arose because they obtained the knowledge and the opportunity because they were the directors of the plaintiff company.

Notwithstanding the breach of fiduciary duty, Lord Russell of Killowen in *Regal (Hastings) Ltd v Gulliver*[249] considered *obiter* that the directors as shareholders of the plaintiff could have protected themselves against liability by a ratification resolution of a general meeting of the shareholders.[250] This *obiter* statement indicates that the breach of the directors' fiduciary duty was ratifiable in circumstances where the plaintiff did not have the opportunity and the plaintiff obtained a benefit from the directors' conduct. The decision in *Regal (Hastings) Ltd v Gulliver*[251] has been criticised because the conduct was considered to be ratifiable, however this case did not determine whether any conduct was ratifiable. This Thesis argues therefore that academic commentary has put undue emphasis upon the *obiter* statement in *Regal (Hastings) Ltd v Gulliver* in seeking to explain and criticise the differences between ratifiable and non-ratifiable wrongs. The academic commentary therefore has not advanced a discussion about the uncertainties of the operation and effect of the doctrine.

In *Furs Ltd v Tomkies*,[252] the defendant was the managing director of the plaintiff company and the director made an unauthorised profit from a transaction which involved a sale of the company's assets. The director was held to be in breach of his fiduciary duties to the company. The academic commentary which discusses the doctrine ratification in the context of this case

[248] [1967] 2 AC 134.
[249] [1967] 2 AC 134.
[250] *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 142 (Lord Russell of Killowen).
[251] [1967] 2 AC 134.
[252] (1936) 54 CLR 583.

has disregarded the fact that the Court was not required to determine whether the conduct was ratifiable. It is not a sensible approach therefore to seek to reconcile the apparent differences between *Cook v Deeks*,[253] *Regal (Hastings) Ltd v Gulliver*[254] and *Furs Ltd v Tomkies*.[255]

In *Cook v Deeks*,[256] *Regal (Hastings) Ltd v Gulliver*[257] and *Furs Ltd*,[258] in breach of their duties, the directors used information which arose from their knowledge as directors of the companies and those directors subsequently profited from the use of the information.

In *Furs Ltd v Tomkies*,[259] Latham CJ considered that "[t]he directors were not at liberty to determine, in favour of any of their own body, that the rights of the company should be disregarded" contrary to the decision in *Cook v Deeks*.[260] The decision in *Furs Ltd v Tomkies*[261] in *obiter* considered that ratification was permissible whether or not the company suffered any loss.[262] This proposition is contrary to the decision in *Cook v Deeks*[263] where the wrong was not ratifiable. This Thesis argues, as previously stated, that reliance on *obiter* statements does not clarify the operation and effect of the doctrine.

There is academic commentary which explains the distinction between a ratifiable and non-ratifiable wrong arises from proof of fraud on the minority by citing examples of when courts have held that a wrong was ratifiable or otherwise.[264] This commentary does not seek to explain the legal basis upon which fraud on the minority cases were decided and is unhelpful in this regard.

[253] [1916] 1 AC 554.
[254] [1967] 2 AC 134.
[255] (1936) 54 CLR 583.
[256] [1916] 1 AC 554.
[257] [1967] 2 AC 134.
[258] (1936) 54 CLR 583.
[259] (1936) 54 CLR 583.
[260] [1916] 1 AC 554.
[261] (1936) 54 CLR 583.
[262] *Furs Ltd v Tomkies* (1936) 54 CLR 583, 592 (Rich, Dixon and Evatt JJ).
[263] [1916] 1 AC 554.
[264] See eg, Goo (n 18).

The cases highlighted above serve to demonstrate the areas of uncertainty for future litigants in determining when a breach of duty is ratifiable by the shareholders in general meeting and those cases show there is no clear legal principle which results in a determination that a particular breach of duty is, or is not, ratifiable.

The distinction between ratifiable and non-ratifiable breaches of duty was considered by Say Goo and attempted to be explained on the basis that a breach of duty resulting in harm to the company was different to a director generally acting in breach of their director's duties.[265] That distinction has been criticised by other commentators principally because all the directors in *Cook v Deeks,*[266] *Regal (Hastings) Ltd v Gulliver*[267] and *Furs Ltd v Tomkies,*[268] took advantage of corporate opportunities which they knew of because they were the directors for their own benefit and not the benefit of the companies.[269]

In light of all of the attempts by academics to explain the differences between ratifiable and non-ratifiable wrongs and the discussion of the relevant law, there is no 'bright-line' test discernible from the decided cases to determine whether any particular breach of a director's duty is ratifiable and accordingly, there is limited predictability of the application of the law outside of existing cases which have a similar factual scenario. It is not proposed by this Thesis to propose a fresh approach to determining what is a ratifiable wrong because there has been a significant narrowing of the scope of ratifiable wrongs following the decision in *Angas Law Services*[270] and *Cassimatis v Australian Securities and Investments Commission*.[271] Therefore its importance has diminished to such an extent that any contribution to the ongoing academic discussion would be of limited value.

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[265] See eg, Goo, S. H., Minority Shareholders' Protection, s 1.3 (Cavendish Publishing Ltd, London, 1994).
[266] [1916] 1 AC 554.
[267] [1967] 2 AC 134.
[268] (1936) 54 CLR 583.
[269] Bakibinga (n 18).
[270] Malcolm Anderson et al, *Evaluating the shareholder primacy theory: Evidence from a survey of Australian directors* (PDF, 18 August 2021)<https://law.unimelb.edu.au/__data/assets/pdf_file/0010/1709839/75-Evaluating_the_shareholder_primacy_theory_-__evidence_from_a_survey_of_Australian_directors__20_11_07_11.pdf> (referring to H. Hansmann and R. Kraakman, 'The End of History for Corporate Law' (2001) 89 Georgetown Law Journal 439; R. Gordon Smith, 'The Shareholder Primacy Norm' (1998) 23 Journal of Corporation Law 277; E. Farmer and N. Jensen, 'Separation of Ownership and Control' (1983) 26 Journal of Law and Economics 301).
[271] [2020] FCAFC 52.

## D. *Conclusion*

The uncertainty and the criticisms of the doctrine are criteria by which this Thesis examined the relevance and appropriateness of the application of the doctrine to companies governed by the Corporations Act.

There are some legal limitations imposed on the approval of a ratification resolution, including when a director is voting as a shareholder to ratify their own breach of fiduciary duties. This is a significant problem for the protection of minority shareholders of proprietary companies and the criticisms and uncertainties of the doctrine support limited statutory law reform to the doctrine. The policy arguments related to ratification are separately addressed in Chapter 7 of this Thesis.

The doctrine of ratification was subject to such continuous and strong criticism that the Corporations Act was amended to include a statutory derivative action to ensure a shareholder had a right to seek leave to commence or intervene in proceedings.[272] These reforms indirectly addressed the criticisms of the doctrine and had an overall effect of reducing the need to resolve the uncertainties in the operation of the doctrine. Despite the Commonwealth Parliament's law reforms, the doctrine of ratification continues to be relevant to directors' breaches and their liability to companies for the loss and damage caused by their conduct.

Only further reforms to the Corporations Act can directly address the ongoing significant problem of a self-interested director voting to approve a ratification resolution for a breach of duty. The law reforms proposed by this Thesis in Chapter 8 retain the benefits of the doctrine and address the problem of a self-interested director voting on a ratification resolution.

[272] Ramsay and Saunders (n 239), 15.

## CHAPTER 5 – THE ATTENUATION OF DIRECTORS' STATUTORY DUTIES

In this Chapter, the question whether statutory duties may be attenuated by retrospective ratification or prospective authorisation is addressed. This analysis is a separate criterion for assessing whether the doctrine of ratification remains relevant and appropriate to companies governed by the Corporations Act.

Attenuation of a director's statutory duty concerns a change to the content of the duty. Its effect is to narrow the scope of the duty. By way of example, one means by which a duty may be able to be attenuated is by the shareholders in general meeting. This is a separate legal possibility to prospective authorisation by the shareholders to an exercise of a director's power which would otherwise involve a breach of duty.[273] A prospective authorisation does not narrow the scope of a director's duty.

The case law concerning attenuation of fiduciary duties arises principally in respect of 'nominee' directors and joint venture style companies and is exemplified in Australia by *Levin v Clark*.[274] Since the issues arose in *Levin v Clark*,[275] there have been significant legislative changes which include the enactment of the current statutory duties of directors in the Coporations Act. The question of whether a director's statutory duties could be attenuated was only partly considered by the High Court in *Angas Law Services*[276] with respect to ratification and not in the context of prospective authorisation. Accordingly, there remain legal and policy issues which have not been addressed in Australia, including by the academic literature.

This Chapter focuses on the problem that there may be the attenuation of statutory directors' duties established by sections 180 to 184 of the Corporations Act. The legal consequences of the attenuation of statutory duties can include a director not acting in breach of a statutory duty

[273] See especially *Winthrop Investments* (n 7).
[274] [1962] NSWR 686.
[275] [1962] NSWR 686.
[276] *Angas Law Services* (n 5).

or ASIC's role as corporate regulator being restricted.[277] This is problematic because of the possibility a breach of statutory duty is avoided by the director. If a director's statutory duties may be attenuated, then this suggests that there should be law reform to the doctrine of ratification to address the legal consequences of the attenuation of statutory duties. This concern arises since attenuation of statutory duties will impact upon the public interest, particularly in the enforcement of breaches of statutory duties.

This Chapter firstly considers how attenuation of statutory duties differs from ratification and authorisation. This Chapter then addresses the current law which concerns the possibility of the attenuation of directors' statutory duties. An important question is

whether the company is the sole beneficiary of duties owed to it by the directors in light of the emergence of statutory directors' duties which have public interest aspects. This issue also concerns the important distinction between a subjective and objective element of a director's statutory duties. It is further questioned how a company's constitution, shareholders' agreement or shareholder resolution could narrow the content of a director's statutory duties.

The following matters are relevant to whether a director's statutory duties are able to be attenuated:

(i) the limitations on the operation of the doctrine of ratification (addressed in Chapter 2);
(ii) the exemption limitations pursuant to section 199A of the Corporations Act (Indemnification and exemption of officer or auditor); and
(iii) the operation of the *Duomatic* principle (addressed in Chapter 3).

This Chapter then considers the policy arguments for and against allowing the attenuation of directors' statutory duties. There are two special situations which have emerged which provide a benefit to a director who is a nominee of a particular shareholder and a director of a wholly-owned subsidiary. There is a benefit to nominee directors because of the possibility of the attenuation of their fiduciary duties to the company. Separately, there is a benefit to directors of wholly-owned subsidiaries because they have attenuated statutory duties pursuant to section

[277] Isuru Devendra, 'Statutory directors' duties, the civil penalty regime and shareholder ratification: What role does the public interest play?' (2014) 32 *Company and Securities Law Journal* 399, fn 115, 356.

187 of the Corporations Act. There are policy arguments in favour of allowing an attenuated duties approach for these two specific situations. Corporate law policy recognises that a nominee director's fiduciary duties can come into conflict with other duties to their appointer, such as contractual or employment duties and thereby treats this situation differently to other directors. Separately, the policy of limited attenuation of the statutory duties of directors of wholly-owned subsidiary companies reflects a policy of allowing these directors to act in good faith for the benefit of the holding company because there can be a conflict between acting in good faith in the best interests of the wholly-owned subsidiary and acting in good faith in the best interests of the holding company. The policy of section 187 does not extend to partly-owned subsidiaries.

There are however substantial policy reasons against allowing statutory duties to be attenuated. A significant reason is the public interest aspects of statutory duties establishes a minimum threshold by which the conduct of directors is to be judged.

This Chapter concludes by considering how the Corporations Act should be reformed in light of the current law and the policy issues considered.

## A. *Why does attenuation of statutory duties differ from ratification and authorisation?*

As discussed in Chapter 2, the legal issues concerning the application of the doctrine of ratification are common to both (i) retrospective ratification and (ii) prospective authorisation of a breach of statutory duty. It will be recalled from Chapter 4 that it is necessary to conceptually distinguish between prospective authorisation and retrospective ratification because in the case of authorisation, there is no cause of action against a director in existence at the time of the granting of the authorisation for the future conduct. The practical effect of the authorisation is to allow the directors to engage in conduct on behalf of the company which would otherwise attract personal liability for a breach of the directors' statutory duties.

Prior to the board of directors embarking upon conduct which may be in breach of the statutory duties to the company, each director may seek authorisation from the shareholders in general

meeting.[278] The same requirements and restrictions which apply to retrospective ratification apply to prospective authorisation.[279] Accordingly, not every proposed breach of statutory duty is capable of prospective authorisation.[280]

If the directors and their associates form a majority of the shareholders, it is to the advantage of the directors to seek authorisation (as distinct from ratification) since the directors may not later be able to form a majority at a future general meeting of the shareholders to approve a ratification resolution because for example there has been a change of the company's ownership structure.

**The nature of a director's statutory duties under the Corporations Act**

The enactment of directors' statutory duties gave rise to statutory remedies, which were in addition to the remedies available under the common law[281] and in equity for a breach of a director's fiduciary duty. This is a consequence of at least (i) section 185 of the Corporations Act, (ii) the broader wording used in the Corporations Act when the co-existing fiduciary duties were codified and (iii) the creation of directors' duties under statute separate from the Corporations Act.[282] There is a further dimension to the issue arising from the public interest aspects of a director's statutory duties which is discussed in detail below.

The principal legal consequences of a breach of statutory duty are:

(i) declaration of contravention pursuant to section 1317E(1);
(ii) pecuniary penalties pursuant to section 1317G;
(iii) a compensation order pursuant to section 1317H; and
(iv) disqualification under Part 2D.6 of the Corporations Act.

[278] See especially *Winthrop Investments* (n 7).
[279] *Pascoe Ltd (in liq) v Peter Charles Lucas* [1998] SASC 7134; *Kinsella* (n 55); *Winthrop Investments* (n 7); *Bamford* (n 6).
[280] Tina Cockburn, Leanne Wiseman, *Disclosure Obligations in Business Relationships* (Federation Press, 1996), 222.

[281] *Corporations Act 2001* (Cth) s 185
[282] For example, directors are required to ensure that the company complies with its tax obligations under Division 269 of Schedule 1 to the *Taxation Administration Act 1953* (Cth).

On current authority, a breach of the directors' statutory duties cannot be prospectively authorised or retrospectively ratified.[283] The questions which arise for consideration in this Chapter are firstly, whether a director's statutory duties can be attenuated by authorisation or ratification and is the attenuation permissible in whole or in part? These issues are discussed below in this Chapter.

## B. *The current law concerning the possible attenuation of statutory duties*

### *(a) The emergence of the power of attenuation of directors' duties*

The attenuation of directors' fiduciary duties emerged in the 20th century in Australia and New Zealand then later in the early 21st century in the United Kingdom exemplified respectively by *Levin v Clark,*[284] *Berlei Hestia (NZ) Ltd v Fernyhough*[285] and *Re Southern Counties Fresh Foods Ltd*.[286]

In *Levin v Clark,*[287] nominee directors of a third party mortgagee were appointed to protect the interests of the mortgagee. The nominee directors approved resolutions for the primary benefit of the mortgagee. It was relevantly held in that case that the fiduciary duties of the nominee directors had been attenuated by agreement of the shareholders and as a result the directors had acted properly in the interests of the company as a whole and those directors were entitled to act solely in the interests of the mortgagee (and thereby not exclusively for the benefit of the company).[288] The case of *Levin v Clark*[289] did not concern the statutory duties of a director under company law.

[283] *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52; *Angas Law Services* (n 5); *Forge v Australian Securities & Investments Commission* [2004] NSWCA 448; *Miller* (n 87) cf *Pascoe Ltd (in liq) v Lucas* (1998) 27 ACSR 737.
[284] [1962] NSWR 686.
[285] [1980] 2 NZLR 150.
[286] [2008] EWHC 2810 (Ch).
[287] [1962] NSWR 686.
[288] *Levin v Clark* [1962] NSWR 686, 700-701 (Jacobs J).
[289] [1962] NSWR 686.

### *(b) Recent consideration of attenuation of statutory duties by the Courts*

In *Angas Law Services*,[290] Gleeson CJ and Heydon J (Gummow, Hayne and Kirby JJ agreeing) stated (by reference to the former sections of the *Companies (South Australia) Code* (SA) under consideration in that case), that ratification by the members cannot relieve a director of a liability to a company arising from a breach of statutory duties imposed on directors by sections 180(1), 182(1) and 184(2). The same conclusion was earlier reached in *Miller*,[291] *Macleod v The Queen*,[292] *Forge v Australian Securities & Investments Commission* [293] and *Australian Securities and Investments Commission v Australian Investors Forum Pty Ltd (No 2).*[294]

In *Forge v Australian Securities & Investments Commission*,[295] the Court stated that civil penalty proceedings to enforce breaches of directors' duties involve public rights.[296] The public interest aspects of the statutory duties has a limiting effect on the extent to which the shareholders can use ratification because the statutory duties include protections which are in the public interest,[297] not merely the company's interests.

The above cases identify that a breach of statutory duty cannot be ratified primarily because of the public interest aspects of statutory duties. The fact that a breach of a statutory duty is a criminal offence is one significant further reason in the cases discussed above why the doctrine of ratification cannot exonerate a director from a breach of statutory duty. There is ultimately no difference identified from the cases between statutory duties which are criminal offences and statutory duties which are not criminal offences.

The prohibition against ratification of a breach of statutory duty is relevant to the further question of whether prospective authorisation may be effective to attenuate statutory duties which is discussed below.

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[290] *Angas Law Services* (n 5).
[291] *Miller* (n 87).
[292] (2003) 214 CLR 230.
[293] [2004] NSWCA 448.
[294] [2005] NSWSC 267.
[295] [2004] NSWCA 448.
[296] *Forge v Australian Securities & Investments Commission* [2004] NSWCA 448, [381].
[297] See *International Swimwear Logistics Ltd v Australian Swimwear Company Pty Ltd* [2011] NSWSC 488 concerning the public interest in the enforcement of directors' duties.

The *obiter* statements by Gleeson CJ and Heydon J in *Angas Law Services*[298] suggest attenuation of a statutory may apply by affecting the practical content of a particular duty although no basis was suggested for such a principle. The example cited in *Angas Law Services*[299] was on a question of impropriety which was discussed in *R v Byrnes*[300] including how the factual question of impropriety may be addressed in certain circumstances. This Thesis considers below the cases which discuss the meaning of 'improper' in connection with sections 182 and 183 of the Corporations Act. There are no reported cases which permitted the attenuation of statutory duties under the Corporations Act. The question of law remains under development in Australia.

***(c) The public interest aspects of statutory duties***

The first statutory duty of care in Australia was section 116(2) of the *Companies Act 1896* (Vic). This section was later re-enacted as section 107 of the *Companies Act 1958* (Vic) but it was significantly modified.[301] The latter statutory duty of care was a significant step because of the possibility of public enforcement by the Attorney-General.[302] This was a novel corporate law development at this time because the regulatory approach was no longer to merely seek to regulate the relationship between the directors as managers of the company and the shareholders as the owners of shares of the company.[303]

Academic commentary on the issue of the private and public nature of director statutory duties highlights that the introduction of the civil penalty regime empowered the Australian Securities & Investments Commission ('**ASIC**') to enforce statutory duties. These powers included the right to apply for declarations and orders,[304] injunctive relief under section 1324 of the

[298] *Angas Law Services* (n 5) [32] (Gleeson CJ and Heydon J).
[299] *Angas Law Services* (n 5).
[300] (1995) 183 CLR 501.
[301] Rosemary Langford et al, 'The origins of company directors' statutory duty of care' (2015) 37(4) *Sydney Law Review* 489, 490.
[302] Ibid, 490 and 511.
[303] Ibid, 490 and 513.
[304] *Corporations Act 2001* (Cth) s 1317J.

Corporations Act, seeking a disqualification order and pecuniary penalty order. Each of those relate to the publicisation of directors' duties under Australian corporate law.[305]

One aspect of the legal issues relevant to attenuation of a statutory duty is the extent to which the statutory duties are public duties. The public interest aspects of statutory duties has been the subject of recent academic[306] and judicial comment.[307]

In the context of the attenuation of statutory duties, the decision in *Cassimatis (No 8)*[308] found that the duties created by section 180 of the Corporations Act were at least partly of a public nature (consistent with the reasoning in *Angas Law Services*[309]). In *Cassimatis (No 8)*,[310] Edelman J determined that section 180(1) of the Corporations Act could be breached by the directors who were the only shareholders of a solvent company. Even though the directors impliedly approved of their own conduct as the shareholders, the statutory duty could not be narrowly construed to be solely for the benefit of the shareholders.[311] The appeal against the decision in *Cassimatis (No 8)*[312] was dismissed[313] and special leave to appeal to the High Court was refused.[314]

The decision in *Foss v Harbottle*[315] supports the view that the fiduciary duties of directors were owed exclusively to the company and not the shareholders. This is not the same for statutory

[305] Michael Whincop and Mary Keyes, 'Corporation, Contract, Community: Analysis of Governance in the Privatisation of Public Enterprise and the Publicisation of Private Corporate Law' (1997) 25 *Federal Law Review* 51, 87-88; Langford (n 301) 513-514.

[306] Se, eg, Devendra (n 277); Rosemary Teele Langford, (n 25), referring at footnote 52 to Dimity Kingsford Smith, 'Australian Directors' Duties: Are they Public Duties?' (Corporate and Commercial Law Conference, Sydney, 2018).

[307] *Cassimatis (No 8)* (n 64) [478] (Edelman J); *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52.

[308] [2016] FCA 1023.

[309] *Angas Law Services* (n 5).

[310] [2016] FCA 1023.

[311] *Cassimatis (No 8)* (n 64) [478] (Edelman J).

[312] [2016] FCA 1023.

[313] *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52.

[314] *Cassimatis v Australian Securities and Investments Commission* [2020] HCASL 158.

[315] (1843) 2 Hare 461.

duties as explained in *Cassimatis (No 8).*[316] As an example, there are cases where the ASIC has sought to enforce a director's statutory duties for the benefit of shareholders and creditors, such as where compensation orders are sought pursuant to section 1317H,[317] which demonstrates the statutory duties are also intended to protect a company's stakeholders.[318]

***(d) Are statutory duties severable between private and public law aspects?***

A separate consideration is whether a statutory duty could be attenuated because the public interest aspects of the duty are severable from its private aspects. In *Cassimatis v Australian Securities and Investments Commission*[319] Greenwood J held relevantly that,

> ...the shareholders cannot sanction, ratify or approve, qua *themselves* as directors, their own conduct in contravention of s 180 [of the Corporations Act]. Nor can they release themselves from such a contravention. That follows because of the normative, objective, irreducible standard of care and diligence directors *must* live up to, as adopted by the Parliament according to the text of the section... (original emphasis)[320]

The irreducible nature of the statutory duty enacted by section 180 indicates that the statutory duty is not severable as between its private and public interest aspects. This Thesis has not identified any cases in Australia which provide support for the severability of a director's statutory duty established pursuant to the Corporations Act.

***(e) The statutory duties and their interpretation in respect of attenuation***

Having established the proper context of the attenuation of statutory duties in the preceding discussion, the remainder of section B of this Chapter considers the relevant cases by commencing with a discussion of the interpretation of a director's statutory duties.

The decision in *Levin v Clark*[321] did not expand shareholders' powers beyond the existing equitable limitations. Accordingly, the attenuation of a director's fiduciary duties will be

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[316] [2016] FCA 1023.
[317] See, eg, *ASIC v Adler* [2002] NSWSC 483.
[318] See, eg, ASC v *Deloitte Touche Tohmatsu* (1996) 21 ACSR 332; *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52.
[319] [2020] FCAFC 52.
[320] *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52,196 (Greenwood J).
[321] [1962] NSWR 686.

limited by the same principles which govern the doctrine of ratification as discussed in Chapter 2. Further, the decision in *Angas Law Services*[322] indicates that attenuation of a director's statutory duties is subject to the doctrine given there is no statement qualifying the important decisions in *Bamford*,[323] *Macleod v The Queen*,[324] *Winthrop Investments*[325] or *Miller*.[326]

The attenuation of a statutory duty may fall foul of the established principles of the doctrine of ratification which invalidates the ratification of actions which are for example; criminal, contrary to public policy, equitable fraud, a fraud on the minority, a misappropriation of company resources, oppressive, or if the company was insolvent as discussed in Chapter 2. In the case of an approval granted at a shareholders meeting, the meeting may separately be contrary to section 249Q of the Corporations Act which requires the meeting to be called for a proper purpose.[327]

Edelman J in *Cassimatis (No 8)*[328] stated in relation to the *obiter* statements in *Angas Law Services*[329] that *'the [shareholders] acquiescence [to a director's conduct] does not eliminate or relieve the duty where there are other relevant interests of the corporation apart from the interests of the shareholders'*.[330] Edelman J in *Cassimatis (No 8)* importantly concluded that the interests of the company are never entirely the interests of the shareholders, even in relation to solvent companies.[331] This conclusion provides support for the view that the public interest aspects of a director's statutory duties will be everpresent in any legal proceeding concerning the attenuation of statutory duties.

[322] *Angas Law Services* (n 5).
[323] *Bamford v Bamford* [1970] Ch 212.
[324] (2003) 214 CLR 230.
[325] *Winthrop Investments* (n 7).
[326] *Miller* (n 87).
[327] *Capricornia Credit Union Ltd v Australian Securities and Investment Commission* [2007] FCAFC 79, [64] (the Court).
[328] *Cassimatis (No 8)* (n 64).
[329] *Angas Law Services* (n 5).
[330] *Cassimatis (No 8)* (n 64) [523] (Edeleman J).
[331] *Cassimatis (No 8)* (n 64).

The developing case law concerning the public nature of statutory duties as primarily discussed in *Forge*,[332] *Cassimatis (No 8)*[333] and *Cassimatis v Australian Securities and Investments Commission*[334] indicates that attenuation of statutory duties may not permissible under the Corporations Act for three reasons.

Firstly, there are consideration affecting the lawfulness of an attenuation of statutory duty. Corporate law public policy expressed through the statutory duties denotes a significant departure from allowing the shareholders to attenuate the breaches of fiduciary duties of the company's directors. An argument that there has been an attenuation of statutory duties would need to establish that the attenuation was not contrary to public policy.

There is a clear nexus between the shareholders attenuating a statutory duty which has a public interest aspect and the purpose of the statutory duty sought to be attenuated. An important purpose of statutory duties is, for example, the enforcement of statutory duties by the ASIC for the protection of the public interest. An attenuation of a statutory duty would on the basis of the decision in *Cassimatis (No 8)*[335] affect the public interest of holding the director to the legislative standards established by the Corporations Act.

Contrary to academic commentary[336] before the decision in *Cassimatis (No 8)*,[337] it would be a surprising result if a director's statutory duty could be attenuated. It would be difficult to reconcile with the decision of the High Court in *Angas Law Services*,[338] which firstly determined that a ratification resolution could not relieve a breach of a statutory duty and secondly considered the cases of *Miller*[339] and *MacLeod v The Queen*[340] without expressing

[332] *Forge v Australian Securities & Investments Commission* [2004] NSWCA 448, [381] (McColl J, Handley and Santow JJA agreeing).
[333] *Cassimatis (No 8)* (n 64).
[334] [2020] FCAFC 52.
[335] *Cassimatis (No 8)* (n 64).
[336] Devendra (n 277), 405 (referring at footnote 50 to Robert Austin et al, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworth, 2005), p 643), 408 (referring at footnote 74 to Elizabeth Boros and John Duns, *Corporate Law* (2nd ed, OUP, 2010), 264) and 412 (referring at footnote 100 to Jason Harris et al, *Australian Corporate Law* (4th ed, LexisNexis Butterworths, 2013), p 518).
[337] *Cassimatis (No 8)* (n 64).
[338] *Angas Law Services* (n 5).
[339] *Miller* (n 87).
[340] (2003) 214 CLR 230.

any doubt as to their reasoning. Since a breach of statutory duty cannot be prospectively authorised or retrospectively ratified, it is unclear what separate legal principle(s) provide support for the attenuation of statutory duties.

Secondly, a separate basis for an argument that a director's statutory duty cannot be attenuated arises from the express words of sections 180 to 184 and 187. The protection of directors of wholly-owned subsidiaries pursuant to section 187 of the Corporations Act is within Part 2D.1 Division 1 of the Corporations Act, the same division which establishes the statutory duties in sections 180 to 184. Only directors of wholly-owned subsidiaries have been expressly given the protection of modified duties of good faith. The principle of statutory interpretation *expressio unius est exclusio alterius* is a principle which is applied where legislation includes provisions relating to similar matters in different terms.[341] This provides additional support for a conclusion that the attenuation of statutory duties pursuant to sections 180 to 184 of the Corporations Act is not permissible in whole or in part because it is not expressly stated by those sections.

Thirdly, it is also relevant to consider the interpretation which would best achieve the purpose or object of the legislation before determining the meaning.[342] It has been stated that the purpose of the statutory duties of directors is 'not to secure compliance with the various requirements of the Corporations Act, but, as it was at general law, to prevent abuses of directors' powers for their own or collateral purposes'.[343] The public interest aspects of the statutory duties would be diminished where the shareholders have sought under the company's constitution or by other agreement to attenuate the statutory duties of a director. This would thereby result in there being less protection of the public interest through the enforcement of statutory duties. In that context, the purpose of the statutory directors' duties would not be achieved if attenuation of those duties is permissible.

[341] See generally *Salemi v Min Immigration & Ethnic Affairs (No.2)* (1977) 14 ALR 1; *Tasmania v Commonwealth* (1904) 1 CLR 329; *Rylands Brothers (Aust) Ltd v Morgan* (1927) 27 SR (NSW) 161; *Colquhoun v Brooks* (1887)19 QBD 400, 406.
[342] *Act Interpretation Act 1901* (Cth) s 15AA.
[343] *Australian Securities & Investments Commission v Maxwell* [2006] NSWSC 1052, [106] (Brereton J)

### *(f) The interpretation of 'improper' in section 182 and 183*

Sections 182(1) and 183(1) of the Corporations Act prohibit the improper use of a director's position or the use of information obtained by a director to gain an advantage for themselves or someone else. This raises the possibility that the approval of a ratification resolution results in the conduct being considered to be 'proper' and outside of the scope of sections 182(1) and 183(1) of the Corporations Act.

In *Miller*,[344] it was considered by Santow J that,

> ratification cannot cure a breach of statutory duty, more especially one imposing criminal liability. The most it can do is remove from the scope of technical dishonesty such actions as issuing shares for a purpose which is not a proper one, in the sense of not being for the benefit of the company as a whole.[345]

The statement in *Miller*[346] refers to whether following approval of a ratification resolution, the conduct engaged in by the directors continues to be 'improper' under current sections 182(1) and 183(1) or for a 'proper purpose' under current section 181(1) and 184(1) of the Corporations Act. The statement is also relevant to 'honesty' which can be raised in connection with; the making of a business judgment for the purposes of section 180(2), whether a director acted *bona fide* in the interests of a company for the purposes of section 181(1)[347] or whether a director used their position dishonestly for the purposes of section 184(2).

The meaning of 'improper' arose for consideration by the High Court in *Angas Law Services*[348] and was discussed in *R v Byrnes*.[349] The test of whether conduct is improper is objective and was described as 'a breach of the standards of conduct of a director expected of the person by reference to a person in that position'.[350] The meaning of 'improper' is also contextual to both the commercial context and the intention or purpose of the director.[351] It will be a question in

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[344] *Miller* (n 87).
[345] *Miller* (n 87), 89 (Santow J). See Austin and Ramsay (n 26) 'Ratification of action in breach of other fiduciary duties' [8.385].
[346] 16 ACSR 73, 89 (Santow J).
[347] *Australian Securities and Investments Commission v Macdonald (No 11)* [2009] NSWSC 287, [659] (Gzell J) citing with approval *Marchesi v Barnes* [1970] VR 434.
[348] *Angas Law Services* (n 5).
[349] (1995) 183 CLR 501.
[350] *R v Byrnes* (1995) 183 CLR 501, 514-515 (Brennan, Deane, Toohey and Gaudron JJ).
[351] *Angas Law Services* (n 5) [65] applying *R v Byrnes* (1995) 183 CLR 501.

each case to determine from the surrounding circumstances the content of the standard of the conduct which is expected of the director.[352]

Elizabeth Boros argued that attenuation may arise in connection with the statutory duties established by sections 182 and 183 of the Corporations Act. This academic commentary is drawn from the discussion in *Angas Law Services*.[353] In particular, the approval of specific conduct by the directors may fall within the requirements of proper use of information or position, or the duty to act for proper purposes since the conduct may no longer be considered to be 'improper'.[354]

By way of example as was questioned by Elizabeth Boros, if the shareholders attenuated section 183 by reducing the scope of what is an improper use of information, would the conduct of the directors be otherwise contrary to the best interests of the company?[355] If so, the directors will likely be in breach of section 181(1) of the Corporations Act even where their conduct was not an improper use of information for the purposes of section 183 of the Corporations Act. The attenuation may therefore avoid a breach of one statutory duty but not a breach of another statutory duty.

A constitutional provision could thereby carve out certain conduct so as to prevent the conduct from being a breach of of sections 182 or 183. For example in *Levin v Clark*,[356] there was a provision in the company's constitution coupled with the terms of a sale and mortgage which modified the fiduciary duties of the directors to the company.

The underlying legal point contended by academic commentary is that the shareholders' approval of certain conduct for the purpose of that conduct being considered 'proper' promotes the rights of the shareholders to attenuate a statutory duty to the detriment of the public interest. This Thesis has not identified any cases which indicate that the shareholders' rights predominate over the public interest aspects of a statutory duty.

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[352] *Angas Law Services* (n 5) [65] (Gummow and Hayne JJ).
[353] *Angas Law Services* (n 5).
[354] Elizabeth Boros, 'How does the division of power between the board and the general meeting operate?' (2010) 31 *Adelaide Law Review* 169, 172.

[355] Boros (n 354), 173.
[356] [1962] NSWR 686.

The recent judicial statement in *Cassimatis v Australian Securities and Investments Commission*[357] that statutory duties are irreducible constrains the possible meaning in *Miller*[358] that there could be attenuation of a statutory duty which has only objective elements. This conclusion arises because the meaning of 'improper' is objective. *Miller*[359] should thereby be limited to be understood to be referring only to the meaning of 'honesty' which is subjective.

***(g) Is the attenuation of statutory duties contrary to section 199A of the Corporations Act?***

Section 199A(1) of the Corporations Act provides that "[a] company or a related body corporate must not exempt a person (whether directly or through an interposed entity) from a liability to the company incurred as an officer or auditor of the company". The express words of the section do not appear to apply to the attenuation of statutory duties. This is because an attenuation of a statutory duty does not exempt a director from a liability to a company because following attenuation of a statutory duty, there is no breach of a director's duty and a liability to the company cannot arise in those circumstances.[360]

The decision in *Eastland Technology Australia P/L v Whisson*[361] held that a release from a *bona fide* disputed claim was not an exemption for the purposes of section 199A(1).[362] *Eastland Technology Australia P/L v Whisson*[363] relevantly approved the decision in *Miller*,[364] which held that former section 241 of the Corporations Law did not override the rules relating to ratification of an officer's corporate related conduct. On a proper construction, section 199A(1) of the Corporations Act did not expressly or impliedly modify or limit the powers of a company to ratify or compromise a claim.[365] Thereby, the prohibition of an exemption from a liability under section 199A(1) of the Corporations Act would be entirely avoided by reason that the attenuation of a statutory duty results in a director's conduct not being in breach of a

[357] [2020] FCAFC 52.
[358] *Miller* (n 87).
[359] *Miller* (n 87).
[360] See generally, Conaglen (n 37), 417.
[361] [2005] WASCA 144.
[362] *Eastland Technology Australia Pty Ltd v Whisson* [2005] WASCA 144, [39] (McLure JA, Malcolm CJ, Steytler P agreeing).
[363] [2005] WASCA 144.
[364] *Miller* (n 87).
[365] *Eastland Technology Australia Pty Ltd v Whisson* [2005] WASCA 144, [38] (McLure JA, Malcolm CJ, Steytler P agreeing).

statutory duty. It is important however to put the decisions of *Eastland Technology Australia*[366] into the right context since the case was concerned with the question whether there was an attenuation of a statutory duty.

The decisions in *Eastland Technology Australia*[367] and *Miller*[368] indicate that there is a basis for a conclusion that a court would determine that attenuation of a statutory duty was permissible because the attenuation of a statutory duty is not inconsistent with the prohibition against an exemption from a liability to a company established section 199A(1).

The current case law suggests that section 199A does not have a role in determining whether the shareholders may lawfully attenuate a statutory duty of a director because the section is not concerned with the attenuation of directors' duties.

The attenuation of a statutory duty would undermine the public policy intention of section 199A(1) of the Corporations Act because the prohibition against a director from being exempted from a liability to a company would be avoided in the event of an attenuation of statutory duties.

***(h) Recent academic commentary on attenuation of statutory duties***

Isuru Devendra in 2014[369] discussed the possibility that prior authorisation could affect the practical content of a statutory duty on the basis the proposition was consistent with both existing authority, including *Angas Law Services*,[370] and the public interest aspects of statutory duties.[371] However, there was no discussion of the underlying legal principles which could give rise to the attenuation of a statutory duty.

[366] [2005] WASCA 144.
[367] [2005] WASCA 144.
[368] *Miller* (n 87).
[369] Isuru Devendra, 'Statutory directors' duties, the civil penalty regime and shareholder ratification: What role does the public interest play?' (2014) 32 Company and Securities Law Journal 399.
[370] *Angas Law Services* (n 5).
[371] Devendra (n 277), 412.

*Devendra's first argument*

Devendra argues that the public interest aspects of a director's statutory duties does not necessarily preclude the shaping of the content of a director's duty. The underlying postulate for that view is that the attenuation is subject to the limits of the law (as discussed in Chapter 2 of this Thesis). This Thesis refers to this point as Devendra's first argument. It is not expressly stated by Devendra, however, from this Thesis' review of Devendra's paper, it is inferred that at least one legal proposition relied on by Devendra is that the private rights of the shareholders can be elevated above the public interest. This Thesis disagrees with that legal proposition because of the importance of the public interest in determining the content of statutory duties which is reflected in the decisions in *Forge*,[372] *Cassmimatis (No 8)*[373] and *Cassimatis v Australian Securities and Investments Commission*.[374]

Devendra indicates that the availability of civil penalties for breaches of directors' duties into Part 9.4B of the Corporations Act reveals the public interest aspects of statutory director's duties.[375] In support of that contention, Devendra drew attention to a Senate Report on the Social and Fiduciary Duties and Obligations of Company Directors,[376] which suggested that *'directors' duties therefore provide a standard by which the public's legitimate interest in accountability may be achieved'*.[377] This provides a relevant context because the civil penalty provisions apply to each of a director's statutory duties and it is not possible to ratify a breach of statutory duty. There is thereby no clear distinction on the current law between the legal requirements for a ratification or attenuation of duty and that aspect of Devendra's argument is consistent with the approach taken in *Angas Law Services*.[378] This Thesis argues that the legal requirements for a ratification and an attenuation of duty are the same.

[372] *Forge v Australian Securities & Investments Commission* [2004] NSWCA 448.
[373] *Cassimatis (No 8)* (n 64).
[374] [2020] FCAFC 52.
[375] Devendra (n 277).
[376] Senate Standing Committee on Legal and Constitutional Affairs, Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors (November 1989).
[377] Devendra (n 277), 401.
[378] *Angas Law Services* (n 5).

There are plainly public interests separate from the interests of the shareholders which are to be considered by a court (as discussed in *Cassimatis (No 8)*[379] and *Cassimatis v Australian Securities and Investments Commission*[380]). The public interest includes the protection of the public (including investors and consumers of credit and financial products) through; ASIC seeking a declaration of contravention or civl penalties against a director, a director being disqualified from acting in the future as a director or the director's conduct being determined to be of a criminal nature and an appropriate sentence or other sanction being imposed. Devendra's first argument does not seek to address the importance of the public interest in determining the content of a director's statutory duties.

The decision of the Commonwealth Parliament to enact statutory directors' duties and permit courts to impose penalties for the breaches of those statutory duties gave greater protection to companies. In addition, the statutory duties also provided greater protection to the public including through the enforcement of statutory duties by the ASIC. If the shareholders are permitted to attenuate a statutory director's duty, that could weaken the protections available which are generally in the public interest.

Before the attenuation of statutory duties could have some legal effect with respect to the public interest aspects of a statutory duty, there would need to be legal principles which support the power of the shareholders to narrow a statutory duty which has objective elements on the basis of the decisions in *Miller,*[381] *Angas Law Services*[382] and *Cassimatis v Australian Securities and Investments Commission*.[383] Those cases suggest that at most an attenuation of a statutory duty could have a legal effect on a subjective element of a statutory duty because it is not open to the shareholders to narrow the meaning of an objective element of a statutory duty. These matters were not directly addressed by Devendra's paper.

[379] *Cassimatis (No 8)* (n 64).
[380] [2020] FCAFC 52.
[381] *Miller* (n 87).
[382] *Angas Law Services* (n 5).
[383] [2020] FCAFC 52.

Further, contrary to Devendra's first argument, no cases or legal principles have been identified by this Thesis which suggest that the powers of the shareholders to attenuate a statutory duty are wide enough to restrict the public interest aspects of a director's statutory duty.

Each of those matters suggests that at most the shareholders may have a power to attenuate the private law aspects of a statutory duty where there is a subjective approach to determining whether there was a breach of a statutory duty. This Thesis argues however that a subjective element, such as honesty, will always intersect with some public interest aspect of a statutory duty because honesty as discussed above may arise in connection with each of the statutory duties enacted by sections 180 to 184 of the Corporations Act.

For the reasons explained, the possibility raised by the High Court in *Angas Law Services*[384] that there could be an attenuation of a statutory duty must be tested against the more recent decisions in *Cassimatis (No 8)*[385] and *Cassimatis v Australian Securities and Investments Commission*.[386]

Whilst the law remains under development, the weight of recent authority discussed above favours, contrary to Devendra's first argument, elevating the public interest against the private rights of shareholders and that is a proper reason to determine that attenuation of statutory duties is prohibited by the Corporations Act.

*Devendra's second argument*

Devendra's second argument is that allowing the attenuation of statutory duties *'does not seek to generally lower the standards applicable to the duty or have any similar wide-reaching impact'*.[387] Devendra therefore suggests that the attenuation will only inform *'certain elements*

[384] *Angas Law Services* (n 5).
[385] *Cassimatis (No 8)* (n 64).
[386] [2020] FCAFC 52.
[387] Devendra (n 277), 407.

*of a duty that by their nature possess a variable content that is intended to adapt to the individual circumstances of the director and/or the company'*.[388]

Devendra's second argument is that a director's non-compliance with the shareholders' wishes (by not engaging in conduct which is within the attenuation of a duty and thereby acting within the scope of the statutory duty) could in appropriate circumstances be considered contrary to upholding responsible standards of corporate behaviour and hence contrary to the public interest.[389]

The point of difference between Devndra's second argument and this Thesis' argument is whether the shareholders have a power to narrow a statutory duty which has a public interest aspect? There are two key reasons raised by this Thesis against Devendra's second argument and in favour of attenuation being prohibited, or permitted only in respect of a subjective element of a statutory duty.

As discussed above, the law has continued to develop with recent judicial statements concerning the public interest aspects of directors' statutory duties. In so far as section 180(1) is concerned, the standard of care and diligence is 'objective and irreducible'.[390] Devendra in 2014 was similarly guided by the public interest aspects of statutory duties as was Justice Greenwood in *Cassimatis v Australian Securities and Investments Commission*[391] in 2020. However, the emphasis on the private rights of shareholders by Devendra is at odds with the later approach taken in *Cassimatis v Australian Securities and Investments Commission* where Justice Greenwood pointed to the 'irreducible' nature of section 180(1).[392]

The cases identified by this Thesis do not support any clear principle why the content of the public interest aspects of a statutory duty may be narrowed by the shareholders of a company or how the private law aspects of a statutory duty can be severed from the public interest

[388] Devendra (n 277), 407.
[389] Devendra (n 277), 407.
[390] *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52,196 (Greenwood J).
[391] [2020] FCAFC 52.
[392] *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52,196 (Greenwood J).

aspects. Rather, it is argued by this Thesis that the focus of the meaning of statutory duties ought to be upon at least the irreducible standards as a primary touchstone for developing the law.

This Thesis now considers in detail the different ways it could be possible for the shareholders to attenuate a director's duty.

### *(i) The different modes of attenuation by prospective authorisation*

The High Court's *obiter* remarks raised the question of whether statutory duties owed by directors could be expressly or impliedly attenuated, including by the conduct of the shareholders. The legal question arises from the doctrine of attenuation of fiduciary duties. Under this doctrine, the fiduciary duties owed by directors may be narrowed in four ways, firstly by the company's constitution,[393] secondly by the shareholders in general meeting,[394] thirdly by the unanimous agreement of the shareholders (including through the operation of the *Duomatic* principle[395]) and fourthly by the shareholders' acquiescence to a course of conduct by the directors.[396] Each of these possibilities is considered below.

**Attenuation by the company's constitution**

Under the general law, a company has a right to the unbiased views and advice of all of its directors and this issue may arise when a director of two companies owes fiduciary duties to each company.[397] The director, for example, may be able to remedy the conflict by disclosure of a benefit to be received by the director of one company to the other company. In consequence of the fiduciary position which a director holds, unless the company's constitution

[393] Austin and Ramsay (n 26) [9.110].

[394] Austin and Ramsay (n 26) [9.320].

[395] *Re Duomatic Ltd* [1969] 2 Ch 365.

[396] *Angas Law Services* (n 5). See generally *Japan Abrasive Materials Pty Ltd v Australian Fused Materials Pty Ltd* [1998] WASC 60; *Grand Enterprises Pty Ltd v Aurium Resources Limited* [2009] FCA 513; *Western Areas Exploration Pty Ltd v Streeter (No. 3)* [2009] WASC 213; *Eastland Technology Australia Pty Ltd v Whisson* [2005] WASCA 144; *Barkley v Barkley Brown* [2009] NSWSC 76; *Guinness Plc v Saunders* [1990] 2 AC 663.

[397] *R v Byrnes* [1995] HCA 1; *Woolworths Ltd v Kelly* (1991) 22 NSWLR 189 citing with authority *Benson v Heathorn* (1842) 1 Y & C CC 326 at 341-342; 62 ER 909, 916 (Knight-Bruce V-C) and *Imperial Mercantile Credit Association v Coleman* (1871) LR 6 Ch App 558, 567-568 (Hatherley LC).

otherwise provides, a director may not enter into a contract with the company.[398] Companies adapted to this possibility and used the company's constitution to alter the general law rule by attenuating the fiduciary duties of a director either expressly or impliedly.[399]

If the company's constitution attenuates a director's fiduciary duties, then provided that the director complies with the terms of the constitutional provision,[400] there will be no breach of duty. In consequence, it will be unnecessary for the shareholders in general meeting to either prospectively authorise, or to ratify the conduct.[401]

A particular constitutional provision which attenuates a fiduciary duty of the directors may be overtaken by the operation of a new or amended statutory provision.[402] This could occur in the future when sections 180 to 184 are amended by the Commonwealth Parliament. An example of such a statutory condition arose in *Centofanti v Eekimitor Pty Ltd*[403] where there was a duty of disclosure to the board of directors which was required to be performed to avoid a director's conflict of interest. Upon a constitutional provision being contrary to a statutory requirement, the provision will be unable to operate on its terms to the extent of the inconsistency with the statutory provision.

Finally, minority shareholders have some protection against this mode of attenuation. There must still be compliance generally with the Corporations Act and the constitution of the company. In the instance where the minority shareholders together represent more than 25% of the company's issued shares, they are protected against changes to the company's constitution which would have the effect of attenuating a statutory duty.

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[398] *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461.
[399] *Woolworths Ltd v Kelly* (1991) 22 NSWLR 189 citing with authority *Imperial Mercantile Credit Association (Liquidators) v J Coleman* (1873) LR 6 HL 189, 205 (Lord Cairns); *Toms v Cinema Trust Co Ltd* [1915] WN 29.
[400] In *MacPherson v European Strategic Bureau Ltd* [1999] 2 BCLC 203 it was held that there was no requirement of formal disclosure because that would not have increased the knowledge of the other directors.
[401] *Woolworths Ltd v Kelly* (1991) 22 NSWLR 189, 208 (Samuels JA); *Re Automotive and General Industries Ltd* (1975) VR 454.
[402] See, eg, *Centofanti v Eekimitor Pty Ltd* (1995) 65 SASR 31 where section 228 of the *Companies (South Australia) Code* required disclosure of a director's conflict of interest to the board of directors.
[403] (1995) 65 SASR 31.

**Attenuation by the formal and informal approval of shareholders**

The authorities in Australia indicate that the shareholders in general meeting have the power to authorise a proposed course of conduct with respect to a breach of fiduciary duty by a director.[404]

In companies with a small number of shareholders there will be the possibility of obtaining the unanimous formal agreement of the shareholders. Further, the operation of the *Duomatic* principle[405] can result in informal unanimous assent. The legal constraints which arise in relation to the attenuation of statutory duties by unanimous informal agreement of the shareholders are the same constraints which were considered in relation to the attenuation of duties by the shareholders in general meeting.

**Attenuation by shareholder acquiescence**

One legal basis for the attenuation of fiduciary duties arises in trust law. If a beneficiary of a trust positively adopts a breach of trust, or if the beneficiary has knowledge of a breach of trust but does not take steps to cause the trustee to remedy the breach, the trustee may succeed in defending a breach of trust claim because of the acquiescence of the beneficiary to the breach.[406] The same legal considerations are applicable to, for example, a beneficiary's prior knowledge of a trustee's proposed conduct.

A second basis for the attenuation of fiduciary duties in trust law arises in circumstances where the beneficiary instigates, consents to[407] (or concurs) in a breach of trust, or engages in unconscionable behaviour.[408] These trust law cases provide analogous examples where a shareholder's conduct may be be equated with their approval.

**Is there a difference between the different modes of attenuation?**

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[404] See especially *Winthrop Investments* (n 7).
[405] *Re Duomatic Ltd* [1969] 2 Ch 365.
[406] See eg. *Life Association of Scotland v Siddal* (1861) 3 De GF & J 58; *National Trustees Co of Australasia Ltd v General Finance Co of Australasia* [1905] AC 373; *Bela v Beehag* (1984) 3 BPR 9402.
[407] *Spellson v George* [1992] NSWCA 254.
[408] *Cory v Gertcken* (1816) 2 Madd 40; *Public Trustee v Larkham* (1999) 21 WAR 295; *Allan v Rea Brothers Trustees Ltd* [2002] EWCA Civ 85.

The principal differences between obtaining shareholder approval for a future course of conduct (i) under the constitution, or (ii) the shareholders in general meeting is a question of whether firstly a specific authority is given (rather than a general authority under a constitutional provision), secondly, the timing of the granting of the authority and thirdly, the size of the majority required to obtain the authority.

It is argued by this Thesis, based on the current law, there is no different legal effect between approval by a constitutional provision, or the shareholders in general meeting. This firstly arises from the fact that, in both circumstances, the authorisation is by the shareholders. There is a difference between the procedure by which the shareholders have sought to attenuate a director's statutory duty because a change to a constitutional provision requires a minimum of 75% of shareholders and only a majority of shareholders are required to approve a ratification resolution. Since the minimum percentage for a constitutional amendment is more than the minimum required to approve a ratification resolution, the minimum requirements to approve a ratification resolution have been achieved.

Secondly, whilst there is a difference in the size of the majority required to amend a company constitution when compared to obtaining the approval of the members in general meeting, the outcome remains the same for the directors once a resolution is approved since their conduct has been prospectively authorised.

The cases which consider the attenuation of a director's duties under a constitutional provision do not also consider the law in connection with the shareholder approval of a prospective breach of fiduciary or statutory duty. This is readily explainable on the basis that if the director's conduct complies with a constitutional provision on the exercise of power, then it is unlikely in the same factual matrix that the shareholders separately prospectively authorise the conduct of the directors. There are no reported cases in Australia which have raised this type of problem.

The analysis in Section B above supports the argument that attenuation of statutory duties is not permitted by the Corporations Act. It is identified however that there is a possibility that the law is permissive of the attenuation of the subjective elements of a statutory duty.

This Thesis will now consider the policy arguments in favour and against the continued application of the attenuated duty approach.

## C. *Consideration of the conflicting policy arguments*

### *(a) Policy arguments in favour of the attenuation of statutory duties*

Notwithstanding the argument presented above with respect to the prohibition under the law in Australia for the attenuation of statutory duties, there are substantial policy reasons in support of attenuated statutory duties of nominee directors[409] and the statutory duties of good faith for directors of wholly-owned subsidiaries,[410] and these policy reasons are discussed below.

**Nominee directors**

The appointment of nominee directors is common in commercial practice and because of this, the common law recognised the circumstances as being distinct from other companies' circumstances and 'bent' to commercial practice.[411] The attenuated duty approach also recognised that under the common law a nominee director may have a duty to their appointer through an agreement, which, for example, may arise from a contract of employment,[412] and this could be in conflict with their fiduciary duties to the company. In light of the conflict of duties it was permissible for a director's fiduciary duties to be attenuated. The underlying policy approach to allowing attenuation in this situation was to ensure as far as possible that there would be consistency between contract law and fiduciary law for the benefit of the nominee director.

The common law and general law remains flexible and under development. The law is thereby able to be molded to suit the particular circumstances of a company. Aligned with this point, the shareholders can fashion the terms of the company's constitution and/or a shareholders'

[409] See eg, *Levin v Clark* [1962] NSWR 686.
[410] *Corporations Act 2001* (Cth) s 187.
[411] See Ahern (n 37).
[412] Ibid.

agreement in a flexible way to suit the circumstances and the needs of the company. This can therefore allow the directors to act with narrowed fiduciary duties. In the case of a constitutional provision, the terms are agreed by a minimum of 75% of the shareholders' votes cast in favour of the amendment. Further, pursuant to the *Duomatic* principle,[413] the shareholders' unanimous agreement protects the minority shareholders from the actions of the majority since in these circumstances there is no minority because all shareholders agreed.

This Thesis is critical of the attenuated duty approach in connection with the fiduciary duties of nominee directors. Firstly, the exercise of the power of the shareholders to attenuate a director's fiduciary duties elevates the interests of the appointer and their nominee director above the interests of the company, the company's stakeholders and the public interest in the enforcement of director's fiduciary duties.

Secondly, nominee directors are motivated to act in the interests of their appointer for the protection of their appointer's and their own interests. The prevalence of the commercial practice merely indicates the extent to which nominee directors are appointed. It does not follow that the practice warrants the treatment of a nominee director's fiduciary duties different from other directors. The common law position only reinforces the use of the legal advantages of structuring the affairs of a company with the appointment of nominee directors to the overall disadvantage of companies and the public interest.

Thirdly, the decision in *Levin v Clark*[414] only concerns the fiduciary duties of a director. It was held in *State Street Australia Ltd in its capacity as Custodian for Retail Employees Superannuation Pty Ltd (Trustee) v Retirement Villages Group Management Pty Ltd*[415] in the context of statutory duties that,

> a director can act in the interests of his or her appointer provided that such interests are also compatible with the best interests of the company and his or her independent judgment and

[413] *Re Duomatic Ltd* [1969] 2 Ch 365.
[414] [1962] NSWR 686.
[415] [2016] FCA 675.

> discretion is not otherwise fettered. But where there is an actual or potential conflict between the appointer's interests and the company's interests, the latter necessarily prevails.[416]

A director's statutory duties are different from a director's fiduciary duties, especially in the context of their public interest aspects. A corporate law policy in support of the attenuation of duties would be inconsistent with maintaining the minimum standard of conduct expected of directors and this would undermine the protection of the public interest.

Corporate law policy could sensibly diverge as between fiduciary duties and statutory duties by allowing attenuation of fiduciary duties, but disallowing the right of the shareholders to attenuate a statutory duty. In that event, the public interest can be protected and a nominee director's fiduciary duties can continue to be attenuated by approval of the shareholders. To acheive that outcome, this Thesis argues that it is necessary for the Corporations Act to be amended to resolve the issue.

**Directors of wholly-owned subsidiaries**

Section 187 of the Corporations Act is important for two reasons. Firstly, the Commonwealth Parliament has limited the benefits of the section to the directors of wholly-owned subsidiary companies. This means that the only shareholder affected by the decisions of the board of directors is the parent (holding) company and for this reason, there cannot be any minority shareholders. This reflects a limited exception to corporate law policy which establishes the content of a director's statutory duties pursuant to sections 180 to 184. The corporate law policy seeks to align the best interests of a holding company with the best interests of a wholly-owned subsidiary company for the benefit of a director of a wholly-owned subsidiary. This is because there may be circumstances where it is not possible for a wholly-owned subsidiary to only take into account its best interests separate from the best interest of the holding company.

[416] *State Street Australia Ltd in its capacity as Custodian for Retail Employees Superannuation Pty Ltd (Trustee) v Retirement Villages Group Management Pty Ltd* [2016] FCA 675 [43] (Beach J).

Secondly, section 187 only modifies the content of specific statutory duties in sections 181(1)(a) (the duty of good faith) and 184(1) (the duty to use position and information for a proper purpose). Section 187 has no application to the fiduciary duties imposed upon directors because the statutory duties are additional to the general law duties.[417] To obtain the protection of section 187, the directors of the wholly-owned subsidiary must act in good faith in the best interests of the parent company and if so, they are taken to have acted in good faith in the best interests of the subsidiary.[418] This provision deems that the directors will not be in breach of a duty of good faith to the wholly-owned subsidiary company by making a decision which benefits the parent company. The corporate law policy benefit to directors of wholly-owned subsidaries is appropriate in this special situation because of the possible differences between what is in the best interests of a wholly-owned subsidiary when compared to the best interests of a parent company. The very close corporate relationship of the two companies will very likely mean that the use of the assets of the two companies are so related that there may be little advantage to distinguishing between which company's best interests must be preferred, especially in an economic context.

### *(b) Policy arguments against the attenuation of statutory duties*

There are also substantial reasons why a generalised attenuated duty approach for all directors may have a negative effect for a company and the public interest in the enforcment of statutory duties and this is discussed below.

#### Protection of the company and the public

The fiduciary relationship of a company to a director is comparable in certain respects to the relationship of a beneficiary to a trustee or a principal to an agent.[419] The shareholders, consistent with trust law and the laws of agency may attenuate a director's fiducary duties.

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[417] *Allco Funds Management Limited (Receivers and Managers Appointed) (in liq) v Trust Company (RE Services) Limited (in its capacity as responsible entity and trustee of the Australian Wholesale Property Fund)* [2014] NSWSC 1251, [190] (Hammerschlag J).

[418] *Corporations Act 2001* (Cth) s 187.

[419] *Levin v Clark* [1962] NSWR 686, 700-701; *Re Lands Allotment Co* [1894] 1 Ch 616, 638 (Kay LJ). See Conaglen (n 37) 404.

A director's statutory duties are different from their fiduciary duties because, as discussed, the statutory duties both protect the company[420] and also protects the public interest. The recognition of the attenuation of directors' statutory duties would affect the scope of the protection which is obtained by the company and the public. This would have a detrimental effect on the enforcement of statutory duties.

It is argued by this Thesis that the benefits arising from the public interest aspects of the statutory duties are of greater importance that the private interests of shareholders because of the far reaching advantages to the public when compared to the private interests of shareholders.

**Corporate governance regulation**

Corporate law policies which support corporate governance regulation are inconsistent with the attenuation of statutory duties for a number of reasons discussed below.

The ongoing development of corporate governance regulation suggests that the interests of other stakeholders including; employees, creditors, customers and the public should also be considered.[421] This is recognised by, for example, the imposition of duties on directors against insolvent trading,[422] under tax legislation to ensure that the company complies with its statutory obligations[423] and State, Territory and Commonwealth environmental legislation to ensure the environment is protected for current and future generations.[424] The attenuation of directors' statutory duties suggests that the only beneficiary of the duties are the company, but for the reasons explained above, this should be doubted because of the public interest aspects of director's statutory duties.

**Relief from liability pursuant to section 1318**

[420] *Australian Securities & Investments Commission v Maxwell* [2006] NSWSC 1052.
[421] Jill Solomon and Aris Solomon (n 34), 14.
[422] *Corporations Act 2001* (Cth) s 588G.
[423] *Taxation Administration Act 1953* (Cth) Sch 1 s 269-15.
[424] See, eg, *Environment Protection and Biodiversity Conservation Act 1999* (Cth).

The attenuation of a statutory duty would limit the need of a director to rely upon section 1318, which gives the State and Territory Supreme Courts and Federal Court the discretionary power to relieve an honest director of a liability owed to a company. For example, a director may avoid a breach of statutory duty as a result of an attenuation of that duty and therefore is not required to apply for relief from liability pursuant to section 1318.

In *Miller*,[425] as discussed above, Justice Santow considered that ratification at most could '*remove from the scope of technical dishonesty such actions as issuing shares for a purpose which is not a proper one*'.[426] Whilst this case considered former section 241 of the Corporations Law (now section 199A of the Corporations Act), it is relevant to how section 1318 would be interpreted.

Where the shareholders exercise the power to attenuate a statutory duty related to a question of the honesty of a director, a director therefore will not be required to show that their conduct is honest at the time of the approval of the attenuation resolution, whereas honesty is a requirement to be established before any relief can be obtained pursuant to section 1318. This circumstance would affect the public interest in the enforcement of statutory duties. The role of a court has been circumvented because of the exercise of the power of attenuation by the shareholders.

## D. ***The proposed reforms***

It is argued in this Chapter that a director's statutory duties cannot be attentuated by any method including by a company's constitution, formal or informal approval of the shareholders in general meeting or a course of conduct engaged in by the shareholders for the reasons discussed above. In particular, the analysis relies upon the decisions in *Forge v Australian Securities & Investments Commission,*[427] *Miller,*[428] *Australian Securities and Investments Commission v*

[425] *Miller* (n 87).
[426] *Miller* (n 87), 89 (Santow J).
[427] [2004] NSWCA 448.
[428] *Miller* (n 87).

*Maxwell*,[429] *Macleod v The Queen*,[430] *Capricornia Credit Union Ltd v Australian Securities and Investment Commission*,[431] *Cassimatis (No 8)*[432] and *Cassimatis v Australian Securities and Investments Commission*.[433]

Prior to the decision in *Cassimatis (No 8)*[434] in 2016, there was academic support for the contention that prior authorisation of a breach of statutory duty could attenuate a statutory duty.[435] There has not been further published academic support for the attenuation of statutory duties following the decision in *Cassimatis (No 8)*.[436] It is argued by this Thesis that the academic commentary prior to 2016 did not seek to draw any legal distinctions between the attenuation of fiduciary duties and statutory duties and the commentary treated the two types of duties in the same way. The decisions in *Cassimatis (No 8)*[437] and *Cassimatis v Australian Securities and Investments Commission*[438] highlight the public interest aspects of statutory duties as a very significant difference from directors' fiduciary duties. This Thesis argues that the public interest aspects of statutory duties is the defining difference between the power of shareholders to attenuate a fiduciary duty and a statutory duty. The two types of directors' duties require their own analysis as to whether attenuation of a director's duty is permissible.

It is argued by this Thesis that the number of situations where the company, or its stakeholders will obtain a benefit from the attenuation of statutory duties will be small. This is because the attenuation of a statutory duty could only have relevance to a subjective element of a statutory duty.

[429] [2006] NSWSC 1052.
[430] (2003) 214 CLR 230.
[431] [2007] FCAFC 79.
[432] *Cassimatis (No 8)* (n 64).
[433] [2020] FCAFC 52.
[434] *Cassimatis (No 8)* (n 64).
[435] Devendra (n 277), 405 (referring at footnote 50 to Robert Austin et al, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworth, 2005), p 643), 408 (referring at footnote 74 to Elizabeth Boros and John Duns, *Corporate Law* (2nd ed, OUP, 2010), 264) and 412 (referring at footnote 100 to Jason Harris et al, *Australian Corporate Law* (4th ed, LexisNexis Butterworths, 2013), p 518).
[436] *Cassimatis (No 8)* (n 64).
[437] *Cassimatis (No 8)* (n 64).
[438] [2020] FCAFC 52.

If attenuation of statutory duties was permitted, unless an equitable limitation applies, the shareholders could attenuate the duties of directors where the attenuation would not be in the best interests of the company. A public policy response to the problem could be to regulate exceptions to a prohibition against attenuation of statutory duties. This approach would be problematic. Framing exceptions to a prohibition against attenuation of statutory duties necessarily requires that value judgments are made on the type of conduct which are broadly beneficial to companies, their stakeholders and the public.

The values of different stakeholders will vary or even be entirely opposed to one another. For example, after an acquisition of an asset by a company from a third party, an unsecured creditor's possible recovery of moneys owed by a company to the creditor may rely upon a breach of statutory duty by a company's director alleging the director was dishonest. The third party which sold the asset to the company has an interest in the director's conduct being held to be honest to prevent any effect on the third party.

A principle that the interests of the shareholders, creditors, employees and consumers are not to be disadvantaged by the attenuation of statutory duties is easy to state with clarity, but in reality it leaves the ultimate interpretation open to the courts. The courts could develop a duty on a major shareholder to act in the best interests of a company, or it may be open to the courts in comity with the development of corporate law in the United States of America to introduce, for example, a fiduciary duty between shareholders.[439] Those potential developments would result in greater complexity of the corporate law in Australia.

Allowing the attenuation of statutory duties for a small number of possible situations would not be in the overall public interest for a number of reasons. Permitting attenuation would reduce the public interest aspects of the directors' statutory duties, including; effects on the ASIC's role as the regulator which provides protection to the company’s stakeholders and the public.

[439] See especially *Kortum v Johnson* 755 N W 2d 432 (N.D, 2008); *Cambio Health Solutions LLC v Reardon*, 213 S W 3d 785 (Tenn, 2006); *McMinn v MBF Operating Acquisition Corp* 164 P 3d 41 (N.M. 2007); *Bellino v McGrath North Mullin & Kratz PC LLO*, 274 N W 2d 434 (Neb, 2007).

In light of the possibility that statutory duties can be attenuated, this Thesis proposes to limit the shareholders' power of attenuation. This is proposed to address the possibility that a director/shareholder will seek to attenuate their statutory duties to avoid a breach of duty to a company. This limitation on shareholders' powers is to be achieved by prohibiting a director/shareholder, their family members and associates from voting on an attenuation resolution.

The proposed law reform represents an efficient mechanism to reach legal certainty, whereas allowing the attenuation of statutory duties in full or in part would create new legal problems for parties to resolve and ultimately the courts to rule upon.

This proposed reform will ensure that the doctrine of ratification is reformed in a holistic and consistent manner and this will result in the same voting restrictions being imposed upon certain shareholders in relation to ratification, authorisation and attenuation resolutions.

## E. ***Conclusion***

The High Court's *obiter* statements in *Angas Law Services*[440] suggest that attenuation of statutory duties may be permisible. The legal basis for the attenuation of a director's statutory duties is unclear and whether this is permissible has not yet arisen for judicial consideration in Australia. There remains the possibility therefore that in certain circumstances, a particular statutory duty of a director could be narrowed and this would have the effect that the director was not acting in breach of a particular statutory duty to a company.

The policy arguments in favour of the attenuation of statutory duties are significant, however, the historical origins of those argument arises in the context of conflicts of duties of nominee directors to their appointer and the limited exception established by section 187 of the

[440] *Angas Law Services* (n 5).

Corporations Act. These examples do not limit the public interest aspects of the statutory duties established by section 180 to 184 of the Corporations Act.

There are substantial arguments against retaining the attenuated duties approach based on the current corporate law and corporate law policies in Australia. The possible recognition of the attenuation of statutory duties is inconsistent with the public interest aspects of each of the director's statutory duties established by the Corporations Act.

It is a conclusion of this Thesis that the legal and public policy issues each suggest that there should be statutory law reform to limit the power of shareholders to attenuate a director's statutory duties.

This Thesis will now consider the international law comparisons with Australian law.

## CHAPTER 6 – INTERNATIONAL LAW COMPARISON

### A. *Introduction*

The doctrine of ratification has been subject to limited statutory reform in connection with companies governed by the Corporations Act in Australia. The report issued in July 1993 by the Companies and Securities Advisory titled "Report on a Statutory Derivative Action" in July 1993[441] considered the possibility of statutory reform in Australia in the context of the doctrine of ratification. The report ultimately resulted in the introduction of the statutory derivative action in March 2000 which is now contained in Part 2F.1A, particularly sections 236 and 237 of the Corporations Act.

The introduction of the statutory derivative action was in part to deal with three difficulties associated with the common law derivative action for the benefit of minority shareholders. Those issues relevantly included the extinguishment of a cause of action following the approval of a ratification resolution. Whilst section 239 of the Corporations Act allows a court to take into account a ratification resolution, it is no bar to leave being granted to commence a derivative proceeding[442] or what orders ought to be made in those proceedings.[443] However, the doctrine continues to be a significant problem for minority shareholders in connection with shareholder remedies as discussed in Chapter 1 and as demonstrated by the criticisms and uncertainties of the doctrine discussed in Chapter 4.

In this Chapter, the law concerning the doctrine in certain other common law countries is considered and discussed with the relevant cases. The statutory law reforms which relate to the doctrine of ratification in the United Kingdom in 2007, in New Zealand in 1993 and the relevant law in Canada and the United States of America are considered. The law in these

[441] Companies and Securities Advisory Committee (n 189).

[442] *Corporations Act 2001* (Cth) s 239(1)(a).

[443] *Corporations Act 2001* (Cth) s 239(2).

jurisdictions have been reviewed for the purposes of comparison with the law in Australia for a number of reasons.

Firstly, each of these countries has a common law system and adopted the doctrine of ratification into their common law. This provides a direct comparison with the system of law in Australia and each jurisdiction has enacted legislation which governs companies.

Secondly, both the United Kingdom and New Zealand have taken steps to reform the doctrine by statute with respect to companies, albeit in different ways from each other and this provides an opportunity to assess the problems which have arisen or may arise in those jurisdictions so that those problems can be avoided for any law reform in Australia proposed by this Thesis.

Thirdly, the common law has developed differently in Canada and the United States of America from Australia and those common law developments provide a separate basis for considering possible law reform to the doctrine in Australia.

Finally and critically, none of the common law jurisdictions reviewed have taken steps to prohibit the operation of the doctrine with respect to companies. Further, it will be recalled from Chapter 3 that there are substantial benefits which arise for companies from the operation of the doctrine. These observations are important in the context of what specific law reforms are proposed by this Thesis.

Each of the abovementioned jurisdictions is now discussed below.

## B. *The United Kingdom's ratification law reforms*

In the United Kingdom, section 239 of the *Companies Act 2006* (UK) deals with the ratification of acts of directors.

The section which commenced on 1 October 2007 is as follows:

(1) This section applies to the ratification by a company of conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company.

(2) The decision of the company to ratify such conduct must be made by resolution of the members of the company.

(3) Where the resolution is proposed as a written resolution neither the director (if a member of the company) nor any member connected with him is an eligible member.

(4) Where the resolution is proposed at a meeting, it is passed only if the necessary majority is obtained disregarding votes in favour of the resolution by the director (if a member of the company) and any member connected with him.

This does not prevent the director or any such member from attending, being counted towards the quorum and taking part in the proceedings at any meeting at which the decision is considered.

(5) For the purposes of this section—

(a) “conduct” includes acts and omissions;

(b) “director” includes a former director;

(c) a shadow director is treated as a director; and

(d) in section 252 (meaning of “connected person”), subsection (3) does not apply (exclusion of person who is himself a director).

(6) Nothing in this section affects—

(a) the validity of a decision taken by unanimous consent of the members of the

company, or

(b) any power of the directors to agree not to sue, or to settle or release a claim made by them on behalf of the company.

(7) This section does not affect any other enactment or rule of law imposing additional requirements for valid ratification or any rule of law as to acts that are incapable of being ratified by the company.

**What was the policy basis for the new section?**

It is important at this point to note firstly that the Law Commission (UK) in its report titled "Shareholder Remedies" prepared in 1997 noted that its terms of reference did not include substantive changes to the law of ratification[444] and secondly in the same report, the Law Commission conceded that the law on ratification was by no means clear.[445] Accordingly, the Law Commission was not requested to consider any policy or economic issues with respect to ratification when it considered any law reform with respect to shareholder remedies, notwithstanding that the Law Commission (UK) recommended that a valid ratification resolution should continue to be a complete bar to the maintenance of a statutory derivative claim.[446]

***Independent shareholders***

The United Kingdom has adopted a policy of only permitting "independent" shareholders to vote on a ratification resolution. The limitation placed upon certain shareholders from voting is defined by section 239(3) and the limitation concerns a ratification resolution within the meaning of section 239(1). The policy of allowing ratification by independent shareholders is enabled by excluding firstly a director in breach of their duties and secondly by excluding any

[444] Law Commission (UK), *Shareholder remedies* (Report LC246, 24 October 1997), para 6.84.

[445] Ibid, para 6.81.

[446] Ibid paras 6.86, 6.113, 8.11.

shareholder connected with the director. For the benefit of companies, in particular small companies, to obviate a risk that quorum may not be possible, section 239(4) preserves the right of any shareholder excluded from voting to be counted towards the quorum of the meeting. This avoids the legal possibility that a decision of the shareholders in general meeting would be invalid because quorum for a meeting was not present.

The *Duomatic* principle remains permissible in the United Kingdom.[447] As stated by the explanatory notes to section 239:

> Subsection (6) makes clear that nothing in this section changes the law on unanimous consent, so the restrictions imposed by this section as to who may vote on a ratification resolution will not apply when every member votes (informally or otherwise) in favour of the resolution. The subsection also makes clear that nothing in this section removes any powers of the directors that they may have to manage the affairs of the company.[448]

Accordingly companies, particularly small companies remain entitled to take advantage of the inexpensive method of approving resolutions by unanimous informal assent.

***Preservation of common law and restricted application***

Section 239 does not affect the common law with respect to any question which may arise concerning which acts or omissions of a director may be ratified and accordingly all the limitations on the scope of the doctrine discussed in Chapter 2, including ratification of illegal acts, fraud, an act beyond power of the company and an act which is void *ab initio* continue to apply. In *Franbar Holdings Ltd v Patel*,[449] it was held that "the connected person provisions in section 239(3) and (4) impose additional requirements for effective ratification which draw on existing equitable rules but which impose more stringent demands".[450] This meant that

[447] Brenda Hannigan, *Company Law* (Oxford University Press, 5th ed, 2018), 388-392.
[448] *Explanatory Notes, Companies Act 2006* (UK).

[449] [2008] EWHC 1534 (Ch).
[450] *Franbar Holdings Ltd v Patel* [2008] EWHC 1534, [44] (Mr William Trower QC (sitting as a Deputy Judge of the High Court)).

section 239(7) which expressly preserved any rule of law which imposed any additional requirements for a valid ratification, ensured the preservation of all of the limitations of the scope of the doctrine.

Section 239(1) expressly however applies to conduct of a director which amounts to negligence, default, breach of duty or a breach of trust. The section therefore does not apply to conduct which gives rise to unfair prejudice pursuant to Part 30 of the *Companies Act 2006* (UK) which is broadly similar to Part 2F.1 (Oppressive Conduct of Affairs) of the *Corporations Act 2001* (Cth).

***Prevention of ratification for directors in breach who are the only shareholders***

One clear outcome of section 239(2) of the *Companies Act 2006* (UK) is the prevention of a valid ratification resolution where the only shareholders are also the directors seeking to ratify conduct which is within the meaning of section 239(1) such as a breach of duty to the company. This policy position is harmonious with the common law of the United Kingdom in respect of the *Duomatic* principle because a sole director / sole shareholder company cannot rely on the *Duomatic* principle to approve a resolution.[451] Section 239(6) expressly preserves the operation of the *Duomatic* principle and accordingly, small companies are unaffected by the change in the law in the event that there is unanimous informal assent to a ratification resolution.

***Preservation of a director's right to settle or release claims***

The law in the United Kingdom expressly preserves the right of the directors to settle or release a claim.[452] This ensures that any powers reserved to the board of directors concerning the

[451] *Ultraframe (UK) Ltd v Fielding* [2004] RPC 479, [40].
[452] *Companies Act 2006* (UK) s 239(6).

management of legal claims and litigation can be exercised following the approval by the shareholders in general meeting of a ratification resolution.

***Bar to proceedings***

Section 263(2)(c) of the *Companies Act 2006* (UK) expressly prohibits a court from granting permission or leave to continue a derivative action where the act or omission giving rise to the cause of action has been ratified or authorised by the company. Accordingly, ratification acts as a complete bar to derivative proceedings under section 261 or 262 of the *Companies Act 2006* (UK).[453]

**The cases which have considered section 239**

***Prevention of the doctrine operating for small companies***

Section 239(3) restricts the shareholders who are entitled to vote on a ratification resolution which seeks to ratify any matter within the scope of section 239(1). The meaning of "member connected" has been considered in two cases in the United Kingdom.

In *Brannigan v Style*,[454] the Court considered section 252 of the *Companies Act 2006* (UK) (Persons connected with a director) and determined that certain shareholders were not within the scope of section 252(2) despite their close personal business associations. This arose from the clear meaning of section 252(2) which states in part "[t]he following persons (and only those persons) are connected with a director of a company…" The section was accordingly held to be narrowly construed because of the express words of the statute.

[453] Law Commission (UK) (n 444) para 6.80.
[454] [2016] EWHC 512 (Ch).

In *Re AMT Coffee Limited*[455] it was held that all the shareholders of the company were within the class of persons proscribed by section 239(3) because they were all members of the director's family[456] and accordingly, no ratification resolution could be passed.[457] In this instance, the shareholders of a small company could not pass a ratification resolution and this was the clear intention of the legislation.

This Thesis proposes the adoption of a statutory definition to exclude shareholders from the right to vote on a ratification resolution. The limited number of cases in the United Kingdom since 2007 suggests that the adoption of a definition limits the number of disputes between shareholders and companies because of the simplicity in applying the definition. This Thesis however proposes to adopt existing definitions in the Corporations Act to limit statutory interpretation problems in Australia.

***Fraud on the minority exception to ratification***

In *Franbar Holdings Ltd v Patel*,[458] the High Court of Justice (UK) was required to interpret section 239(7) of the *Companies Act 2006* (UK). It was contended that *"the connected person provisions in section 239 have replaced the principle that breach of duty by a director is incapable of ratification where it constitutes a fraud on the minority in circumstances in which the wrongdoers are in control of the company."*. That argument was rejected because it was held that section 239(7) explicitly preserved any rule of law as to acts that are incapable of being ratified by the company.[459]

It is clear that section 239(7) has an important role in preserving the benefits of the doctrine of ratification. For the reasons explained in Chapter 3, the benefits of the doctrine should be

[455] [2019] EWHC 46 (Ch).
[456] *Companies Act 2006* (UK) s 252(2)(a).
[457] *Re AMT Coffee Limited* [2019] EWHC 46 (Ch), [183] (HHJ Paul Matthews).
[458] [2008] EWHC 1534 (Ch).
[459] *Franbar Holdings Ltd v Patel* [2008] EWHC 1534, [44] (Mr William Trower QC (sitting as a Deputy Judge of the High Court)).

retained and it is proposed by this Thesis to adopt the same approach in section 239(7) of the *Companies Act 2006* (UK).

### C. *The identified deficiencies with the UK ratification laws*

There are a number of significant deficiencies which have been identified with the law in the United Kingdom which are explained below.

**Who is connected with a director?**

The meaning of section 239(3) relies on sections 252 (Persons connected with a director), section 253 (Members of a director's family) and 254 (Director "connected with" a body corporate) of the *Companies Act 2006* (UK) to determine which shareholders are connected with a director. Those sections establish when a person or a body corporate is connected with a director.

In *Brannigan v Style*,[460] discussed above, whether certain persons were connected with a director was not of trivial significance since the plaintiff's derivative claim was reported to be between £9 million and £58 million. The ratification resolution was validly approved by the shareholders and this barred the derivative claim.[461] If the meaning of persons connected with a director in section 252 of the *Companies Act 2006* (UK) was broader to include certain persons with close business relationships to the director, the ratification resolution would have been determined to be invalid. Accordingly, the statutory law reform in this particular instance prevented a plaintiff from pursuing a derivative claim of substantial value and that outcome arises under the law irrespective of the merits of the cause of action.

[460] [2016] EWHC 512 (Ch).
[461] *Brannigan v Style* [2016] EWHC 512 (Ch), [72(Asplin J)

Proxies appointed by a director or person connected with a director are excluded by the operation of section 285 of the *Companies Act 2006* (UK) from voting on a ratification resolution. It is unclear however under section 252 of the *Companies Act 2006* (UK) whether any administrator, liquidator, trustee in bankruptcy, executor or legal personal representative of a director or person connected with a director would be permitted to vote.

**Exclusion of prospective authorisation**

Section 239 of the *Companies Act 2006* (UK) omits prospective authorisation from its scope of operation and it has been argued by this Thesis that this is problematic because the consequences for the company can only be predicted for authorisation, whereas in the case of retrospective ratification, at least shareholders can assess the consequences of the director's conduct for the company.[462]

The exclusion of prospective authorisation from the statutory reform leaves open the possibility that a director/shareholder could vote at a shareholders meeting to prospectively authorise their own proposed conduct which is alleged to be in breach of a duty to the company. It is not clear what underlies the policy basis for such an approach in the United Kingdom, especially in light of the fact that the law reform did directly deal with the possibility that a director/shareholder could vote at a shareholders meeting to retrospectively approve their own prior conduct. In that regard, there is no consistent policy approach to this question of whether a director/shareholder should be entitled to vote to relieve themselves of the consequences of a breach of duty to the company.

**No express protection of Constitutional provisions**

[462] Chivers (n 27) 7.57.

Section 239(7) of the *Companies Act 2006* (UK) does not expressly preserve the operation of a company's constitutional provision which limits ratification and there are no cases in the United Kingdom which have considered this question.

An example of a constitutional provision would be a clause which has the effect of excluding a shareholder from voting on a ratification resolution by reason of their relationship or association with a director.

It would be open to a party to argue that section 239 was a comprehensive and exclusive code with respect to ratification. The argument is not likely to succeed for numerous reasons. Firstly, as described in this Chapter, section 239(7) does not purport to affect any existing rule of law which imposes additional requirements for a valid ratification in relation to acts which cannot be ratified. Secondly, section 239 omits any matter arising from prospective authorisation of a proposed breach of duty. Finally, section 239 does not displace any common law rule which concerns the conduct of a meeting of the shareholders in general meeting, or the manner in which disclosure is made by a director in breach of their duties. Each of those matters indicate that section 239 is not a comprehensive and exclusive code.

There is a question of interpretation of the legislation whether a shareholder has a right to contract out of the operation of the section. For example, where a company's constitution contains a provision which seeks to exclude the operation of section 239 or narrow the definition of shareholders which are excluded from voting on a ratification resolution. In light of the fact that the section is a beneficial provision at least for minority shareholders, it may be concluded that at least on that basis a shareholder cannot contract out of the section.

In the United Kingdom and Australia, the operation of an estoppel may be prevented because it operates contrary to a statutory provision.[463] An example may be a constitutional provision

[463] *Lindsay v Smith* [2002] 1 Qd R 610, [20]–[36]; *Overmyer Industrial Brokers Pty Ltd v Campbells Cash & Carry Pty Ltd* [2003] NSWCA 305, [44]–[57]; *Equuscorp Pty Ltd v Wilmoth Field Warne* (2007) 18 VR 250, [81]–[88]; *Tudor Developments Pty Ltd v Makeig* (2008) 72 NSWLR 624; *St Alder v Waverley Local Council* [2010] NSWCA 22, [21]–[44]; *Hobsons Bay City Council v Gibbon* (2011) 32 VR 168, [156]–[172]; *Equuscorp*

which pre-dates the enactment of section 239 which extends the statutory definition of a shareholder excluded from voting on a ratification resolution. The effect of the constitutional provision is to limit certain shareholders who are entitled to vote pursuant to section 239 and it is sought to be argued therefore to be contrary to section 239. Subject to the interpretation of the section, a court may determine that the constitutional provision being contrary to section 239 is invalid to the extent of the inconsistency and the estoppel cannot operate to prevent a shareholder who is entitled under section 239 to vote on a ratification resolution.

If a court did determine that section 239 of the *Companies Act 2006* (UK) had the effect of being a statutory code and this had the effect of excluding the operation of a company's constitutional provision, then there would be circumstances where a ratification resolution is approved notwithstanding an express provision seeking to exclude, for example, a defined group of shareholders. Accordingly, the express agreement of the shareholders reached via a constitutional provision may not in all circumstances protect a minority shareholder and thereby the drafting of section 239 leaves open a risk that additional constitutional protections may not be valid.

**Problems arising from the Duomatic principle**

There are two problems which arise from the retention of the *Duomatic* principle.[464]

Firstly, the operation of the *Duomatic* principle can lead to factual and legal disputes between companies and shareholders.

Secondly, whilst it is recognised that there are no shareholders opposed to a ratification resolution for the *Duomatic* principle to operate, it appears that the *Duomatic* principle does

*Pty Ltd v Haxton* 286 ALR 12, [106]–[107]. See John Heydon et al, *Meagher, Gummow & Lehane's Equity Doctrines and Remedies* (LexisNexis Butterworth, 5th ed, 2014).

[464] *Re Duomatic Ltd* [1969] 2 Ch 365.

not protect any shareholder which owns a class of shares which do not have voting rights. If this is correct, there will be circumstances whereby the *Duomatic* principle operates to the detriment of shareholders which hold non-voting shares.

However, it must be highlighted that this Thesis has not identified any case where the problem of non-voting shares have arisen. Accordingly, whilst these are concerns about the operation of the doctrine in connection with the *Duomatic* principle, the concerns are not of such magnitude that those particular criticisms or problems warrant statutory reform.

**Strict compliance obligation**

Section 239 of the *Companies Act 2006* (UK) does not permit a court to determine that there has been substantial compliance with the requirements.

A significant drawback of the legislation is that if a ratification resolution would have been approved but for non-compliance with the prohibition against certain shareholders voting, a court cannot grant relief other than to make a declaration that the resolution was invalid. This consequently will require a further meeting of the shareholders to be convened to consider the resolution again.

The issue could arise, for example, where there is an incorrect ruling by a chairperson that a shareholder was entitled to vote on a ratification resolution. The outcome for the company is additional delay and costs arising from the necessity to convene a further meeting of the shareholders and the parties have possibly expended time and money arguing whether the resolution was valid.

This possibility could be avoided by allowing a company to tender evidence that a ratification resolution would have been approved notwithstanding the non-compliance with the section.

## D. *The New Zealand ratification law reforms*

Section 177 of the *Companies Act 1993* (NZ) which was operative from its enactment in 1993 is in the following form:

Ratification of certain actions of directors

(1) The purported exercise by a director or the board of a company of a power vested in the shareholders or any other person may be ratified or approved by those shareholders or that person in the same manner in which the power may be exercised.
(2) The purported exercise of a power that is ratified under subsection (1) is deemed to be, and always to have been, a proper and valid exercise of that power.
(3) The ratification or approval under this section of the purported exercise of a power by a director or the board does not prevent the court from exercising a power which might, apart from the ratification or approval, be exercised in relation to the action of the director or the board.
(4) Nothing in this section limits or affects any rule of law relating to the ratification or approval by the shareholders or any other person of any act or omission of a director or the board of a company.

**What was the policy basis for the section?**

The New Zealand Parliament has adopted a policy of maintaining the doctrine of ratification. Section 177(1) to (2) codifies the common law with respect to retrospective ratification and prospective authorisation.

As is made clear by section 177(3), a court retains its powers to grant relief in respect of an action of a director which was in breach of duty. This section expresses a similar policy basis to the approach taken in Australia under section 239 of the Corporations Act whereby a court has a discretion to take into account a ratification resolution.

Section 177(4) ensures that the common law continues to operate with respect to both retrospective ratification and prospective authorisation. The benefits of the doctrine which were discussed in Chapter 3 are retained as a result of the section. The problem of a director / shareholder voting to approve their own conduct, was sought to be addressed in section 177(3).

What is not clear from the section is how section 177(3) and 177(4) work together. By way of example, does a valid ratification resolution extinguish a cause of action and thereby act as a bar to a proceeding? This is discussed further below.

## E. *The identified deficiencies with the NZ ratification laws*

**Extinguishment of a cause of action**

It is convenient to commence this section with a discussion about the most troubling aspect of the statutory reform, being whether a cause of action is extinguished by a ratification resolution. The answer is of importance to this Thesis because the limited statutory reforms which are proposed are guided by, in part, a review of the law in New Zealand.

Section 177(4) expressly preserves any rule of law relating to ratification or approval by the shareholders. One such rule is the power of the shareholders in general meeting to ratify a breach of a director's duty. The consequence of a valid ratification resolution under the common law is to extinguish the cause of action for the breach of duty.

Section 177(3) contemplates an exercise of a court's power, notwithstanding for example that there is a ratification or approval of some conduct of a director. However, if the ratification or approval is valid, the company is bound by the ratification and there is no cause of action for the breach of duty. It is not therefore immediately apparent from section 177 what powers a court would be exercising. Any proceedings pleading a cause of action for breach of duty would be met with a complete defence of ratification. There is no case authority in New

Zealand on the statutory interpretation of section 177.[465] Accordingly, a discussion of the likely interpretation of the section is below.

In its axiomatic that all words in a statute have meaning and effect[466] and where there is a conflict between a general provision and a specific provision, the specific provision prevails.[467] On one reading of section 177, subsection (3) is a specific provision and subsection (4) is a general provision and subsection (4) must be read in conjunction with subsection (3).[468] However, that possibility requires at least an interpretation that a valid ratification resolution does not bind the company. Such an interpretation seems very unlikely given that subsection (1) expressly permits ratification or approval by the shareholders and there are no express words in the section which otherwise purport to limit the consequences or effect of a ratification or approval resolution. Rather, subsection (4) expressly preserves any rule of law, which necessarily includes the legal consequences of a ratification or approval resolution.

One possible interpretation of section 177(3) is that the effect of the ratification resolution does not extinguish a cause of action because under the section a court has a discretion to exercise a power despite the ratification resolution. Section 177(3) would seem to be robbed of its practical meaning unless that interpretation is ultimately reached.

The *Companies Act 1993* (NZ) has no equivalent provision to section 239 of the Corporations Act. The Commonwealth Parliament considered it necessary to expressly state in that section that the ratification does not prevent a person from bringing or intervening in proceedings with leave under section 237 or from applying for leave under section 237 and further that

[465] Susan Watson, et al, *Corporate Law in New Zealand* (Thomson Reuters, 2018); Watts, Peter, et al, *Company Law in New Zealand* (2nd ed, LexisNexis, 2015).
[466] *Project Blue Sky v Australian Broadcasting Authority* [1998] HCA 28, [71] (McHugh, Gummow, Kirby and Hayne JJ); *Commonwealth v Baume* (1905) 2 CLR 405, 414 (Griffiths CJ). See also Dennis Pearce and Robert Geddes, *Statutory Interpretation in Australia* (LexisNexis Butterworths, 9th ed, 2019), 2.43.

[467] *Perpetual Executors and Trustees of Assoc of Australia Ltd v FCT* (1948) 77 CLR 1, 29. See also Pearce and Geddes (n 466), 2.21.
[468] Susan Watson and Owen Morgan, A Matter of Balance: The Statutory Derivative Action in New Zealand (1998) 19(8) *The Company lawyer* 236, 243.

ratification does not have the effect that the proceedings must be determined in favour of the defendant.[469]

There are no express words in section 177 which seek to alter the common law, whereas there are express words in section 177(4) which preserve the common law. It is difficult to conclude that a court would agree that words should be read into section 177 which would have the effect of altering the clear meaning of the express words in section 177(4). Such an approach is not a process of statutory interpretation.

Another possible means of statutory interpretation is to read down the effect of section 177(4). In *R v Young*[470] it was explained that:

> the process of construction will, for example, sometimes cause the court to read down general words, or to give the words used an ambulatory operation. So long as the court confines itself to the range of possible meanings or of operation of the text — using consequences to determine which meaning should be selected — then the process remains one of construction.[471]

An effective ratification resolution of the shareholders in general meeting binds the company. Would a more reasonable result arise under section 177 if this were not true? The doctrine of ratification is broader in its application than ratifying breaches of a director's duty. The doctrine protects third parties dealing with companies with respect to contracts, guarantees and charges.[472] In order to construe the section narrowly and to ensure the ongoing protection of third parties dealing with companies in New Zealand, it would be necessary to interpret section 177 as being limited to the common law with respect to only breaches of a director's duty.

It would be incorrect to say that section 177 was limited in its application to breaches of duty by a director. Section 177(1) is clear that it relates to any power vested in the shareholders or

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[469] *Corporations Act 2001* (Cth) s 239(1).
[470] [1999] NSWCCA 166.
[471] *R v Young* [1999] NSWCCA 166, [15] (Spigelman CJ).
[472] see *ANZ Executors & Trustee Company Limited v Qintex Australia Limited (Receivers and Managers appointed)* [1991] 2 Qd R 360; *Williams Group Australia P/L v Croker* [2015] NSWSC 1907.

any other person. Those persons include agents of the company appointed by the board of directors. There are no express words which indicate that section 177 has a narrow purpose. It is accordingly not clear what interpretation of section 177 could produce a result where the company is not bound by a ratification resolution.

The foregoing discussion leads to an inevitable conclusion that section 177 does not have the effect of altering the common law to prevent a ratification resolution from extinguishing a cause of action against a director. If as a consequence, section 177(3) is devoid of practical meaning, is it possible to interpret the section to produce a more reasonable result?[473]

If an interpretation of a section leads to an absurd result, the language can be interpreted to avoid the absurdity.[474] In the United Kingdom, it is the case that a ratification resolution extinguishes a cause of action for breach of duty. That is the position under the common law which was not changed by statute. There is no absurd result from the interpretation of the statute in the United Kingdom. There is equally no absurd result from the interpretation of the statute in New Zealand.

In light of the above, no absurd result arises from the interpretation that section 177 retains the common law effect of a ratification resolution. The issue which arises is in all regards a consequence of poor drafting and this is not a basis for a court to find that there was a contrary intention from the express words used.[475]

The most likely interpretation of the interaction between section 177(3) and 177(4) is that the latter provision is not subject to section 177(3). This interpretation arises from a rule of last resort where it is not possible to reconcile two sections, a later provision takes precedence over an earlier provision.[476]

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[473] *Minister for Resources v Dover Fisheries Pty Ltd* (1993) 43 FCR 565, 574 (Gummow J). See also Pearce and Geddes (n 466), 2.43.
[474] See generally *Grey v Pearson* (1857) 6 HLC 61.
[475] See generally *Simpson v Nominal Defendant* (1976) 13 ALR 218.
[476] *Wood v Riley* (1867) LR 3 CP 26.

In consequence of the foregoing discussion, a cause of action is extinguished by a ratification resolution in New Zealand.

**Director permitted to vote on ratification of own conduct**

Section 177 has the effect of ensuring that a director/shareholder is entitled to vote on a ratification or authorisation resolution in respect of their own breach of duty. By extension, the law reform also fails to deal with shareholders which are associated with the director alleged to have breached a duty to the company. This criticism is the most significant criticism of ratification which was discussed in Chapter 4.

The statutory law reform in New Zealand seeks to address the issue through section 177(3) by allowing a court, for example, to determine what orders including damages should be made notwithstanding that a ratification resolution was approved by the shareholders in general meeting. Arising from the interpretation of section 177(3) and 177(4) discussed previously, it is not possible for a court to determine that a ratification resolution does not bind a company, or alternately that, subject to an interpretation of the resolution, the ratification resolution did not extinguish the cause of action.

**Limitation on the future development of equity law**

A possible consequence of the statutory reform is a limitation imposed upon a court to further develop the doctrines of equity with respect to ratification by reason of the maxim 'equity follows the law'. In *Delehunt v Carmody*,[477] the question came before the High Court in the context of a conveyancing statute. The Court considered that,

[477] [1986] HCA 67.

> [i]t would be indeed surprising if the rules of equity required the courts to follow a rule of the common law that no longer existed and in doing so to reach a result which equity generally tried to avoid. However the doctrines of equity are not so inflexible. If equity follows the law, it will follow the rules of law in their current state.[478]

On the basis that a new statutory provision would likely, but not invariably, affect the doctrines of equity, following the enactment of section 177, the doctrines of equity in New Zealand could not develop a principle, for example, that a director/shareholder cannot vote to approve a ratification resolution in respect of their own conduct. There are no reported cases in New Zealand which have considered this issue. The conclusion must follow from the fact that the common law has been expressly preserved by section 177(4).

There are no reported cases in New Zealand which have sought to interpret section 177 or determined that a resolution passed under that section was invalid. This may be as a result of the significant legal difficulties faced by minority shareholders following the approval of a ratification resolution except in the clearest of cases where the common law imposes a restriction on the right of the shareholders, which includes for example the exception against the fraud on the minority.

**Criticisms and uncertainties unresolved**

The criticisms and uncertainties discussed in Chapter 4 have not been resolved by the law reforms in New Zealand. It has also been argued above that the law reform has now inhibited the future development of the doctrines of equity with respect to ratification. The law reform accordingly has not addressed the extant problem that a company cannot obtain relief for a breach of duty following the valid approval of a ratification resolution and minority shareholders similarly cannot obtain a legal remedy either by way of derivative action on behalf of the company, or personally.

[478] *Delehunt v Carmody* [1986] HCA 67, [9] (Gibs CJ, Wilson, Brennan, Deane and Dawson JJ agreeing).

In light of the criticisms and uncertainties discussed above, this Thesis does not propose to adopt the statutory law reforms which were adopted in New Zealand.

## F. *The Canadian law*

Section 120 of the *Canada Business Corporations Act 1985* ("Disclosure of interest") is set out below in so far as it relates to authorisation and ratification.

> (5) A director required to make a disclosure under subsection (1) shall not vote on any resolution to approve the contract or transaction unless the contract or transaction
>
> > (a) relates primarily to his or her remuneration as a director, officer, employee, agent or mandatary of the corporation or an affiliate;
> >
> > (b) is for indemnity or insurance under section 124; or
> >
> > (c) is with an affiliate.
>
> (7) A contract or transaction for which disclosure is required under subsection (1) is not invalid, and the director or officer is not accountable to the corporation or its shareholders for any profit realized from the contract or transaction, because of the director's or officer's interest in the contract or transaction or because the director was present or was counted to determine whether a quorum existed at the meeting of directors or committee of directors that considered the contract or transaction, if
>
> > (a) disclosure of the interest was made in accordance with subsections (1) to (6);
> >
> > (b) the directors approved the contract or transaction; and
> >
> > (c) the contract or transaction was reasonable and fair to the corporation when it was approved.

(7.1) Even if the conditions of subsection (7) are not met, a director or officer, acting honestly and in good faith, is not accountable to the corporation or to its shareholders for any profit realized from a contract or transaction for which disclosure is required under subsection (1), and the contract or transaction is not invalid by reason only of the interest of the director or officer in the contract or transaction, if

(a) the contract or transaction is approved or confirmed by special resolution at a meeting of the shareholders;

(b) disclosure of the interest was made to the shareholders in a manner sufficient to indicate its nature before the contract or transaction was approved or confirmed; and

(c) the contract or transaction was reasonable and fair to the corporation when it was approved or confirmed.

(8) If a director or an officer of a corporation fails to comply with this section, a court may, on application of the corporation or any of its shareholders, set aside the contract or transaction on any terms that it thinks fit, or require the director or officer to account to the corporation for any profit or gain realized on it, or do both those things.

In connection with a derivative action, or statutory oppression action, section 242(1) introduced from 1 January 2003 provides:

An application made or an action brought or intervened in under this Part shall not be stayed or dismissed by reason only that it is shown that an alleged breach of a right or duty owed to the corporation or its subsidiary has been or may be approved by the shareholders of such body corporate, but evidence of approval by the shareholders may be taken into account by the court in making an order under section 214, 240 or 241. (emphasis added)

**The policy basis**

Section 120 arose out of the report titled "Proposals for a New Business Corporations Law for Canada, vol 1" ('**Dickerson Report**').[479]

It is notable that section 120 of the *Canada Business Corporations Act* does not modify the common law with respect to ratification or authorisation of a breach of a director's fiduciary or statutory duties. The purpose of the section is to establish disclosure requirements by the directors and officers in relation to contracts and transactions where the director or officer has an interest and to limit the right of any director or officer to vote on the ratification of that contract or transaction.

The Dickerson Report when considering the question of law reform in connection with breaches of a director's duties stated:

> Rather than set out a specific rule declaring how an act of the directors may be ratified, we think it better to characterize shareholder ratification or waiver as an evidentiary issue, which in effect compels the court to go behind the constitutional structure of the corporation and examine the real issues.[480]

On the important question of whether there should be law reform with respect to limiting the right of a director to vote to approve their own breach of duty, it should be noted that the common law in Canada has developed independently of the United Kingdom, the United States of America, Australia and New Zealand. The Dickerson Report made the following observation in relation to this point:

> If, for example, the alleged misconduct was ratified by majority shareholders who were also the directors whose conduct is attacked, evidence of shareholder ratification would carry little

[479] Robert Dickerson et al, *Proposals for a New Business Corporations Law for Canada* (Information Canada, 1971) ('Dickerson Report').

[480] Ibid, para 487.

> or no weight. If, however, the alleged misconduct was ratified by a majority of disinterested shareholders after full disclosure of the facts, that evidence would carry much more weight indicating that the majority of disinterested shareholders condoned the act or dismissed it as a mere error of business judgement.[481]

Accordingly, for the purposes of corporate law policy, any law reform concerning a prohibition on voting by a director who acted in breach of their fiduciary or statutory duties would only result in codification of the common law and in this respect is an unnecessary law reform in Canada.

A ratification resolution remains relevant to a director's liability for a breach of duty to a company.[482] Section 242(1) of the *Canada Business Corporations Act 1985* overturns the common law with respect to the effect of a ratification resolution by preventing the ratification resolution from extinguishing a cause of action for a breach of a director's duty. A court retains a discretion to take into account the ratification before determining any orders.[483]

There have not been any other statutory reforms in Canada to address any matter in relation to the doctrine of ratification.[484]

The common law in Canada addresses the problem of a self-interested director voting to approve a ratification resolution concerning their own breach of duty. In this regard, the most criticised aspect of the doctrine has been addressed by adopting a policy of allowing "independent" shareholders to vote on a ratification resolution.

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[481] Ibid.

[482] See generally, Kevin McGuiness, *Canadian Business Corporations Law* (3rd ed, LexisNexis Canada, 2017), Vol 2, 677.

[483] See generally *LeDrew v LeDrew Lumber Co* 223 APR 71, [41] (Lang J); *Bellman v Western Approaches Limited* 130 DLR (3d) 193 (British Columbia Court of Appeal), 55-56.

[484] See generally *Heath v Mercantile Finance Service Ltd* 2015 PECA 11.

**Criticisms**

The Canadian law does not seek to address prospective authorisation or the attenuation of a director's duties. A director and their associates are not restricted from voting as shareholders in relation to those matters which is a significant limitation on the scope of the voting restrictions in Canada. There is therefore a difference between the legal outcome for a director/shareholder in connection with prospective authorisation because the director/shareholder can approve the authorisation resolution to avoid a breach of duty, whereas, the director/shareholder cannot approve a ratification resolution.

The statutory reforms in Canada do not establish a definition of which shareholders are excluded from voting on a ratification resolution. This can result in disputes being required to be determined by a court between shareholders and companies.

## G. *The law in the State of Delaware*

A review of law reforms in the United States of America is limited to a review of the law in the State of Delaware because firstly, a majority of companies in the United States of America are incorporated under the *Delaware General Corporations Law* and secondly, as will be discussed below, as a result of the common law developing independently of other countries, in particular, the United Kingdom and Australia, the United States of America has not been required to substantially reform the law concerning ratification of a breach of a director's duties.

**Formal requirements of ratification**

Section 144 of the *Delaware General Corporations Law* concerns the ratification of a contract or transaction between a company and a director or officer. The section does not affect the common law concerning ratification of a breach of a director's fiduciary or statutory duty.

Accordingly, ratification of a breach of duty is permissible under the common law[485] subject to compliance with the *Delaware General Corporations Law*.

One such compliance obligation arises under section 228 of the *Delaware General Corporations Law* which permits the shareholders to consent to resolutions without the requirement for a formal meeting.

In *Espinoza v Zuckerberg*,[486] the plaintiff claimed the directors were in breach of their fiduciary duties arising from decisions taken by the board of directors to award alleged excessive remuneration to those directors. The Court held there had been no valid ratification of certain remuneration decisions because there was no formal meeting of the shareholders, or written consent in accordance with the requirements of section 228. This was found notwithstanding the defendants were the major shareholders and Mr Zuckerberg who was not the recipient of any of the remuneration, could have validly (as the major shareholder) approved a ratification resolution.

**Independent shareholder requirement**

Section 144(a)(2) *Delaware General Corporations Law*, enacted in 1967, establishes a requirement for 'disinterested' shareholders to vote on a ratification resolution. The section provides as follows:

> 144(a) No contract or transaction between a corporation and 1 or more of its directors or officers, or between a corporation and any other corporation, partnership, association, or other organization in which 1 or more of its directors or officers, are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the

[485] *Lewis v Vogelstein* 699 A 2d 327 (Del, 1997).

[486] 124 3d 47 (Del, 2015).

meeting of the board or committee which authorizes the contract or transaction, or solely because any such director's or officer's votes are counted for such purpose, if:

…

(2) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders;

The section has been interpreted to mean that shareholders entitled to vote (the 'disinterested' shareholders) are the shareholders which do not have an interest in the contract or transaction and this interpretation has been extended to cases concerning the ratification of breaches of a director's fiduciary duties.[487]

Further, it has also been held that there is a requirement that a majority of the disinterested shareholders vote in favour of a ratification resolution as distinct from merely a majority of disinterested shareholders present at a shareholders meeting called for the purpose of considering the ratification resolution.[488]

In *Claman v Robertson,*[489] it was held that a 'disinterested' majority of the shareholders of a corporation have the power to ratify fraudulent acts of directors or officers, provided there was no actual fraud in either inducing or effecting such ratification.

**What is the effect of a ratification resolution?**

Under Delaware law, there are no less than four different legal effects that a ratification resolution can have. Those effects are to either; have no effect whatsoever, fully extinguish a

[487] *Lewis v Fuqua* 502 A 2d 962 (Del, 1985); *Klinicki v Lundgren* 695 P 2d 906 (Or, 1985). See Thomson Reuters, *Corpus Juris Secundum* (11 January 2013) § 608 'Doctrine of corporate opportunity'.

[488] *Fliegler v Lawrence* 361 A.2d 218 (Del, 1976), 221 (McNeilly, Christie and Duffy JJ).

[489] *164 Ohio St.*, 128 N E 2d 429 (Ohio, 1955).

legal claim, shift the burden of proof to the plaintiff of whether there was 'entire fairness', or maintain the business judgment rule's presumptions.[490]

The distinctions found in the law are a function of two matters. Firstly, whether some conduct is void or voidable. It is notable that the law in all of the jurisdictions reviewed by this Thesis adopt this same distinction as discussed particularly in connection with Australia in Chapter 4.

Secondly, the different circumstances under which duty of loyalty claims arise.[491] The effect of ratification on the amount of damages which can be awarded depends on the nature of the duty which was ratified.[492]

## H. *Criticisms of the Delaware ratification law*

It is notable that section 144 of the *Delaware General Corporations Law* does not deal with the consequences of a ratification resolution. It has been held however by the Delaware Supreme Court in *Gantler v Stephens*[493] that a valid ratification resolution does not extinguish a claim against a director for a breach of fiduciary duty with respect to a breach of duty of care and a breach of loyalty. A valid ratification resolution also does not extinguish either a director's 'Revlon duty' or the 'Unocal duty' which arise in cases concerning mergers between companies.[494] In relation to the last two duties, there are no equivalent directors' duties which arise in Australia under the Corporations Act.

The different legal effects of a ratification resolution are more diverse than the position in Australia, the United Kingdom and Canada. Two of the effects are particular to the law in Delaware being to firstly shift the burden of proof to the plaintiff of whether there was 'entire fairness', or secondly maintain the business judgment rule's presumptions. The law concerning

[490] *Solomon v Armstrong* 747 A 2d 1098 (Del, 1999).

[491] *Solomon v Armstrong* 747 A 2d 1098 (Del, 1999), 1114.

[492] *Re Prime Hospitality Inc* (Del, 2005).

[493] 965 A 2d 695 (Del, 2009).

[494] *Revlon Inc v MacAndrews* 506 A 2d 173 (Del, 1986); *Unocal Corp v Mesa Petroleum Co* 493 A.2d 946 (Del, 1985).

ratification is accordingly more complex than in any other jurisdiction considered by this Thesis. In none of the other jurisdictions considered by this Thesis can a ratification resolution have either of these legal effects.

The problem of the shifting of the burden of proof arises, for example, when the board has used a well-functioning committee of independent directors.[495] The plaintiff is then required to establish the contrary contention. There is no equivalent shifting of the burden of proof under the law in the United Kingdom, Canada, New Zealand or Australia.

The maintenance of the business judgment rule's presumptions protects the directors in so far as it is it presumed that the directors acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company.[496] A plaintiff has the burden of proof that these presumptions do not apply to the circumstances of the directors.

The common law concerning the effect of ratification in Delaware is further complicated where the issue is a breach of fiduciary duty in respect of a contract or transaction (a matter outside the scope of section 144(a)(2)). A valid ratification resolution subjects the decision to the business judgment rule and extinguishes a breach of fiduciary duty.[497]

The decision in *Gantler v Stephens*[498] may not represent the law in other States of the United States of America because each of the decisions in States other than Delaware referred to in this Chapter were decided prior to this decision in 2009.[499]

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[495] *Solomon v Armstrong* 747 A 2d 1098 (Del, 1999), 1119.
[496] *Solomon v Armstrong* 747 A 2d 1098 (Del, 1999), 1099.
[497] *Corwin v KKR Financial Holdings LLC* 125 A 3d 304 (Del, 2015) citing with approval *Re S. Peru Copper Corp. S'holder Derivative Litig.*, 52 A 3d 761 (Del, 2011), 793; *Sample v Morgan* 914 A 2d 647 (Del, 2007), 663; *Re PNB Holding Co* 28-N (Del, 2006), 14; *Apple Computer Inc v Exponential Technology Inc* CA No 16315 (Del, 1999), 7.

[498] 965 A 2d 695 (Del, 2009).

[499] See, eg, *Delahousseaye v Newhard* 785 S W 2d 609 (Missouri, 1990); *Dyer v Shafer* 779 S W 2d 474 (Texas, 1989); *Re Wheelabrator Technologies Inc Shareholders Litigation* 663 A 2d (Del, 1995); *Claman v Robertson*

In light of the significant criticisms of the law in the State of Delaware in the United States of America, this Thesis does not propose to adopt those law reforms.

## I. *Conclusion*

Each of the jurisdictions considered in this Chapter have not prohibited the whole application or operation of the doctrine of ratification to companies. As discussed in Chapter 3, there are significant benefits to the operation of the doctrine and the law reforms in the jurisdictions discussed have not eroded the beneficial aspects of the doctrine.

The limited statutory law reform to the doctrine in the United Kingdom prohibited a director and defined persons connected with that director from voting to approve a ratification resolution to prevent a director alleged to be in breach of their duties to the company from voting to approve their own breach of duty.

The statutory law reforms to the doctrine in the United Kingdom are in a different legal context to Australia because the *Companies Act 2006* (UK) has no equivalent provision to section 239 of the Corporations Act. This means that in the United Kingdom, a valid ratification resolution is a bar to a derivative claim, whereas in Australia, a court has a discretion to take into account a ratification resolution, but the ratification resolution of itself is not a bar to a derivative claim. In this regard, the law in Australia is distinct from the law in the United Kingdom and this is relevant to any law reforms in Australia which are proposed by this Thesis.

The State of Delaware in the United States of America did not need to address statutory law reform in relation to the shareholders which were entitled to vote on a ratification resolution because in that jurisdiction the statutory provision has been interpreted to require a majority vote of all 'disinterested' shareholders. As discussed above, the key problems in Delaware are

*164 Ohio St.*, 128 N E 2d 429 (Ohio, 1955) where it was held that a ratification resolution did extinguish claims of a breach of a director's fiduciary duties.

firstly the complexity of determining what is the effect of the ratification resolution and secondly, the damages which may be awarded for a breach of duty. These problems have not plagued the jurisprudence in the United Kingdom, Canada, New Zealand or Australia.

The common law in Canada has been overturned by statute with respect to the effect of a ratification resolution. According, the law in Canada is similar to the effect of section 239 of the Corporations Act in Australia.

The corporate law policy approach in New Zealand has been to limit the effect of a ratification resolution so as to prevent a cause of action being extinguished, however, it appears that the policy intent is not capable of that interpretation.

The review of the jurisdictions in this Chapter provides support for limited law reform to the Corporations Act to address the most significant criticisms and uncertainties of the doctrine but retain the beneficial aspects of the doctrine. The recommendations for law reform in Australia are addressed in Chapter 8. Before however explaining the proposed law reforms, the following Chapter considers the corporate law policy arguments in favour of and against law reform in connection with ratification of a breach of a director's statutory duties.

## CHAPTER 7 – EVALUATING THE POLICY ARGUMENTS FOR LAW REFORM

### A. *Introduction*

In Australia, legislative amendments and the development of the common law have significantly curtailed the operation of the doctrine of ratification in relation to companies. Significantly, it is not possible for the shareholders in general meeting to ratify a breach of a statutory duty[500] and major shareholders who are also the directors of a company may be unable to rely on their voting power to approve a ratification resolution of their own breach of duty if that conduct is contrary to Chapter 2E or section 232 of the Corporations Act.[501] Further, the doctrine does not apply to companies which are insolvent or nearing the point of insolvency.[502] Notwithstanding those matters, as discussed earlier in this Thesis, the doctrine continues to operate in connection with companies governed by the Corporations Act.

This Chapter argues for limited law reform based on policy considerations as a separate argument from earlier Chapters. The law reforms proposed will address the major criticisms identified in Chapter 4, while retaining the benefits of the doctrine discussed in Chapter 3.

This Chapter will firstly consider the policy argument in favour of further limiting the operation of the doctrine. The question has been previously considered by the Corporations and Markets Advisory Committee ('**CAMAC**') and addressed by specific law reforms to the former Corporations Law. The principal statutory law reforms which were made to address the operation of the doctrine were to enact a statutory derivative action,[503] to limit the effect of the

[500] *Angas Law Services* (n 5).

[501] *HNA Irish Nominee* (n 44); See also *Peter Exton v Extons Pty Ltd* [2017] VSC 14, [39] (Sifris J).

[502] *Kinsella* (n 55); *The Bell Group Ltd (In Liq) v Westpac Banking Corporation (No 9)* [2008] WASC 239; *ANZ Executors & Trustee Co. Ltd v Qintex Ltd* [1991] 2 Qd R 360, *Spies v The Queen* [2000] HCA 43, [94] (Gaudron, McHugh, Gummow and Hayne JJ) approving *Re New World Alliance Pty Limited (Receiver and Manager Appointed)* [1994] FCA 1117.

[503] *Corporations Act 2001* (Cth) s 236.

doctrine in connection with statutory derivative actions[504] and to limit in what circumstances a director can avoid or limit a liability even where a ratification resolution has been approved.[505]

This Chapter will then consider shareholder primacy theory in the context of the doctrine. There is no specific legislative expression of the theory in the Corporations Act and, in particular, the extent to which the theory should operate when there are other policy considerations. One such policy consideration is whether the right of a director/shareholder to vote on a ratification resolution concerning their own breach of duty should be limited.

This Chapter will then consider the risks of retaining the doctrine in its current form before explaining the limited law reforms proposed by this Thesis and the benefits and risks of those proposed reforms.

### B. *The history of Australian law reform to the doctrine*

In 1991 the House of Representatives Standing Committee on Legal and Constitutional Affairs tabled its report titled "Corporate Practices and the Rights of Shareholders". In relation to the doctrine of ratification, the report recommended that:

> [I]t is desirable to confirm in the legislation that the duty of directors should be capable of modification in advance and breaches exonerated but only by the shareholders in general meeting and only on the basis of adequate disclosures.[506]

> The power of shareholders to excuse or authorise a breach of duty should be confined to situations where the breach of duty does not attract criminal sanctions and where the only adverse effect of the breach would be on the shareholders. Shareholders should not have power to authorise a breach of directors' duty where the duty involved is the

[504] *Corporations Act 2001* (Cth) s 239.
[505] *Corporations Act 2001* (Cth) s 1318.
[506] House of Representatives Standing Committee on Legal and Constitutional Affairs (n 187) Recommendation 22 at para 5.4.43.

> duty to have regard to the interests of creditors. However, the court should be given power to order that the breach of duty not be excused (however the shareholders have voted) if the company goes into liquidation within 12 months.[507]

The recommendation did not result in any amendment to the Corporations Law (or subsequently the Corporations Act).

In 1993, the Companies and Securities Advisory Committee issued a report titled "Report on a statutory derivative action". The report considered the law in Canada and relevantly the problems associated with the doctrine. The report recommended in the context of the introduction of a statutory derivative action the following amendment to the Corporations Law:

> An application shall not be stayed or dismissed by reason only that it is shown that an alleged breach of a right or duty owed to the corporation or its subsidiary has been or may be approved by the shareholders of that corporation, but evidence of approval by the shareholders may be taken into account by the Court in hearing an application where the Court is satisfied that <u>such approval by shareholders has been undertaken by independent shareholders fully informed as to all relevant facts</u>.[508] (emphasis added)

That recommendation was only partially adopted when section 239 was inserted into the Corporations Law in 1999.[509] As proposed by the 1993 CAMAC report, section 239 permits a court to take into account a ratification resolution. There are however significant differences between the recommendations in the report and section 239. Relevantly, one significant difference is that pursuant to section 239 a court must have regard to whether the shareholders who ratified or approved the conduct were acting for proper purposes which is significantly

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[507] House of Representatives Standing Committee on Legal and Constitutional Affairs, (n 187) Recommendation 22 at para 5.4.44.

[508] Companies and Securities Advisory Committee (n 189), 24.

[509] See *Corporate Law Economic Reform Program Act 1999* (Cth) which was assented to on 24 November 1999.

different from the report's proposal to ensure a court was satisfied that the ratification or approval was by independent shareholders.

The most important function of section 239 is to allow a shareholder to seek leave to commence or intervene in proceedings under section 237 even where a ratification resolution has been approved. *Ergo*, section 239 ensures that a ratification resolution does not affect a right to sue, since otherwise there would be no basis for a derivative claim. There is no case authority in Australia which however considers whether section 239 prevents the extinguishment of the cause of action or merely protects the right to sue.

### C. *The policy argument for amending the Corporations Act*

Given that the question of the operation of the doctrine has been carefully considered in the past and the law amended as discussed above, what is the policy argument for further amending the Corporations Act in relation to the doctrine?

Notwithstanding the amendments to the Corporations Law and later the Corporations Act which had the effect of further curtailing the operation of the doctrine, this Thesis argues for specific limited amendments to the Corporations Act. Those amendments are to address the problems arising from the doctrine of ratification, in particular, to prevent a self-interested director voting to approve their own breach of duty. The reasons for the proposed amendments are set out below.

Firstly, the policy issues raised in previous Australian parliamentary reports which were discussed by this Thesis have not been adequately addressed. Those policy issues included allowing only independent shareholders to approve a ratification resolution.

Secondly, it is argued by this Thesis that the corporate law policy evident in section 239(2) of the Corporations Act has a wider beneficial purpose for companies than simply permitting

leave to be granted for the commencement or intervention in derivative proceedings. The section adopts a more general context of modifying the application of the doctrine to companies governed by the Corporations Act. Section 239(2) establishes that a court may take into account whether the shareholders who ratified the director's conduct were acting for the same improper purpose. This section indicates there is a policy of excluding the votes of interested directors/shareholders who participated in approving a ratification resolution in appropriate circumstances. This existing corporate law policy of possible exclusion of interested director/shareholder votes should be extended to apply outside of the context of derivative proceedings to limit all ratification of breaches of duty by self-interested directors and their associated entities and family members.

Thirdly, this Thesis has identified additional criticisms and uncertainties which were not considered by the Commonwealth Parliament. This was discussed in detail in Chapter 4. Further Chapter 5 considered the possibility of the attenuation of a director's statutory duties in the context of the doctrine of ratification. It is argued by this Thesis that law reform is required in relation to the possible attenuation of statutory duties for the reasons explained in that Chapter.

Fourthly, there has been relevant law reform in the United Kingdom after the Commonwealth Parliament last considered the issues concerning the doctrine. By way of comparison, the Parliament of the United Kingdom found it necessary to limit the rights of a director/shareholder (or any connected person) to vote on a ratification resolution and otherwise preserved the common law on the ratification of acts of directors, notwithstanding other earlier curtailments of the operation of the doctrine.

Finally, the Australian corporate law policy position on dealing with the inherent problem of a self-interested director voting to ratify their own breach of duty is contrary to the law in the Canada and Delaware in the United States of America as discussed in Chapter 6.

Each of Chapters 4 and 5 drew attention to the ongoing problems of the doctrine and those chapters highlight strong reasons in support of limited law reform to the Corporations Act to further curtail the operation of the doctrine in relation to companies governed by the Corporations Act. It was however recognised in Chapter 3 that there are significant legal benefits to companies (and their members) arising from the doctrine and accordingly, the beneficial aspects of the doctrine should be retained.

Limited statutory reform is necessary to address two primary policy problems evident with the doctrine:

1. which shareholders can vote to approve a ratification, authorisation or attenuation resolution?; and
2. what types of conduct can be ratified by the shareholders who are entitled to vote?

The first policy issue has been addressed in Canada and the State of Delaware in the United States of America. Both of those policy issues were directly addressed by limited law reform in the United Kingdom, which was discussed in Chapter 6.

The formulation of any legislative response by the Commonwealth Parliament to the issues raised by this Thesis will best arise from firstly establishing what the corporate policy responses should be in light of the issues which have been raised in Chapters 2 to 5 and secondly, having regard to the differences between the Corporations Act and the laws in the other common law jurisdictions considered by this Thesis.

This Chapter will now consider shareholder primacy theory in the context of the doctrine of ratification.

## D. *Shareholder primacy theory*

Before proceeding to discuss shareholder primacy theory in the context of shareholder ratification, it is necessary to discuss the purpose of using the shareholder primacy theory as the theoretical lens for the analysis of the doctrine. There are three reasons for this approach.

Firstly, shareholder primacy theory has influenced the development of corporate law in common law countries, including Australia. Its analysis thereby provides a basis for considering the corporate law policy issues which concern the operation of the doctrine. Secondly, this Thesis considers the limits of shareholder powers in the context of ratification and those limits relate to shareholder primacy theory. Finally, shareholder primacy theory provides a means to consider corporate governance issues in the context of ratification.

The theory has been described to be a central tenet of corporate governance[510] whereas the critics of the theory describe it as an ideology or dogma.[511] The theory is more than a description of shareholders' rights, it has been considered to be a normative judgment on the most socially efficient way of organising the economy.[512]

The theory can be traced back to the seminal work of Adolf Berle and Gardiner Means in 'The modern corporation and private property' published in 1933.[513] It is an economic theory[514] however its influence over the development of Australian corporate law policy is very significant.

One version of the theory proposes that the shareholders, as the principal in the principal/agent relationship, have priority interest in the corporate governance of the company and its financial performance.[515] There are however different understandings of the shareholder primacy theory in different jurisdictions including whether in Australia the shareholders are recognised as the

[510] Rhee (n 14), 124.

[511] See eg. Lynn Stout, 'The shareholder value myth' (2013) *Cornell Law Faculty Publications* 771; David Millon, 'Shareholder Primacy in the Classroom after the Financial Crisis' (2013) 8 *Journal of Business & Technology Law* 191, 192.

[512] Matthew Bodie, 'AOL Time Warner and the false god of shareholder primacy' (2006) 31 *Journal of Corporations Law* 975, 980.

[513] Berle and Means (n 13).
[514] Stout (n 511), 2.
[515] Rhee (n 14) 122-123.

principal (or principal/owner) in an agency relationship.[516] Aside from the United States case of *Dodge v Ford Motor Co.*,[517] there is no authority for shareholder primacy as a legal doctrine.[518]

In economic terms, any dividends to shareholders are a reflection of the financial performance of the company. It is necessary however to observe that a dividend is a result of past financial performance and that necessarily arose because the company was solvent and thereby the company was not subject to claims from employees, secured creditors and unsecured creditors which all rank ahead of shareholders in the event of the company's insolvency.[519] Under the Corporations Act, the rights of creditors become paramount when a company is near the point of insolvency (or insolvent) and accordingly, the doctrine of ratification ceases to operate at this time.

The shareholder primacy theory provides context for the question: In whose interests are companies run? The answer arising from the corporate policy of the Corporations Act is "the shareholders" although the Corporations Act does not state this policy.[520] The influence of the shareholder primacy theory on the Corporations Act can be seen from the powers of the shareholders in general meeting, the duties of the directors, the remedies available to shareholders and the existing limitations on a director's right to vote as discussed below.

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[516] Jennifer Hill, 'Visions and Revisions of the Shareholder' (2000) 48 *The American Journal of Comparative Law* 39, 42-67. The paper does not clearly differentiate between the shareholders as principals or owners.

[517] 170 N W 668, 684 (Mich, 1919).

[518] Millon (n 511), 192. See *Teck Corp Ltd v Millar* (1972) 33 DLR (3d) 288, [107] (Berger J); *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285, 305 (Wilson J). See also Jason Harris, 'Shareholder Primacy in Changing Times' (Conference Paper, The Supreme Court of New South Wales Corporate and Commercial Law Conference, 2018), 15.

[519] *Corporations Act 2001* (Cth) s 563A.

[520] Malcolm Anderson et al, Evaluating the shareholder primacy theory: Evidence from a survey of Australian directors, as at 18 August 2021, https://law.unimelb.edu.au/__data/assets/pdf_file/0010/1709839/75-Evaluating_the_shareholder_primacy_theory_-__evidence_from_a_survey_of_Australian_directors__20_11_07_11.pdf (referring to H. Hansmann and R. Kraakman, 'The End of History for Corporate Law' (2001) 89 Georgetown Law Journal 439; R. Gordon Smith, 'The Shareholder Primacy Norm' (1998) 23 Journal of Corporation Law 277; E. Farmer and N. Jensen, 'Separation of Ownership and Control' (1983) 26 Journal of Law and Economics 301).

Firstly, the directors have fiduciary and statutory duties as discussed in Chapter 2. It is important to recall from that discussion that whilst fiduciary and statutory duties are owed to the company and not to shareholders,[521] the exclusive power to authorise or ratify a breach of a director's general law duties is vested in the shareholders in general meeting. This reinforces the corporate policy perspective that since the shareholders may be affected by the conduct of the directors, they are entitled to vote on whether the directors' conduct ought to be ratified.

A director's fiduciary duties however are not boundless nor do they seek to strictly implement the shareholder primacy theory. As an example, there is no legal duty upon the directors to maximise profit, or shareholder wealth.[522] In that context, the maximisation of profits and shareholder value is unenforceable unless there is a breach of a director's duty. The directors can thereby pursue other objectives such as benefiting employees, or the community which may not maximise profits or shareholder wealth and not act in breach of a duty to the company.[523]

Secondly, the shareholders have the power to appoint and remove the directors even where there has been no breach of duty by the directors. A majority of the shareholders, in the absence of a special provision in a company's constitution or a shareholders' agreement, can remove any or all of the directors from office and replace those directors where the directors fail, for example, to maximise profits or shareholder wealth.[524] A majority of the shareholders can accordingly determine the company's priorities or objectives.

Thirdly, the shareholders have various existing remedies available which include legal rights directly against the directors under Part 2F.1 (Oppressive conduct of affairs), Part 2F.1A (Proceedings on behalf of a company by members and others) and to prevent an unlawful act by way of injunctive relief.[525]

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[521] *Brunninghausen v Glavanics* (1999) 46 NSWLR 538, [57] (Handley JA, Priestley and Stein JJA agreeing).
[522] Stout (n 511), 4.
[523] See generally, Paul Redmond, 'Directors' duties and corporate social responsiveness' (2012) 35(1) *UNSW Law Journal* 317.
[524] Bodie (n 512), 977.
[525] *Corporations Act 2001* (Cth) s 1324.

Fourthly, there are existing limitations on the right of a director/shareholder of a public company to vote on a transaction which gives rise to a financial benefit if they are a related party.[526] In this context, shareholder primacy theory provides a basis upon which a shareholder is prohibited from voting by reason of their relationship to a director and thereby, a subset of all the shareholders have the power to determine whether a financial benefit is obtained by a director. This restriction has the same policy objective as the common law prohibitions against fraud on the minority, expropriation of the company's property or where there is actual, constructive or equitable fraud.

As can be seen from the powers, duties, remedies and limitations on a director/shareholder discussed above, companies are, as posited by the shareholder primacy theory, managed by the directors for the benefit of the shareholders.

**Is the power of ratification consistent with the shareholder primacy theory?**

The power of ratification is consistent with shareholder primacy theory. This arises from a number of observations about the Corporations Act in the context of ratification.

Firstly, the power of ratification of a breach of a director's duty is reserved exclusively to the shareholders in general meeting. The board of directors as the only other repository of power to bind the company is excluded from exercising such a power.

Secondly, granting the power of ratification to the shareholders necessarily excludes all other stakeholders from that decision, including employees, creditors and the public which may use the goods and/or services provided by the company.

Thirdly, the duties of the directors are owed to the company. It is axiomatic that a director must not have any power to approve a ratification resolution in relation to the conduct of that

[526] *Corporations Act 2001* (Cth) ss 208(1) and 224.

director because the exercise of the power would bind the company. There is a clear conflict between the duty of the director to act in accordance with their fiduciary and statutory duties to the company and the personal benefit they would obtain from the ratification of their breach of duty.

The corporate law policy of allowing a majority of shareholders to bind the company is a rule of general application, unless statute, a constitutional provision, a shareholders' agreement or the general law provide otherwise. The Corporations Act, in particular the replaceable rules which apply to a company governed by the Corporations Act,[527] does not require any more than a majority of shareholders to cast their vote to approve a ratification resolution.

A ratification resolution may be approved by a majority of the shareholders. This means that a bare minimum of fifty percent plus one of the votes in favour of a ratification resolution satisfy the requirements of a valid resolution under the Corporations Act. By comparison to trust law, a minority shareholder would have greater rights if they were the beneficiaries of a trust because a trustee requires that each beneficiary consent to a breach of fiduciary duty.[528] There is thereby a significant difference between the individual rights of a shareholder under shareholder primacy theory where the shareholder is a minority shareholder when compared to a shareholder with a majority interest in the voting shares of a company.

Whilst the granting of the exclusive power of ratification to the shareholders in general meeting is consistent with shareholder primacy theory, the theory does not explain why it is beneficial that the minority of shareholders must be bound by a lawful decision of the majority of the shareholders with respect to any ratification resolution.

Any amendments to the Corporations Act should therefore take into consideration the circumstances where the shareholder primacy theory operates inconsistently with the interests of all of the shareholders.

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[527] *Corporations Act 2001* (Cth) s 135.
[528] *Keech v Sandford* (1726) 25 ER 223.

**Interrelationship with the doctrine of ratification**

The shareholder primacy theory operates harmoniously with the doctrine of ratification when shareholders exercise their powers in general meeting in support of the best interests of the company. Clearly, the opposite can arise where a director in breach of duty owns more than 50% of the shares of the company and uses their voting power to approve a ratification resolution. The problem of the divergence of interests between the directors and the shareholders was recognised by Berle and Means.[529] However, their treatment of the issues was dominated by economic considerations and not the development of any legal doctrine or law reform. Law reform however can and should provide a solution to the competing policies.

In an economic and legal context, a majority of the shareholders have an important power of ratification. Shareholder primacy theory is permissive of a majority of shareholders exercising this power because it is reasoned that the shareholders are the ultimate beneficiaries of the financial performance of the company and, accordingly, they should be able to determine the outcome of a ratification resolution including for economic reasons. It can be seen in this context that the operation of the doctrine of ratification and the shareholder primacy theory overlap in relation to both corporate governance and shareholder wealth maximisation. By way of simple example, where the breach of duty relates to a quantifiable loss to the company arising from, for example, an undervalue sale of an asset to a director, the approval of a ratification resolution may result in the company losing its right to commence legal proceedings to recover any losses. The shareholders could regard that result as the best outcome because of direct and indirect economic consequences to the company which would be expected to arise from pursuing the claim against the director such as damage to the reputation of the company, the costs of litigation and the costs of replacing the director.

## E. *What should be the limits of shareholder power?*

It will be recalled from Chapter 2 that the doctrine of ratification limits the powers exercisable by the shareholders in general meeting. A question asked by this Thesis is whether there should

[529] Berle and Means (n 13), 123.

be further encroachment upon the right of a shareholder to vote, especially where that shareholder is also a director in breach of their duties to the company?

In relation to the doctrine, if a self-interested director is to be prevented from voting on a ratification resolution in respect of their own breach of duty, any further restriction on their right to vote is a narrowing of the implementation of the shareholder primacy theory because it is a restriction on the rights of some defined shareholders. The principle of restricting voting rights would thereby be further expanded if there were limits on other shareholders from voting because of their relationship with the director in breach of their duties to the company.

Any law reform to the doctrine can be limited to the problem of addressing the right of a self-interested director voting in their capacity as a shareholder. Accordingly, any limiting of a director/shareholder's rights can be limited to exercising voting rights which relate specifically to the conduct of a director which amounts to negligence, default, breach of duty or a breach of trust in the relation to the company. Such an approach provides a principle upon which the shareholder primacy theory can be somewhat limited by reference to its application to certain resolutions.

This narrowing of the rights of a director/shareholder results in increased independent shareholder power with respect to corporate governance and economic issues for the company in so far as the exercise of power relates to the doctrine of ratification. Shareholder primacy theory continues to operate in a narrowed form for the benefit of all shareholders by recognising that some shareholders will be motivated to approve a ratification resolution for self-interested reasons (and not reasons which may not be in the best interests of the company).

It is argued by this Thesis that the limited narrowing of the rights of a self-interested director and their associates provides an overall benefit to companies and minority shareholders and the implementation of the corporate law policy goes no further than addressing the primary concern of the operation of the doctrine.

## F. *What are the policy risks of maintaining the doctrine in its current form?*

This Thesis now considers what are the policy risks of maintaining the doctrine in its current form.

Two considerations of the policy of maintaining the doctrine in its current form are the relative benefits and risks arising from retaining the doctrine in its current form. The benefits of the doctrine were discussed in Chapter 3 and are not discussed further in this Chapter. The criticisms and uncertainties of the doctrine were discussed in Chapter 4, however, this section provides a different focus on more fundamental issues, namely, concerns arising from interference in private property rights attaching to shares, the risks arising from uncertainty in the current law, the risks of continued 'sharp' practices by directors and the economic risks.

### Should there be further limits on the voting rights of a director/shareholder?

One underlying legal principle which resulted in the application of the doctrine to companies was a shareholder's entitlement to exercise all of their rights and powers which attach to their shares, notwithstanding that the shareholder was also a director.[530]

As discussed in Chapter 2, there are now significant limitations on the freedom of a shareholder to vote on resolutions at a general meeting. The limitations which relevantly prevent a valid ratification resolution are, for example, where there is a fraud on the minority, a misappropriation of company assets, a member's personal right is defeated or where the conduct of certain shareholders in approving a ratification resolution is contrary to section 232 of the Corporations Act. In particular, the decision in *HNA Irish Nominee*[531] is a recent example where a court limited the rights of shareholders under section 232 of the Corporations Act to vote to approve a ratification resolution.

[530] *Beatty* (n 4).
[531] *HNA Irish Nominee* (n 44).

On one view, the decision in *HNA Irish Nominee*[532] is a demonstration that existing corporate law policy with respect to ratification is effective and the policy risks have been avoided. Before considering that issue, it is important to consider the essential facts of the case. Two shareholders, Messrs Veal and Kinghorn, controlled 38 companies as the only directors after using their majority shareholding power to remove three other directors. Messrs Veal and Kinghorn established a new business and entered into a transaction which posed a conflict of interest between the 38 companies and their new business which would receive management fees from the 38 controlled companies. This conflict gave rise to a breach of section 182 of the Corporations Act by reason of the improper use of their positions. The Court held that holding a general meeting to ratify a breach of duty by the directors was ineffective where the oppressors controlled the voting power of the meeting.[533]

It is more likely in a small company that the directors would own a majority of the shares, however corporate law policy should not be judged merely by how effective it is with respect to small companies. As discussed above, there are voting restrictions imposed upon directors of public companies under Chapter 2E of the Corporations Act, however that does not apply to proprietary companies. Large public company collapses in Australia including HIH, Harris Scarfe and Quintis Ltd (formerly TFS Ltd) demonstrate that shareholder value can be quickly destroyed. Accordingly, any corporate policy response to the risks of the doctrine should take into account the overall financial risks to all investors in Australia and not be constrained by the impact of the doctrine on small companies.

A corporate policy which adopts a view that there should be no further interference in the private rights of a director/shareholder in connection with ratification is counter to the law reforms in the United Kingdom and the prevailing interpretation of the law in the State of Delaware in the United States of America and Canada which was discussed in Chapter 6. In particular in the United Kingdom, reform to the doctrine of ratification was primarily concerned with limiting the right of a director (and any persons connected to the director) to vote in favour of ratification resolution of their own breach of duty to the company. That reform enabled the doctrine to continue largely in its current common law form but allowed

[532] *HNA Irish Nominee* (n 44).
[533] *HNA Irish Nominee* (n 44), [601] (Emmett J).

for a corporate law policy of only "independent" shareholders being permitted to vote on a ratification resolution.

Law reform in Australia does not need to and is not proposed by this Thesis in Chapter 8 to extend to a wide interference in the private property rights of all shareholders. That level of interference would exceed the minimum law reform required to address the key criticisms and uncertainties of the doctrine whilst retaining the benefits of the doctrine.

**Risks arising from the current law**

As discussed in Chapter 4, there are aspects of the doctrine which have been significantly criticised and remain uncertain. If legislative reform to the doctrine is not undertaken to address these areas of criticism and uncertainty, those criticisms and uncertainties will continue to give rise to legal disputes between companies, shareholders and directors.

In Discussion Paper No. 11 of the Companies and Securities Law Review Committee,[534] ratification was considered as follows:

> [47] The actuality or possibility of the company in general meeting forgiving or ratifying the breach of duty complained of has been a significant, if not decisive, factor in many cases of members seeking to enforce duties owed to the company, even on occasions when what proceeded on the basis of an action to enforce personal member rights was in reality a derivative action.

The effect of section 239 is a significant legal benefit to minority shareholders and section 232 has been applied to prevent oppression arising from a ratification resolution.[535] These sections avoid the legal uncertainty in the doctrine by limiting the operation of the doctrine. Notably however, there has been no review on the effectiveness of the legislative reforms which have sought to curtail the effect of the doctrine. The focus of this Thesis however is to consider

[534] Companies and Securities Law Review Committee (n 186).

[535] *HNA Irish Nominee* (n 44).

what further limited law reform would be beneficial, not to determine whether there is a statistically significant benefit based on the reported cases in Australia in comparison to other common law jurisdictions.

The policy of permitting only "independent" shareholders to vote highlights a risk in the current law. The issue of whether the power of ratification should be restricted to independent shareholders was not considered until 1990 when the Companies and Securities Law Review Committee released a report titled "Indemnification, Relief and Insurance in relation to company directors and officers".[536] Recommendation 20 of the Report sought to implement a policy of only allowing disinterested shareholders to vote on a ratification resolution. Recommendation 20 was as follows:

> That the question whether a release should be accompanied by ratification of a transaction which was invalid because the director or officer was in breach of duty should be a matter for decision by disinterested members in general meeting. Ratification should be the subject of a resolution separate from any which releases a director or officer from civil personal liability. The pre-meeting disclosure about the proposed ratification should provide information as to why it will be for the benefit of the company that the transaction should be ratified. (*emphasis added*).

The policy basis of Recommendation 20 was not discussed in the report, however, such an approach seeks to impose a practical limitation upon the ability of a director/shareholder to vote to approve a ratification resolution in respect of their own breach of duty which is the most significant criticism of the operation of the doctrine.

In the years following the legislative reforms to the doctrine in the United Kingdom in 2007, as discussed in Chapter 6, there were two reported judgments concerning the ratification of a breach of fiduciary or statutory duty in the context of section 239 of the *Companies Act 2006* (UK) and neither case was appealed. In the twelve years prior to the legislative amendments

[536] Companies and Securities Law Review Committee (n 37).

in 2007 there were eleven reported cases in the United Kingdom concerning ratification of breaches of a director's duties. Only two of those cases were appealed.

There have been no reported inquiries or studies into the effect of the amendments to the operation of the doctrine in the United Kingdom, so it is unclear whether the legislative reforms have been effective in either preventing directors seeking ratification of a breach of duty, or whether the reforms have resulted in limiting legal disputes following the approval by the shareholders of a ratification resolution because the law has clarified aspects of the doctrine which could have been the subject of a legal dispute.

The number of reported cases both prior to and following the legislative reforms is not statistically significant because of the small sample sizes, however there is a weak trend emerging that the legislative reforms to the doctrine have been successful in reducing legal disputes proceeding to a court for determination.

**Risks of continued 'sharp' practices**

A major shareholder who is also a director can seek to use the doctrine to approve a ratification resolution where they form a majority of the votes exercisable at a general meeting of the shareholders.

In the event of a valid ratification resolution, the company is exposed to the risks of 'sharp' practices which include, for example; the sale of assets to a director based on a low market valuation, the purchase of an asset from a director based on a high market valuation, or the entry into a commercial transaction with an associate which is strongly weighted in favour of the associate such as a long term expensive lease or hire of equipment.

The risk of a director using the doctrine to obtain a private benefit for themselves or for an associate must be considered against the extent to which any further legal interference should

be permitted in relation to the right of a shareholder to vote at a general meeting in accordance with their own wishes.

The view that there should be no law reform to the doctrine overlooks the possible risks to companies and their shareholders. Continuing to allow a self-interested director/shareholder to vote to approve a ratification resolution concerning their own breach of duty fails to deal with the most substantial criticism of the doctrine of ratification.

The risk of not addressing which shareholders can vote to approve a ratification resolution will mean that minority shareholders will need to continue to rely on some existing member's remedy, such as proving there was a fraud on the minority, or the conduct of the directors using their voting power was contrary to section 232 of the Corporations Act.

Accordingly, a failure to directly address the voting power of a self-interested director/shareholder by statute will continue to inhibit meritorious shareholder actions by virtue of the fact that a director/shareholder can continue to vote to approve the ratification of their own breach of duty.

**Economic risks**

There has been no economic study of the effect of any change to the Corporations Act or its counterparts in the other jurisdictions considered by this Thesis in relation to the doctrine. There are economic benefits to maintaining the doctrine in its current form. One benefit includes the community avoiding litigation costs concerning new legislative measures. However, there are also economic risks. The economic risks discussed below are divided into two categories, investment risks for potential shareholders and the loss of shareholder value.

***Investment risks for potential shareholders***

Investment risk for Australia is one dimension to the policy risks of not reforming the doctrine of ratification. Australia is a part of a global economy and the system of law in a country represents an element of risk to an investor because the application of the law in one country may be very different from another country.

As is discussed in Chapter 6, Australia is a common law country which has currently not adopted statutory reform of the doctrine of ratification, whereas the United Kingdom and New Zealand have each undertaken specific legislative reform to the doctrine. Only independent shareholders can vote on a ratification resolution in the State of Delaware in the United States of America and in Canada. If investors are wary of investing in companies in a particular jurisdiction, then the result is that there is less economic activity in that jurisdiction. The risks cannot be quantified because there is no reported analysis of the economic effects of the change to the law in any of the jurisdictions considered by this Thesis, in particular, New Zealand and the United Kingdom.

***Loss of shareholder value***

An underlying assumption of the Corporations Act arising from shareholder primacy theory is the maximisation of shareholder value by the directors. There has been no economic study of the economic consequences of the doctrine, however, there are plain connections between a director's conduct and the loss of shareholder value. A simple example is provided to highlight this connection.

Imagine a corporation with global sales which decides to move all of its manufacturing to one country for the benefit of one director. It is marginally cheaper for the company and greater profits can be made but the director is able to make substantial personal profits from the new factory. Soon after, for longer than 6 months, the company's supply chains are severely interrupted causing the financial collapse of the company. What if the decision of the directors to move the factory resulted in the loss of shareholder value and a ratification resolution was approved?

The approval of the ratification resolution in the above example could result in a total and permanent loss to the company and a proportionate reduction in shareholder wealth.

Limited law reform to the doctrine by preventing a self-interested director from voting to approve a ratification resolution could reduce the economic risks which are faced by companies when directors breach their duties to a company, however, there is no analytical data available to establish whether there are any substantial economic risks.

## G. *What limited law reform should be made to the doctrine?*

In light of the benefits of the doctrine discussed in Chapter 3, the criticisms and the uncertainties considered in Chapter 4, the possibility of attenuation of a director's statutory duties discussed in Chapter 5, the corporate law reforms to the doctrine in other common law jurisdictions discussed in Chapter 6 and the foregoing discussion above in this Chapter in support of limited law reform to the doctrine, the reforms to the Corporations Act should seek to achieve the following four objectives.

Firstly, it is necessary to circumscribe what conduct of a director will be capable of ratification, authorisation or attenuation under the new proposed section to limit as far as possible the legal arguments about the scope of the section. This will not modify the existing law with respect to what conduct of a director is ratifiable.

Secondly, to define which shareholders are excluded from voting on a ratification, authorisation or attenuation resolution to define a group of "independent" shareholders. There are two central principles for the proposed law reform. Firstly a person shall not derive an advantage from their own wrong and secondly that a director must act in the best interests of and avoid conflicts of interest to the company. Those principles give rise to proposed law reforms which exclude a director/shareholder from voting on a ratification resolution which concerns their own conduct. To limit the influence of a director/shareholder, their immediate

family members and the director's associates are also excluded from voting to approve a ratification resolution. The interference with private shareholder rights is limited to the shareholders within the statutory definition.

The interference with a director/shareholder's right to vote (and their family and associates) on a ratification, authorisation or attenuation resolution ensures as far as possible a decision on the merits by "independent" shareholders. The statutory definition of which shareholders are excluded is necessary because it defines which shareholders are "independent". The definition of the persons excluded from voting allows the shareholders and the chairperson of a shareholders' meeting to determine which shareholders are entitled to vote. Challenges to a shareholder's right to vote can be determined at the general meeting by the chairperson without the need to commence legal proceedings. Any decision of the chairperson can be appealed to a court. A shareholder could also obtain a declaration from a court that it will be entitled to vote on a ratification resolution.

Thirdly, to maintain the *Duomatic* principle for the primary benefit of small companies. Companies should be entitled to take advantage where possible of the informal unanimous assent of the shareholders since there is no minority which can be affected by the ratification.

Fourthly, to allow the shareholders to impose additional requirements for a valid ratification, authorisation or attenuation resolution or to prohibit that ratification, authorisation or attenuation. This approach ensures that existing or future protections agreed by shareholders in the company's constitution or a shareholders' agreement are not affected by the reform to the doctrine. Such an approach would preserve the existing agreements of the shareholders as there does not appear to be a proper reason to interfere with pre-existing legal arrangements which would have the effect of further limiting the operation of the doctrine in excess of the law reforms proposed by this Thesis.

Each of those objectives provides guidance for the draft legislative amendments which are set out in Chapter 8.

## H. *The benefits of limited law reform*

The review of the Acts and common law of the jurisdictions considered in Chapter 6 demonstrated that the doctrine can be meaningfully maintained without a loss of the benefits of the doctrine as discussed in Chapter 3. However, the operation of the doctrine would be improved by addressing the primary legal problem that a director, together with their family and associates may have voting control at a general meeting of the shareholders to approve a ratification resolution for the director's benefit.

The legislative amendments in the United Kingdom are the best example of the jurisdictions discussed in Chapter 6 of how law reforms can be effectively implemented for the benefit of minority shareholders. The limitation of the right of a director and persons connected with them to vote on ratification resolutions was clearly defined and extended only to persons judged to be likely to be influenced by the director who was in breach of their duties to the company. The policy of allowing only independent shareholders to vote on a ratification resolution did not extend to a director who was not in breach of their duties to the company. Accordingly, each other director/shareholder retained the right to vote on a ratification resolution.

When only independent shareholders can vote, there is a much greater likelihood that those shareholders will exercise their powers for the benefit of the company because those shareholders' interests are more likely to be aligned with the best interests of the company and not the narrower interests of an individual director. There will be situations, for example during a hostile takeover bid when new shares are issued, in which independent shareholders may consider the conduct of the directors was beneficial to the company and in consequence approve a ratification resolution notwithstanding the issuance of the shares was a breach of duty to the company. This example highlights that there can be conduct of the director in breach of their duties which is ratified because the conduct was considered to be beneficial to the company by a majority of shareholders.

The use of a statutory definition to exclude certain shareholders from voting on a ratification resolution establishes a generalised approach to modifying the operation of the doctrine. The

use of a general rule applicable to all companies governed by the Corporations Act is beneficial for a number of reasons. Firstly, a general rule is more likely to be easily applied than a rule which includes exceptions to the rule. This is desirable for small proprietary limited companies because of the prevalence of the use of companies for conducting commerce in Australia recognising that the directors may not be highly educated and the fact that small companies would not generally budget for legal expenses.

Secondly, section 15AA of the *Acts Interpretation Act 1901* (Cth) promotes an interpretation which supports the purpose or object of a provision over an interpretation that does not promote the provision's purpose or object. It will be more readily determined by a court from a generalised rule what the purpose of the rule is in contrast to a provision which provides for exceptions to a general rule. This will be important when more than one construction arises from the words of the provision.[537] Clearly, resort to section 15AA of the *Acts Interpretation Act 1901* (Cth) will only be required if the provision could have more than one meaning such as where the literal approach and purposive approaches to statutory interpretation produce different results.

One objective of the limited law reform is to ensure there are clear definitions of which shareholders can vote on a ratification resolution to limit future disputes. By way of example, as was demonstrated in the United Kingdom, there may be a legal and/or factual question whether a particular shareholder is eligible to vote on a ratification resolution. In that instance, this is a new category of controversy between a director and a shareholder, however, provided that the proposed definition is drafted carefully, the number of disputes should overall reduce following the amendments to the Corporations Act as appears to be the experience in the United Kingdom since 2007. This type of dispute is likely easier to quell than disputes about the equitable limitations of the doctrine which are not always easy to determine.

A further likely benefit is the avoidance of the need to resolve each of the criticisms and uncertainties of the doctrine discussed in Chapter 4. The case law in the United Kingdom which was discussed in Chapter 6 indicates that the only substantive question since the law

[537] *Mills v Meeking* (1990) 169 CLR 214.

was reformed in the United Kingdom in 2007 for determination was whether a shareholder was prohibited from voting on a ratification resolution. The United Kingdom appear to have avoided the need to determine legal disputes about undetermined common law aspects of the doctrine.

The economic benefit arising from the proposed law reforms for minority shareholders, companies or generally for Australia arising from foreign investment is likely to be very difficult to measure because the operation of the doctrine in Australia has been significantly curtailed by previous legislative reforms to the Corporations Act. Those benefits may also be unable to be estimated because the law reforms which define the persons excluded from voting on a ratification resolution are in part designed to reduce the number of disputes between shareholders and directors. However, it is important to note that there is no evidence of analysis of the economic benefits or economic risks which arose from any of the law reforms of the jurisdictions discussed in Chapter 6.

### I. *The risks of limited law reform*

Any law reform to the Corporations Act will require corporate actors to understand those changes and to adapt their behaviour. Any law reforms should not go beyond what is necessary to achieve their stated purpose and be easy to apply so as to limit the possibility of legal disputes.

The proposed amendments to the Corporations Act should achieve the four objectives referred to above and not have unforeseen or unintended consequences. As was discussed in Chapter 6 in connection with the limited law reform in New Zealand, there is the risk that the legislation is ineffective to achieve its stated purpose. Similarly, if the legislation results in unintended consequences, minority shareholders might be left in the same or worse position than before. Consequently, there is a need for careful consideration of all of the issues arising from any amendment to the Corporations Act.

One rule which is easy to apply is to exclude shareholders by clear definitions. In relation to which shareholders should be excluded from voting to approve a ratification resolution, there is always the risk that the scope of the definition of excluded shareholders is criticised to be too narrow or too broad. There is no simple answer to the policy question of which shareholders should have been excluded from voting because the answer is inevitably affected by subjectivity. It is argued however by this Thesis that the proper scope of which shareholders are excluded from voting is informed by the amendments to the law in the United Kingdom and previous cases which have demonstrated that family members and business associates are likely to be aligned with the interests of related or associated director/shareholder.

For example, there is no single answer to whether an adult child of a director would in all cases vote to approve a ratification resolution for the sole benefit of their parent. Whilst a long family relationship is likely to be an influencing factor in many situations, the shareholder's economic interests may be paramount in many other situations. Neither of those may be the prevailing factor for a shareholder in their decision to vote in favour or against a ratification resolution. There is clearly no simple analysis which would predict how an adult child may vote.

A rule which utilises definitions will establish a generalised approach for all companies based on the definitions. No rules of special application would apply to some companies and not others. The adoption of this generalised approach will for practical purposes embed a significant and far reaching change to the application of the doctrine.

The possible longevity of a general rule could cause greater problems than it solves. For example, the general rule assumes that it is beneficial for companies that certain defined persons not be entitled to vote on a ratification resolution. The assumption arises in the historical context of how it is generally understood that people could be influenced to vote according to their relationships and the history of problems with the doctrine discussed in this Thesis. Those assumptions could in the future be found to be incorrect and the effect of the rule is having a negative consequence for companies. There is no reason in the future however why the generalised rule could not be modified to suit the changes in society.

If the view was adopted, as is the case in the United Kingdom, that immediate family members are excluded from voting, this ensures that those shareholders neither vote in favour or against a ratification resolution. By prohibiting the right to vote, the law promotes the policy objective of only allowing independent shareholders to vote on a ratification resolution.

Whichever formulation is ultimately adopted for the exclusion of some shareholders, it may result in directors which have concerns about their conduct taking steps to ensure that shares are owned by non-excluded persons at the time of the general meeting of the shareholders. The risk that shares can be transferred by anyone determined to defeat the statutory restrictions is not evident from the any of the cases considered by this Thesis.

This discussion has highlighted that there are identified risks from the proposed law reforms. The risk of a broad or narrow definition of an excluded shareholder is a neutral risk because it limits certain shareholders voting in favour and against a ratification resolution. The benefits however of limited law reform discussed in this Chapter indicate that minority shareholders obtain a direct benefit by the exclusion of a director/shareholder and their family members and business associates. The risk of new legal questions arising should be controlled by the use of clearly defined persons who are excluded from voting on a ratification resolution.

## J. *Conclusion*

Law reforms to the Corporations Act which enacted the statutory derivative action[538] and statutory oppression remedy[539] were effective to limit the role of the doctrine in the context of ratification of breaches of a director's duties to a company. Those law reforms however failed to directly address the concern that a director/shareholder is entitled to vote on a ratification resolution in respect of their own breach of duty to the company. Outside of the voting restrictions for related parties of public companies under Chapter 2E, Australian corporate law policy as a result does not consider which other shareholders should be prohibited from voting on a ratification or approval resolution.

[538] *Corporations Act 2001* (Cth) Part 2F.1A.
[539] *Corporations Act 2001* (Cth) Part 2F.1.

It was argued in this Chapter that the benefits of limited law reform to the Corporations Act outweigh the risks of those proposed reforms for a number of reasons.

Firstly, whilst it remains sensible to allow shareholders the right to ratify a breach of a director's duty, restricting the right to vote of the director/shareholder in breach allows the independent shareholders to determine whether a ratification resolution is in the best interests of the company.

Secondly, adopting a corporate law policy restricting some shareholders from voting is consistent with the law reforms in the United Kingdom and the interpretation of the law in the State of Delaware in the United States of America and Canada.

Thirdly, there may be economic benefits for companies arising from a shift in corporate law policy. For example, there could be a positive effect for companies raising capital. There should also be fewer disputes between directors and shareholders and in many instances the disputes will very likely be determined by a chairperson appointed at a shareholders' meeting.

The four objectives set out in this Chapter establish the basis for the draft legislative amendments which are discussed in the next Chapter.

## CHAPTER 8 – PROPOSALS FOR LAW REFORM

### A. *Introduction*

This Chapter draws together the issues addressed by Chapters 2 to 7 and provides proposals for limited law reform to the Corporations Act to (i) retain the benefits of the doctrine discussed in Chapter 3 and (ii) limit the scope of the operation of the doctrine by addressing the key problems discussed in Chapter 4.

It is important to recall from Chapter 2 that the statutory derivative action was, in part, enacted to relieve the prejudice which arose from circumstances where minority shareholders were unable to commence proceedings by reason of the rule in *Foss v Harbottle*.[540] It is therefore consistent with previous corporate law reforms concerning the doctrine that statutory reforms to the Corporations Act be undertaken to further protect the rights of companies and minority shareholders.

In Chapter 3, it is recognised that the doctrine is beneficial because it performs important functions including allowing shareholders to vote on a ratification resolution, the doctrine provides a counterbalance against breaches of duty by honest directors and the doctrine may protect third parties dealing with companies if they must rely upon a prospective authorisation of a breach of fiduciary duty. Whilst the benefits of the doctrine provide a sound argument for retaining the doctrine, Chapter 4 identified significant problems with the doctrine. The primary problem with the doctrine is the right of a director/shareholder to vote on a ratification resolution with respect to their own breach of duty.

Limited statutory law reform to the Corporations Act would provide a means to eliminating or reducing the identified problems, while retaining the benefits of the doctrine. Statutory law reform is also considered essential to reform the operation of the doctrine because arising from

at least the decisions in *Spies v The Queen*,[541] *R v Byrnes*,[542] *Macleod v The Queen*,[543] and *Angas Law Services*,[544] the courts have not narrowed the operation of the doctrine in Australia. Accordingly, it would be incumbent on the Commonwealth Parliament to amend the Corporations Act with respect to the doctrine of ratification.

There are two significant points about the right of a shareholder to vote at a general meeting. Firstly, unlike directors under section 181(1) of the Corporations Act and the equivalent fiduciary duty, shareholders are generally not under a duty to act in good faith in the best interests of the company and for a proper purpose, with respect to either the company or to any other shareholder. Secondly, there is conflicting authority that a shareholder is subject to an implied limitation that their power is to be exercised in good faith in the best interests of the company.[545] Both of these matters draw attention to the right of a shareholder to vote to approve a ratification resolution. As discussed in Chapter 1, the right of a shareholder to vote in their own interests conflicts with other principles of law, however, it has been retained subject to common law and equitable limitations.

As identified in Chapter 5, the question of whether shareholders of a company can legally attenuate a director's statutory duties remains unresolved in Australia. If that is possible, neither a company, its minority shareholders nor ASIC would be able to seek a remedy for misconduct of the directors to the extent that a director's statutory duty was attenuated.

The law in the jurisdictions considered in Chapter 6 demonstrated that the benefits of the doctrine can be retained whilst narrowing the operation of the doctrine. The use of clear definitions to exclude certain persons from voting can reduce legal disputes and the limited law reform may have an economic benefit. The fact that an economic benefit was not identified as

[541] [2000] HCA 43.
[542] (1995) 183 CLR 501.
[543] (2003) 214 CLR 230.
[544] *Angas Law Services* (n 5).
[545] Compare *Ngurli Ltd v McCann* (1953) 90 CLR 425 and *Bamford* (n 6). See Austin and Ramsay (n 26) 'The limits to the general meeting's power to ratify' [8.390].

a basis for law reform was not a barrier to the Parliament of the United Kingdom modifying the operation of the doctrine in 2007.

It was also identified that law reform can have unforeseen and unintended consequences arising from poor drafting, or when definitions are too narrow or too broad leaving minority shareholders with the same risks the legislation sought to avoid. Moreover, any legislative definition once implemented could give rise to directors ensuring a person is not excluded from voting by transferring shares to non-excluded shareholders. Those issues do not significantly detract from statutory law reform to the Corporations Act to address the policy issues evident with the existing scope and operation of the doctrine.

Chapter 6 addressed the approaches in other common law countries to all of the issues raised in Chapters 2 to 5. Significantly all jurisdictions adopted some form of statutory law reforms in relation to the doctrine. New Zealand's statutory reforms were largely intended to codify the existing scope and application of the doctrine. The law reform in New Zealand preserved a self-interested director's right as a shareholder to vote on a ratification resolution. The United Kingdom was the only country to adopt statutory reforms permitting only independent shareholders to vote on a ratification resolution by following the interpretation of the law in the State of Delaware in the United States of America and Canada. While section 239 of the *Companies Act 2006* (UK) still has a number of identified deficiencies, Chapter 6 concluded that the law reforms in the United Kingdom adopted the best policy to directly address the 'sharp' practice of a company director voting to ratify their own conduct which was in breach of duty.

Chapter 7 of this Thesis evaluated the conflicting policy arguments concerning law reform to the doctrine of ratification. Based on the four objectives discussed in Chapter 7, this Chapter will now consider what specific law reforms to the Corporations Act would address the identified criticisms and legal uncertainty to companies and their minority shareholders. This Chapter will also consider whether the proposed reforms are consistent with the existing framework of the Corporations Act.

## B. ***Proposed new section modifying the doctrine of ratification***

It is proposed that a new section be inserted into a new Division under Part 2D.1 of the Corporations Act (Duties and Powers) to implement new voting restrictions affecting directors and in general terms, their close family members and the director's associates.

One basis for proposing in this Thesis an amendment to the Corporations Act is that the problems identified have a public policy dimension. By way of example, section 180 of the Corporations Act has been described as *'normative and its burden is a matter of public concern not just private rights'*[546] and a previous equivalent statutory duty was expressed to encompass *'again a recognition that the duty to be discharged by a director was a matter of "public concern" and properly to be regarded as a matter of public law, not just a matter of the law of private rights and obligations between directors and the company inter se.'*[547]

One further basis for amending the Corporations Act and not merely recommending constitutional amendments to company shareholders, is that at least 75% of shareholders of a company would be required to amend the company's constitution. Accordingly, unless there is significant support for implementing a new or amended constitutional provision dealing with ratification resolutions, no change will result. An amendment to the Corporations Act achieves changes for the benefit of both proprietary and public companies from the date of commencement of the amendment without the need for a constitutional amendment to be approved by the shareholders.

The proposed section is first presented in this Chapter and then the interpretation of the proposed section is discussed. This Thesis does not propose the specific number of the new Division, or the section number for insertion into the Corporations Act.

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[546] *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52, [27], [131], [141] (Greenwood J) citing with approval Langford (n 301), 490-492; Geoffrey Nettle, 'The Changing Position and Duties of Company Directors' (2018) *Melbourne University Law Review* 13,1408.

[547] *Cassimatis v Australian Securities and Investments Commission* [2020] FCAFC 52, [140] (Greenwood J, Rares J agreeing [240]).

The proposed section is set out below as follows:

(1) Notwithstanding anything contrary to this section in a constitution of a company, a contract or in a deed, an excluded person must not vote on a matter being considered at a general meeting of a company which concerns:

(i) the authorisation or ratification of:

a. conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company;[548] or

b. the exercise of a power by a director;[549]

(ii) the attenuation of a duty of a director; or

(iii) a release, forbearance to sue or settlement of a claim in relation to:

a. conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company; or

b. the exercise of a power by a director.[550]

(2) For the purposes of this section:

'excluded person' means:

(i) each director whose conduct is being considered under subsection (1);[551]

(ii) a connected person or connected entity of a director within the meaning of subsection (2)(i); or

(iii) a partner, trustee, trustee in bankruptcy, executor or legal personal representative of an excluded person but excluding any trustee of an employee share scheme.

'associated entity' has the same meaning in section 50AAA.

'conduct' includes acts and omissions.[552]

[548] See to the same effect *Companies Act 2006* (UK) s 239(1).
[549] *Companies Act 1993* (NZ) s 177(1).
[550] *Companies Act 1993* (NZ) s 177(1).
[551] Noting a director necessarily includes a shadow director or a de facto director. Section 120(5) Canada Business Corporations Act , RSC 1985, C-44only restricts the director who is giving disclosure.
[552] The equivalent sub-section in the United Kingdom is *Companies Act 2006* (UK) s 239(5).

'director' has the same meaning in section 9 and includes a former director.[553]

'connected entity' means:

(i) if the company is a public company, a related party of a director within the meaning of subsection (2)(i);
(ii) an entity controlled by an excluded person;[554]
(iii) an associated entity of a director within the meaning of subsection (2)(i);

'connected person' means a spouse, parent, child or step-child of a director within the meaning of subsection (2)(a)(i).

'control' has the same meaning in section 50AA.

'related party' has the same meaning in section 228.

(3) This section does not prevent an excluded person from attending, being counted towards the quorum or taking part in the proceedings at any meeting at which the decision is considered.[555]

(4) This section does not limit any other enactment or rule of law.[556]

(5) If any votes on the resolution are cast in contravention of subsection (1), it must be the case that the resolution would still be passed even if those votes were disregarded.

(6) The ratification or authorisation under this section of the conduct or the exercise of a power by a director does not prevent a court from exercising a power which might, apart from the ratification or authorisation, be exercised in relation to the conduct of the director.[557]

(7) A person contravenes subsection (1) if they are:

(i) an excluded person who votes on a matter concerned with subsection (1); or
(ii) involved in a contravention of subsection (1).[558]

[553] The equivalent sub-section in the United Kingdom is *Companies Act 2006* (UK) s 239(5).
[554] The term 'control' is defined by section 50AA of the *Corporations Act 2001* (Cth).
[555] The equivalent sub-section in the United Kingdom is *Companies Act 2006* (UK) s 239(4).
[556] The equivalent sub-section in the United Kingdom is *Companies Act 2006* (UK) s 239(7).
[557] The equivalent sub-section in New Zealand is *Companies Act 1993* (NZ) s 177(3).
[558] See *Corporations Act 2001* (Cth) s 209.

(8) If the company contravenes subsection (1), the company is not guilty of an offence and the contravention does not affect the validity of any contract or transaction connected with the giving of a benefit.

(9) A person commits an offence if they contravene or are involved in a contravention of subsection (1) and the contravention or involvement is dishonest.[559]

(10) The company has the legal and evidential burden to establish that a resolution was validly approved by its members.

Note 1: This section is a civil penalty provision (see section 1317E).

Note 2: Section 79 defines *involved*.

## C. *Interpretation of the proposed section*

### Rationale and applicability of the proposed section

The proposed section deals directly with the problem of a director and their close family or associated entities voting as shareholders to approve a ratification, authorisation or attenuation resolution concerning the director's breach of duty.

The proposed section will apply to proprietary and public companies. Currently, only public companies must under Part 2E.1 of the Corporations Act obtain shareholder approval when giving a financial benefit to a related party[560] (including a director) of the public company. Section 224 of the Corporations Act provides corporate law policy guidance concerning which shareholders are unable to vote on a resolution under Division 3 of Part 2E.1 of the Corporations Act. This Thesis adopts the policy underlying section 224 and is used as a basis for establishing the definition for a person excluded from voting under the proposed section. It is also beneficial to have regard to the law in the United Kingdom for corporate law policy guidance on which shareholders are prohibited from voting on a ratification resolution. There

[559] See *Corporations Act 2001* (Cth) s 209.
[560] *Corporations Act 2001* (Cth) s 228.

is academic support for adopting the law reforms to the *Companies Act 2006* (UK) concerning the doctrine.[561]

Whilst regard is given to the United Kingdom corporate law policy, it is essential that the definitions currently contained in the Corporations Act are used for a number of reasons. Firstly, there are many differences between company law in the United Kingdom and Australia with both the use of terms and their defined meanings. Secondly, Australia has developed a body of law concerning defined terms such as 'related parties' and 'associate' and, accordingly, the use of these definitions will limit the need for additional statutory interpretation of the proposed section.

The proposed section is not a replaceable rule and, accordingly, the directors of all companies governed by the Corporations Act must comply with the proposed section. If the proposed section were to be a replaceable rule, there would be no guaranteed minimum requirement for the approval of a resolution which would (as established by proposed subsection (1)) firstly approve, or ratify certain conduct of a director of a company, secondly, attenuate a director's statutory duties or thirdly release or settle a claim of a director of a company (hereinafter referred to as the '**Excluded Matters**' for the purposes of this Chapter). For clarity in relation to the use of the term 'independent shareholder' in this Chapter, this is a reference to a shareholder who is not an excluded person within the meaning of subsection 2.

Arising from the *obiter dicta* in *Westfield Management Limited v AMP Capital Property Nominees Limited*,[562] a company or a person would be unable to contract out of the proposed section because the effect of contracting out would be to override the purpose and policy of the proposed section.

A significant benefit of proposed subsection (1) is that an aggrieved shareholder could as a result of an alleged contravention of subsection (1) apply for the grant of an injunction. An

[561] Langford (n 25), 150-151.
[562] [2012] HCA 54, [39] (French CJ, Crennan, Kiefel and Bell JJ).

injunction under section 1324 of the Corporations Act is available if an excluded person votes on a ratification resolution in contravention of the Corporations Act.[563] An injunction granted prior to a shareholders' meeting (in the case of threatened conduct) would at a minimum prevent shareholders considering the proposed resolution and an injunction granted after a shareholders' meeting would at least prevent further steps being taken following the alleged approval of a resolution.

**Preservation of the doctrine in a modified form**

The proposed section has been drafted to preserve the existing law concerning the doctrine of ratification in recognition of its significant benefits to companies governed by the Corporations Act. This Chapter discusses any differences from the common law as a result of the proposed section.

**No retrospective operation of the proposed section**

It is not proposed by this Thesis that the proposed section operate retrospectively.

If the proposed section was to apply retrospectively, it would be arguable that a previously valid resolution is now invalid because the proposed section establishes procedural requirements which limit or restrict ratification and that procedure was not adopted at the time of the approval of the resolution. If that is correct, retrospectivity of the section could revive a cause of action for a company and separately, a director having given consideration for a release may no longer be protected by the resolution.

**Certain shareholders restricted from voting**

Proposed new subsection (1) restricts an 'excluded person' (as defined by proposed subsection (2)) from voting on a resolution concerning the Excluded Matters (ie. the matters in subsection

[563] *Corporations Act 2001* (Cth) s 1324(1)(a).

(1)(i) to (iii)). This applies to all resolutions on an Excluded Matter to be considered by the shareholders in general meeting.

A significant benefit of subsection (2) is that it will overturn the common law on the right of all shareholders to vote on a ratification resolution.

The definition of ‘excluded person’ is restricted by the use of the word 'means' (and not 'includes') and seeks to implement a public policy of permitting only shareholders which are independent of the directors, their close family and associated entities to vote on resolutions which concern any Excluded Matters. There are examples of the use of such a corporate law policy in the Corporations Act including in connection with directors of proprietary companies under section 194 (Voting and completion of transactions—directors of proprietary companies), directors of public companies under section 195 (Restrictions on voting—directors of public companies only), section 224 (Voting by or on behalf of related party interested in proposed resolution) and in connection with Responsible Entities under section 253E (Responsible entity and associates cannot vote if interested in resolution).

Only the director and persons or entities connected with the director are excluded persons as defined by subsection (2). By way of example, if a director were a spouse of another director, the spouse would be excluded from voting on a resolution concerning the director even if they are not alleged to be in breach of any duty to the company. The purpose of excluding certain shareholders from voting on a resolution concerning an Excluded Matter is to recognise firstly that the director/shareholder has a conflict of interest between the interests of the company and their personal interest and secondly, to recognise that close family members, business associates and entities controlled by those persons are less likely to vote impartially on a resolution which concerns the director. Finally, the definition of excluded persons seeks to obviate the possibility that a number of people may be acting together for a common purpose, a concept which concerns the definition of a related party under section 228(7) of the Corporations Act.

A generalised rule can have negative consequences because of its inability to cater for special situations. For example, two directors/shareholders who were married are later divorced. Each director/shareholder would after the divorce now be entitled to vote on a ratification resolution for the other director/shareholder. If the divorce were acrimonious, in all likelihood the director/shareholder would vote against the approval of a ratification resolution for the other director/shareholder. In this present scenario, there would be a temptation to simply amend the definition of 'excluded person' to include a *former* spouse to seek to avoid the scenario. The result of such an amendment would be that no shareholder has a right to vote. The outcome is contrary to the purpose of the proposed section because ratification becomes prohibited and not merely limited to approval by the independent shareholders. Thereby the director/shareholder and the company would lose the possibility of a ratification resolution being approved.

The definition of 'excluded person' has been defined in the present tense, consistent with the law in the United Kingdom. This approach is consistent with the definition of 'closely related party', 'immediate family member' and 'spouse' pursuant to section 9 of the Corporations Act.

The definition of 'excluded person' does contain some differences from the law in the United Kingdom, as explained below.

Firstly, there is no equivalent of an 'enduring family relationship' under the Corporations Act. The definition in the United Kingdom deals with a third category of relationship which is different from a spouse or a de facto spouse[564] and these relationships are not defined by their length although the duration of the relationship is a relevant factor in determining whether there is an enduring family relationship.[565] If the proposed section was to adopt a new category of family relationship, it would create uncertainty in the definition of an 'excluded person' and the uncertainty could only be resolved on a case by case basis. This Thesis' concern of greater uncertainty was not a concern in the United Kingdom when the *Companies Act 2006* (UK) was enacted because a body of case law had developed from the prior enactment of the *Protection*

[564] See the *Human Fertilisation and Embryology Act 2008* (UK) which concerns surrogacy arrangements.
[565] P & B v Z [2016] EWHC 1594, [28] (Russell J).

*of Children Act 1978* (UK) (addressing the exploitation of children), the *Adoption and Children Act 2002* (UK) (addressing adoption by unmarried persons and same-sex couples) and *The Civil Partnership Act 2004* (UK) (which addressed legal rights for persons in same-sex relationships).

There is no difference between the proposed section and the definitions applied in the United Kingdom to exclude a spouse, de facto spouse (including in the context of same-sex married and de facto couples) and any children of the spouse or de facto spouse.

Secondly, the United Kingdom has adopted a control test of 20% for a 'connected body corporate' to determine whether an entity is controlled by a director together with other connected persons. To ensure that the proposed section adopts as far as possible the existing definitions of the Corporations Act, proposed subsection (2) defines 'connected entity' to mean firstly in relation to public companies, a related party of the relevant director under section 228 of the Corporations Act and secondly in relation to private companies, an entity controlled by an excluded person (by reference to section 50AA of the Corporations Act), or an entity associated with the relevant director (by reference to section 50AAA).

The proposed section is broader that the law in the United Kingdom because trustees of pension schemes are not excluded from the definition of excluded person. It is commonplace in Australia for a person to establish a self-managed superannuation fund. The Australian Taxation Office reported that as at 30 June 2017, self-managed superannuation funds held 30% of the total superannuation assets for 1.1 million people[566] and generally all working adults have superannuation controlled by trustees. Accordingly, there is a higher risk represented by the use of this type of entity by an excluded person. Whether the trustee of a superannuation fund is a connected entity depends upon who are the persons controlling the fund.

[566] Australian Taxation Office, 'SMSF Segment Review' (Webpage, 23 May 2021) <https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/super-statistics/smsf/self-managed-superannuation-funds--a-statistical-overview-2015-2016/?page=2>.

Although 'excluded person' is broadly defined, the definition does not extend to a person who may become a de facto partner or spouse, or generally any parent-in-law, grandparent, grandchild, sibling, aunt, uncle, niece, or nephew unless any of those persons are related parties of a public company under section 228 of the Corporations Act.

Under the law in the United Kingdom any receiver, receiver and manager, administrator, or liquidator, of a connected entity may be permitted as a controller of the shares of a company to vote on a ratification resolution. Under the law in the United Kingdom, the definition of a body corporate connected with a director turns on a question of the relevant interest in shares of the director and persons connected with the director, not whether the directors or other controllers of the company are themselves connected with the director.[567]

It is unclear under the law in the United Kingdom whether a trustee in bankruptcy, executor or legal personal representative of a person would be a person connected with a director.[568] The question could arise for example in the context of a deceased director who acted in breach of their duties to a company. The issue of whether these persons are connected persons has not arisen in any proceedings for determination.

To avoid the possibility of an interpretation of the proposed section that any such person appointed to the position of trustee in bankruptcy, executor, or legal personal representative for an excluded person is considered not to be an excluded person, the definition of excluded person expressly states that these appointed persons are also excluded persons. This approach is consistent with section 224(1) of the Corporations Act which excludes a vote being cast 'by or on behalf of (a) a related party of a public company to whom the resolution would permit a financial benefit to be given or (b) an associate of such a related party.'

The proposed section relies upon section 249X(1) of the Corporations Act which prohibits the appointment of proxies by a person who is not entitled to vote. Any proxy of an excluded

[567] *Companies Act 2006* (UK) s 254.
[568] *Companies Act 2006* (UK) s 252.

person is accordingly also an excluded person. In the case of corporate representatives appointed under section 250D(1) of the Corporations Act, the appointment does not permit the body corporate from voting if the body corporate is excluded from voting by reason of subsection (2).

In relation to the definition of 'associated entity' for the proposed section, the Corporations Act excludes from the definition of 'associate' any persons which give advice in a professional capacity or a business relationship, clients of Australian Financial Services Licensees, entities offering a takeover bid and persons appointing people as proxies or representatives in a meeting.[569]

If there is a question at a general meeting of the shareholders whether a particular person is an 'excluded person', the chairperson of the meeting has the power to rule on the question[570] and the meeting can be adjourned for advice to be obtained for the purpose of determining a person's eligibility to vote on a resolution concerning any Excluded Matters. Any shareholder aggrieved by a decision of the chairperson can commence proceedings under section 1322 of the Corporations Act for the purpose of invalidating the decision.[571]

In seeking to achieve the public policy objective of only allowing independent shareholders to vote on resolutions concerning the Excluded Matters, there may be consequential problems which are discussed below.

**Extended definition of director**

[569] *Corporations Act 2001* (Cth) s 16.
[570] *Corporations Act 2001* (Cth) s 250G.
[571] See, eg. *Cordiant Communications (Australia) Pty Ltd v The Communications Group Holdings Pty Ltd* [2005] NSWSC 1005.

The proposed section applies to all directors and all former directors of the company. The definition of 'director' in section 9 of the Corporations Act includes an alternate director, shadow director[572] or de facto director.[573]

The inclusion of former directors is necessary to avoid a situation where a former director is in breach of their duties, but the ratification of those breaches is not subject to the same restrictions and limitations proposed by the section for all *current* directors. By way of example, the proposed section could be obviated by the resignation of a director who was in breach of their duties. The same approach was adopted by section 239(5)(b) of the *Companies Act 2006* (UK).

**Proxy solicitation**

The solicitation of proxies by a director/shareholder to procure the approval of independent shareholders could be utilised by a director/shareholder to increase the number of votes in favour of a ratification resolution.

The issue of proxy solicitation is not dealt with under the ratification law reforms in the United Kingdom. In Australia, whilst there is no special rule governing the authority of directors in connection with proxy solicitation, the heightened risk of confusion between private interests and the best interests of the corporation is a matter of concern for ratification under the proposed section because a director will be unable to rely upon the close family and associated entities voting in favour of an authorisation, ratification or attenuation resolution. It accordingly necessitates particular care where that conduct has the effect of influencing the outcome of a ratification resolution in favour of a director.[574]

There is no clear guiding principle for determining whether proxy solicitation should be permitted or prohibited under the proposed section and accordingly, this Thesis does not

[572] See eg, *Natcomp Technology Australia Pty Limited v Graiche* [2001] NSWCA 120; *Amann Aviation P/L (in liq) v Continental Venture Capital Limited* [2004] NSWSC 228.
[573] See eg, *Chameleon Mining NL v Murchison Metals Limited* [2010] FCA 1129; *White Act (in liq) v G B White* [2004] NSWSC 71.
[574] See eg., *Advance Bank of Australia Ltd v Fai Insurances Australia Ltd* (1987) 9 NSWLR 464, 485 (Kirby P, Glass JA and Mahoney JA agreeing).

recommend any specific proposal. The shareholders of a company could determine the matter in a constitutional provision or in a shareholders' agreement. In relation to whether proxy solicitation could give rise to a legal question, section 232 of the Corporations Act is sufficiently broad because a court can make an order under section 233 in respect of a resolution or proposed resolution which is oppressive to, unfairly prejudicial to, or unfairly discriminatory against a member.

**Contraventions and offences**

Contraventions by excluded persons and persons involved with contraventions are dealt with under proposed subsection (7).

The proposed section is a civil penalty provision[575] and, accordingly, an attempt to contravene the proposed section is taken to have been a contravention of the section[576] and the ASIC can seek a pecuniary penalty order under section 1317G of the Corporations Act. If the proposed section were enacted, section 1317E of the Corporations Act would need to be amended to include the proposed section in the table to section 1317E, which lists all civil penalty provisions.

Subsection (9) establishes an offence where there is a contravention of subsection (1), a person is involved in that contravention and the involvement is dishonest. The offences under proposed subsection (7) do not apply under the *Companies Act 2006* (UK) and *Companies Act 1993* (NZ).

Under proposed subsection (8) the company cannot be guilty of an offence. Such an approach has been adopted under section 209(1)(b) of the Corporations Act (Consequences of breaches) which concerns contraventions by public companies and entities controlled by public

[575] *Corporations Act 2001* (Cth) s 1317E.
[576] *Corporations Act 2001* (Cth) s 1317E(4).

companies of section 208 of the Corporations Act (Need for member approval for financial benefit).

Sections 208 (Need for member approval for financial benefit) and 209 (Consequences of breach) of the Corporations Act would continue to apply with respect to public companies. With respect to the operation of section 209, this ensures the validity of any contract or transaction connected with the giving of a financial benefit is not affected and accordingly, third parties dealing with the company are protected. Subsection (8) extends the protection of contracts and transactions to all companies. This ensures there is no difference in consequences for any underlying contact or transaction between a public company and a private company for the protection of third parties dealing with the company.

It remains open to a shareholder to seek an injunction from a court under section 1324 of the Corporations Act in relation a contravention of the proposed section.

**Scope of Excluded Matters**

The scope of Excluded Matters is broader than the conduct included under the law of the United Kingdom as follows.

*Prospective authorisation*

The words 'authorisation or ratification' in subsection (1)(i) are used to ensure that *prospective* authorisation and *retrospective* ratification of conduct are both within the meaning of the section. This Thesis argues that both prospective and retrospective ratification be subject to the same regulated process which is different from the law in the United Kingdom which is permissive of two different processes for authorisation and ratification.

The inclusion of prospective authorisation ensures that the approval process for a prospective authorisation and a retrospective ratification resolution is the same, as it currently is under common law. There is no justification for diverging from the current single approach.

It has been argued with respect to the position in the United Kingdom that the exclusion of prospective authorisation is problematic because the consequences for the company can at that stage only be predicted, whereas in the case of retrospective ratification, at least shareholders can assess the consequences for the company.[577] The proposed section includes prospective authorisation to avoid the criticism which has been made of the legislation in the United Kingdom.

*Attenuation of duties*

A resolution which concerns the attenuation of a fiduciary or statutory duty is included within the scope of the section. The inclusion of attenuation of a duty is different from all of the jurisdictions included in Chapter 6 and is accordingly a novel aspect of this Thesis. The inclusion of the attenuation of duties is necessary because it is so closely associated with other aspects of the doctrine of ratification that it should be included to ensure, as discussed above for authorisation, there is one uniform process for shareholders to consider resolutions concerning ratification, authorisation or whether a duty ought to be attenuated.

This Thesis proposes by the new subsection (1)(ii) to expressly prohibit the possibility of the attenuation of a director's duty without approval by a majority of independent shareholders.

The proposed section does not affect the operation of section 187 of the Corporations Act, which has enacted modified duties concerning acting in good faith and the best interests of the subsidiary company for the benefit of a director of a wholly-owned subsidiary. It would remain open for the directors of a wholly-owned subsidiary to seek the benefit of a resolution concerning an Excluded Matter for a duty not modified by section 187 of the Corporations Act.

[577] Chivers (n 27) 7.57.

*Exercises of power*

The proposed section deals with conduct which arises from the exercise of a power by a director, a matter which is expressly excluded by the law in the United Kingdom. Including an exercise of power ensures that the company must use the proposed section where, for example, the exercise of the power is (or may be) contrary to section 232 of the Corporations Act. In light of the fact that the approval of a ratification resolution was held to be contrary to section 232 of the Corporations Act in *HNA Irish Nominee*,[578] oppression arising from a ratification resolution can arise in a particular factual situation.

The proposed section includes releases, forbearance to sue and settlements of claims. Each of those matters are within the powers of a board of directors under the Corporations Act.[579] There is a question whether a director requires a formal release from the board of directors for a breach of duty arising from the decision in *Miller*,[580] which has not been expressly overruled in Australia. Accordingly the law is in an uncertain state in Australia. The proposed section however requires that any release be approved by an independent majority of shareholders.

The inclusion of releases, forbearance to sue and settlements of claims has the purpose of protecting the rights of minority shareholders from the possibility that a resolution is proposed to avoid or limit the liability of a director to the company. The law in the United Kingdom expressly preserves the right of a director to settle or release a claim.[581] However this Thesis argues that this would be insufficient to protect a company and minority shareholders in Australia. Although section 199A of the Corporations Act prohibits exemptions and indemnification of a liability owed to the company, that section does not prohibit a deed

[578] *HNA Irish Nominee* (n 44).
[579] See, eg. *Eastland Technology Australia Pty Ltd v Whisson* [2005] WASCA 144 which concerned the grant of a release to a former director.
[580] *Miller* (n 87).
[581] *Companies Act 2006* (UK) s 239(6).

releasing a director from a breach of fiduciary duty or the company agreeing to a forbearance from commencing proceedings against a director.[582]

Including a release in the proposed section is beneficial because parties may be able to avoid this legal issue. Agreements for the forbearance against a suit and settlement of claims (or generally compromises of claims) are in the same categories of matters as a release. Each of these matters is within the power of the board of directors and accordingly, this Thesis proposes to narrow the powers of the directors, but only in respect of conduct within subsection (1). A failure to include releases, forbearances to sue and settlements of claims would allow a director to secure the support of the board of directors and obviate the purpose of the proposed section.

**Application to small companies**

A consequence of proposed subsection (1) is that a sole director, sole shareholder company cannot approve a resolution concerning an Excluded Matter. Moreover, where each shareholder is an excluded person, a valid resolution cannot be approved by the shareholders, even though there would be quorum present for a meeting. Section 239 of the Companies Act 2006 (UK) is to the same effect as proposed subsection (1) for sole director / sole shareholder companies[583] and the situation where each shareholder is prohibited from voting because of their relationship with the relevant director.

This approach is justified for the following reasons.

Firstly, the corporate law policy that only independent shareholders are entitled to vote is preserved as a policy without exception as a rule of general application.

[582] See especially *Miller* (n 87) and *Eastland Technology Australia Pty Ltd v Whisson* [2005] WASCA 144 which considered former section 241(1) of the Corporations Law which provided as follows: A company or a related body corporate must not: (a) indemnify a person who is or has been an officer or auditor of the company against a liability incurred by the person as such an officer or auditor; or (b) exempt such a person from such a liability.

[583] See *Goldtrail Travel Limited (in liq) v Aydin* [2014] EWHC 1587, [116]-[117] (Rose J).

Secondly, the approach proposed does further protect creditors of the company against actions by a sole director to gain an advantage for themselves or another person and in the event an administrator or liquidator is appointed, proceedings can be commenced against the director for their breaches of duty against the company by the administrator or liquidator.

Thirdly, the approach codifies the decision in *Macleod v The Queen*,[584] which held that a sole director / sole shareholder could not take for his own advantage the assets of the company, it being a separate legal entity. The conduct of Mr MacLeod was held to be fraudulent conduct of a director contrary to former section 173 of the *Crimes Act 1990* (NSW).

**Consequences of a valid ratification resolution on sections 232, 236 and 237**

If a resolution concerning an Excluded Matter is approved by independent shareholders, it seems likely that there would be less litigation under parts 2F.1 (the statutory oppression remedy) and 2F.1A (the right to bring or intervene in proceedings on behalf of a company) of the Corporations Act in the context of ratification. This is because, for example, the independent shareholders are not likely to be said to have acted for the same improper purpose as the directors of the company who engaged in the conduct which was ratified. Nevertheless, both members remedies would continue to operate for the benefit of a minority shareholder following the approval of a ratification resolution if their elements are satisfied.

**What conduct is excluded?**

The proposed section only seeks to impose voting restrictions for specific matters which are carefully limited by express inclusion in subsection (1).

[584] (2003) 214 CLR 230.

Importantly, the proposed section will not prevent the ratification of contracts which are made by a director or agent of a company without authority. The proposed section will not affect the operation of sections 126 (Agent exercising a company's power to make contracts) or 131 (Contracts before registration) of the Corporations Act.

**Quorum and right to participate**

Proposed subsection (3) ensures that a valid shareholders meeting can be held by allowing an excluded person to be counted towards the quorum for a meeting for the purposes of section 249T of the Corporations Act or any constitutional provision which displaces section 249T, provided always that the person already had a right to be counted towards quorum. The law in the United Kingdom is to the same effect.[585]

The proposed section also ensures that any excluded person can take part in the meeting, which necessarily includes the right to be heard on any procedural motion or the business of the meeting.

**Protection of existing common law and statutory provisions**

Proposed subsection (4) is broader than section 239(7) of the *Companies Act 2006* (UK) which is amended as follows:

> This section does not ~~affect~~ limit any other enactment, or rule of law ~~imposing additional requirements for valid ratification or any rule of law as to acts that are incapable of being ratified by the company~~.

Proposed subsection (4) is a beneficial provision which seeks to ensure that the general law and any statutory provision are not limited by the proposed section other than as expressly provided. It seeks to ensure that any additional requirements for a valid authorisation,

[585] *Companies Act 2006* (UK) s 239(4).

ratification or attenuation resolution are not affected by the proposed section. For example, any conduct which as discussed in Chapter 2 is not ratifiable remains outside the operation of the doctrine of ratification. This is of importance in connection with, for example, situations where the company is nearing the point of insolvency ensuring that creditors are protected against a ratification of any conduct of the directors.[586]

Since the shareholders in general meeting do not have the power of ratification in the context of pre-insolvency situations and when a company is insolvent, there is no benefit to proposing additional law reforms separate from proposed subsection (4).

Proposed subsection (4) also seeks to ensure the common law can continue to develop with respect to any additional requirements for an authorisation, ratification or attenuation resolution and further to ensure that a court's powers are not affected by the enactment of the section.

With respect to public companies, subsection (4) ensures that all public companies must also comply with Chapter 2E (Related party transactions). This is discussed in detail below.

**No change to operation of *Duomatic* principle**

There is the possibility that the shareholders may informally approve a ratification resolution under the *Duomatic* principle,[587] which permits unanimous informal assent by the shareholders without formal meeting of the shareholders. The law in the United Kingdom[588] and New Zealand[589] permits the *Duomatic* principle to operate with respect to a ratification resolution. However, in the United Kingdom, the *Duomatic* principle does not apply to sole director / sole shareholder companies.[590] There are no cases in Australia which consider the question whether the *Duomatic* principle applies to sole shareholder companies. However, it seems likely that the *Duomatic* principle does apply to sole shareholder companies because section 249B of the

[586] See especially *Kinsella* (n 55). See also *Vivendi SA v Richards* [2013] EWHC 3006 (Ch).
[587] *Re Duomatic Ltd* [1969] 2 Ch 365.
[588] *Companies Act 2006* (UK) s 239(6)(a).
[589] *Companies Act 1993* (NZ) s 177(4).
[590] *Ultraframe (UK) Ltd v Fielding* [2004] RPC 479, [40].

Corporations Act does not purport to limit the manner in which a resolution may be approved by a company with only one shareholder. There would be reliability and credibility issues for any witness who sought to prove a resolution was approved without recording at least some relevant information in writing at or near the time of the approval of the resolution.

Proposed subsection (5) is partly an evidential provision which allows evidence to be adduced that a resolution would have been approved even where there has been non-compliance with subsection (1). It is to the same effect as section 225(1) of the Corporations Act. Public companies remain permitted to seek a declaration under section 227 that there was substantial compliance with Division 3 of Part 2E.1 of the Corporations Act.

The proposed subsection is justified for a number of reasons.

Firstly, the *Duomatic* principle requires that there be unanimous assent of the shareholders. Accordingly, there are no minority shareholders which have voted against an authorisation, ratification or attenuation resolution.

Secondly, there are evident practical and financial advantages to allowing the *Duomatic* principle to operate arising from the ease and simplicity with which an informal meeting can be called and conducted.

Thirdly, under subsection (5), a resolution in connection with an Excluded Matter is invalid unless there is evidence that a resolution would have been approved but for the non-compliance with subsection (1).

Fourthly, section 239 of the *Companies Act 2006* (UK) and section 177 of the *Companies Act 1993* (NZ) do not permit a court to determine that there has been substantial compliance with the requirements whereas section 227 of the Corporations Act is to the contrary in Australia. In light of the existing corporate law policy in Australia evident from Chapter 2E of the

Corporations Act (Related party transactions), it is proposed to maintain the flexibility provided by section 227 because it only applies to public companies and the declaration must be obtained from a court.

**Postal and electronic voting issues**

The proposed section does not specifically contemplate the possibility of a postal or electronic vote being conducted. There is currently no prohibition under the Corporations Act for either postal or electronic voting and there is no consensus on ensuring the validity of a ballot being conducted by postal or electronic means.[591] It is accordingly a matter for individual companies to determine in their constitutions whether and how a postal or electronic vote would be conducted.

It is observed that to permit postal or electronic voting may result in an excluded person more easily exerting their influence on a shareholder than at a physical meeting, contrary to the spirit of the law reforms proposed by this Thesis. Without evidence, it is impossible to know whether an excluded person's presence at a meeting would have the same kind of influence on a shareholder as there would have been in the case of postal or electronic voting. Separately, there may be little difference between a falsely lodged postal or electronic ballot paper and a forged signature on a proxy form where there is little oversight of the validity of the voting. This issue is one which will require the use of new or better technologies in the future to limit the risk of these voting methods being used to manipulate the outcome of a vote.

A postal or electronic vote could be conducted with the use of a declaration by each shareholder that they are not an excluded person. The evidence of a false declaration may not invalidate a ratification resolution because subsection (5) is a provision designed to ensure the validity of a resolution concerned with an Excluded Matter but for some non-compliance with subsection (1). Separately, any false declaration could be dealt with under existing laws since there are

[591] See generally, Francesco Bonollo, 'Electronic meetings' (2002) 14 *Australian Journal of Corporate Law* 95.

already criminal penalties which can be imposed if an excluded person makes a false declaration.

A shareholder who is unable to attend a shareholders' meeting can already lodge a proxy form with the company nominating and directing any person to vote in a particular way on any resolutions to be put to the meeting. Adopting postal and electronic means for participation may enhance the rate of shareholder participation notwithstanding the existing right of a shareholder to appoint a proxy to attend a shareholders' meeting.

It is outside of the scope of this Thesis to assess the benefits and risks of postal and electronic voting systems. The proposed section leaves the issue to shareholders of companies to determine, rather than establishing any requirement or prohibition in the proposed section. Technology will continue to develop and, as this occurs, it may be more common for shareholders to participate in meetings through the use of these new technologies which allow for secure methods of postal and electronic voting.

**Court powers**

Proposed subsection (6) is a modified version of section 177(3) of the *Companies Act 1993* (NZ) shown with the amendments below:

> The ratification or ~~approval~~ authorisation under this section of the ~~purported~~ exercise of a power by a director ~~or the board~~ does not prevent ~~the~~ a court from exercising a power which might, apart from the ratification or ~~approval~~ authorisation, be exercised in relation to the ~~action~~ conduct of the director ~~or the board~~.

The use of the word 'approval' has been replaced with 'authorisation' in the proposed subsection to ensure it is clear that prospective authorisation is within the meaning of the proposed subsection and to be consistent with the language of proposed subsection (1).

Proposed subsection (6) expressly preserves the right of a court to exercise a power in relation to a director of a company. The proposed subsection thereby preserves the current law with respect to, for example, sections 216,[592] 239[593] and 1318[594] of the Corporations Act to ensure that a court is not inhibited from, for example, permitting a financial benefit to be given to a director, taking into account a ratification, or partially or wholly relieving a director from a liability to a company.

Further, subsection (6) is necessary because there would be unintended consequences arising if the proposed section were interpreted to mean that a court has reduced powers to, for example, regulate the affairs of a company under section 233 of the Corporations Act in connection with conduct of the directors.

There is no justification for restricting the powers of a court which it currently has in relation to directors. The purpose of the proposed section is to deal directly with the 'sharp' practices of directors of companies from using their own and their close associates voting powers to ensure, for example, a ratification resolution is approved at a general meeting of the shareholders, or to obtain a release, or settle a claim by a resolution of the board of directors.

## D. *Potential issues with the proposed section*

The proposed section is intended to achieve the corporate law policy of limiting voting rights for resolutions concerned with Excluded Matters to independent shareholders. However, it is necessary to consider any potential legal or practical drawbacks of the proposed section to assess whether its intended benefits outweigh the risks of amending the Corporations Act.

**Resolution unable to be validly passed**

[592] Section 216 does not provide a general jurisdiction on the Court to make orders excluding the operation of section 208 (Need for member approval for financial benefit): *Re Boart Longyear Limited (No 2)* [2017] NSWSC 1105, [335] (Black J) citing with approval *Re Summit Resources (Aust) Pty Ltd* [2012] WASC 125.

[593] Section 239 concerns the effect of ratification by members.

[594] Section 1318 concerns the court's power to grant relief to an officer, including a director.

There will be circumstances where it is not legally possible to approve a resolution concerning an Excluded Matter notwithstanding that there is a quorum present for the general meeting of the shareholders. This will prevent the company from obtaining a benefit from the ratification resolution. This can arise for example where the directors in breach of their duties are the only shareholders, or where independent shareholders fail to attend or appoint a proxy for a general meeting. Both of these examples are much more likely to affect very small companies with one or two shareholders.

This conceivable problem with the proposed section is not a reason of itself to not amend the Corporations Act to modify the operation of the doctrine of ratification for a number of reasons.

Firstly, as was held in *Macleod v The Queen*,[595] a sole director / sole shareholder was unable to gift to himself the assets of the corporation because it was a criminal offence and a company could not consent to the furtherance of a crime. Therefore the conduct was not ratifiable by the sole shareholder in general meeting and moreover the scope of non-ratifiable wrongs discussed in Chapter 2 is not altered by the proposed section. The proposed law reforms only seek to exclude the director in breach of their duties and persons connected with them from voting. All remaining shareholders remain entitled to vote on a ratification resolution.

Secondly, a significant problem with the current operation of the doctrine is the effect of a ratification resolution on minority shareholders. The proposed law reform is for the general benefit of all companies and their shareholders. The risk of the proposed law reform affecting some small companies is not a basis for allowing the ongoing operation of the doctrine in its current form.

Thirdly, the fact that a resolution cannot be validly passed is a positive legal development because it gives protection to the company and its creditors from the possibility of a ratification

[595] (2003) 214 CLR 230.

resolution being approved. A future controller of a company such as a liquidator will not have to take legal steps to invalidate a ratification resolution.

Fourthly, if the independent shareholders (who may also be directors) decide to abstain from voting or disapprove of a ratification resolution, the conduct will not be ratified and the persons seeking the benefit of the ratification resolution will not obtain that benefit. This is not different to the current law. The proposed section does not seek to prevent a resolution concerning an Excluded Matter from being approved, rather it primarily seeks to ensure that only independent shareholders can vote on an Excluded Matter. An exception under the proposed section is not warranted to assist very small companies because the benefit to some companies must be considered against the risks for all companies as discussed in this Thesis.

**No exclusion of officers**

The proposed section only extends to the conduct of a director of a company and not to officers. The definition of director pursuant to section 9 of the Corporations Act is significantly different from the definition of an officer. The contrast may be observed by considering the question whether a person was an officer. It was recognised in *Australian Securities and Investments Commission v King*[596] that,

> determining whether a person falls under para (b)(i) of the definition requires consideration of the role the person played in the corporation. The inquiry is not limited to any particular issue or act which the person was involved in, and which is said to constitute a breach of duty. The text of para (b)(i) draws a distinction between those who make decisions and those who participate in making decisions. The notion of participation "directs attention to the role that a person has in the ultimate act of making a decision, even if that final act is undertaken by some other person or persons.[597]

[596] [2020] HCA 4.

[597] *Australian Securities and Investments Commission v King* [2020] HCA 4, [89] (Nettle And Gordon JJ) citing with authority *Shafron v Australian Securities and Investments Commission* [2012] HCA 18.

It is apparent from the decisions in *King*[598] (and *Shafron*[599] discussed in that case) that whilst the definition of officer is broad, the definition of director is much narrower. It would therefore be possible for a company to be established with a sole director and for other persons to act in advising the director. For an extreme example, see *Re Plutus Payroll Australia Pty Limited*,[600] where there was evidence that persons appointed to the position of director were unaware of their appointment.[601]

Even where the advisory persons assisting a director are held to be officers, those persons are not subject to the same procedure required by the proposed section. There is therefore a risk that the proposed section would be avoided by the advisers and those persons could ratify a breach of duty by the officers as shareholders of the company. The principal problem for the advisory group to the sole director would be the risk that they were held to be *de facto* or shadow directors and accordingly unable to ratify any breach of duty given that the doctrine of ratification continues to operate. It would be a matter for each person to establish a basis for being excused from a liability to the company pursuant to section 1318 of the Corporations Act.

Whilst the proposed section could be avoided by the deliberate structuring of the roles of the persons involved in the management of the company, subsection (4) ensures in all respects that the common law and other statutory obligations continues to operate for the protection of the company, the shareholders and the creditors. Accordingly the risks which arise in this instance are the same risks which are present under the current law in Australia.

**Application to public companies**

The proposed law reform will apply to public companies.

Section 229(3)(f) of the Corporations Act provides, as an example, that the giving a financial benefit includes the releasing of an obligation of a related party. Further section 229(1)(a) of

[598] *Australian Securities and Investments Commission v King* [2020] HCA 4.
[599] *Shafron v Australian Securities and Investments Commission* [2012] HCA 18.
[600] [2017] NSWSC 1041.
[601] *In the matter of Plutus Payroll Australia Pty Limited* [2017] NSWSC 1041, [8] (Brereton J).

the Corporations Act gives a broad interpretation to financial benefits, including where criminal or civil penalties may be involved. It is considered by this Thesis therefore that a resolution concerning an Excluded Matter will be a "financial benefit" for the purposes of section 229 of the Corporations Act. This will result in the public company complying with the requirements of Chapter 2E (Related party transactions) unless a statutory exception applies under sections 210 to 216 of the Corporations Act[602] and also complying with the proposed section.

It will be recalled that sections 199A to 199C of the Corporations Act prohibit giving an indemnity, exemption or paying and insurance premium for an officer. The proposed section would not affect the operation of any of the requirements of these sections.

The requirements for the materials that will be put to shareholders[603] and the explanatory memorandum[604] are independent from the requirement to give full and frank disclosure because subsection (4) preserves the common law.

With respect to voting restrictions, the more stringent requirements of section 224 must be complied with, which further limits the persons entitled to vote on a ratification resolution. Subsection (5) of the proposed section is drafted the same as section 225(1) of the Corporations Act to ensure there is no difference in interpretation of when a resolution is valid. Section 225(2) to (6) of the Corporations Act continue to apply to public companies following the enactment of the proposed section.

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[602] Those exceptions by way of summary are; the parties are dealing at arm's length or the terms are less favourable to the related party than an arm's length transaction (s 210), remuneration to an officer or employee which is reasonable in the circumstances of the public company and the related party's circumstances or payments of expenses to a related party is reasonable in the circumstances of the public company (s 211), an agreement to give an indemnity, exemption or insurance premium in respect of a liability incurred as an officer or the giving of the same and it would be reasonable in the circumstances of the public company or paying the legal costs of an officer and the giving of the benefit is reasonable in the circumstances (s 212), the value of the financial benefit is less than $5,000 (as at 10 April 2020) as prescribed by Corporations Regulation 2E.1.01 (s 213) the benefit is to closely-held subsidiary by the public company or the closely-held subsidiary to the public company (s 214) the benefit is given to a related party in their capacity as a shareholder of the public company and the giving of the benefit does not discriminate unfairly against other the other shareholders (s 215) or the benefit is given under a court order (s 216).

[603] *Corporations Act 2001* (Cth) s 218.

[604] *Corporations Act 2001* (Cth) s 219.

The additional requirement to comply with the proposed section is unlikely to cause additional administrative difficulties for public companies because the definition of 'excluded person' in subsection (2) has been modelled on existing requirements for public companies under Chapter 2E of the Corporations Act and those definitions have been uniformly applied by the proposed section to proprietary companies.

**Disputes as to validity of a resolution**

There is room for abuse of proposed subsection (5) by the chairperson of a meeting treating a resolution as being valid, by for example including the votes of an excluded person. However, subsection (10) ensures that the company must establish that the resolution was validly approved by the shareholders. Accordingly, an aggrieved shareholder can challenge the validity of a resolution without a concern that they are not in possession of the information or documents which establish whether the resolution was valid. There is therefore an incentive upon companies expressly designed into the proposed section to ensure that all steps are taken to include only shareholders which are entitled to vote on an Excluded Matter.

The proposed section does not seek to limit any existing shareholder protections. The proposed section may enlarge shareholder protections, in particular under section 1322 of the Corporations Act. For example, if there was a dispute between a shareholder and the directors in relation to the validity of a resolution approved by a general meeting of the shareholders, a shareholder is not prohibited under the proposed section from commencing proceedings under section 232, seeking leave under section 237 of the Corporations Act, or commencing proceedings to invalidate a resolution under section 1322 of the Corporations Act. Separately, a shareholder can seek the grant of an injunction pursuant to section 1324 of the Corporations Act.

Whether orders would be granted by a court under section 1322 of the Corporations Act would depend at least on whether there was non-compliance with subsection (1). It is arguable that non-compliance with subsection (1) would be a procedural irregularity which may cause substantial injustice which cannot be remedied by an order of a court. This is because firstly,

non-compliance with the section is proposed to be a civil penalty provision which could result in a compensation order pursuant to section 1317H. Secondly, there may be serious consequences for a company and the shareholders if a resolution is approved because the effect of the resolution may be to protect to a director in breach of their duties from any legal claim.

**Shares without voting rights**

It is permissible under the Corporations Act for a company, subject to any rights established under its constitution, to issue classes of shares which do not include voting rights.[605] If the independent shareholders of a company only have non-voting shares, they would be prevented from voting on a ratification resolution.

The possible structuring of a company with non-voting shares being issued to independent shareholders would not defeat the proposed section. Under the proposed section, the directors would be classed as excluded persons under subsection (2) if a resolution on an Excluded Matter was sought to be approved, rendering the company unable to approve the resolution. In this situation, the proposed section achieves its stated purpose.

If this type of corporate structuring situation were to arise, there would be a question whether the use of the voting power gave rise to, for example, conduct which was oppressive, unfairly prejudicial or unfairly discriminatory within the meaning of section 232 of the Corporations Act as was the case in *HNA Irish Nominee*[606] where the directors voted at a general meeting of the shareholders to ratify their own conduct. The decision in *HNA Irish Nominee*[607] suggests that directors who use their voting power to approve resolutions could be acting contrary to section 232 of the Corporations Act.

**Transfers of shares by an excluded person**

[605] *Corporations Act 2001* (Cth) s 254B.
[606] *HNA Irish Nominee* (n 44).
[607] *HNA Irish Nominee* (n 44).

One possible problem with proposed subsection (1) is an excluded person could transfer their shares to a person who is outside of the definition of excluded person in subsection (2) to defeat the purpose of the section.

Firstly, there may be prohibitions or restrictions in a company's constitution or a shareholders' agreement which prevent a shareholder from transferring their shares without complying with a particular procedure. Such procedures prohibiting or restricting the transfers of shares commonly include a right of pre-emption by existing shareholders to buy the shares of a shareholder desirous of selling their shares.

Secondly, the board of directors may have a power to refuse to register a transfer of shares. It would be open to the board of directors to approve or refuse to register a transfer where the dominant purpose was considered to be the avoidance of the purpose of subsection (1), a civil penalty provision. An aggrieved shareholder can challenge the legality of the decision of the board to approve or refuse to register a transfer of shares. If the transfer is approved by the board of directors, the purpose of proposed subsection (1) will be defeated and the minority shareholders will be in no better position than prior to the statutory reform.

Thirdly, an affected shareholder could seek an injunction to prevent a transfer of shares if they are aware of the proposed transfer of the shares. It may not be a requirement of a shareholders' agreement to give notice of a proposed transfer of shares. Further, even where there is strict legal compliance with the proposed section, that does not mean that a shareholder is prohibited from commencing proceedings to challenge, for example, the validity of the transfer of shares at least on the basis that the conduct was contrary to section 232.

The issue has not been raised as a problem in connection with law reforms to ratification under company law in the United Kingdom where the public policy of only independent shareholders voting on a ratification commenced in 2007. Further, this Thesis has not identified any cases in Australia where a shareholder has sought to utilise a transfer of shares to avoid the definition of 'related party' in section 228 of the Corporations Act for the purpose of a related party

obtaining a financial benefit without complying the requirements of section 208 of the Corporations Act.

In light of the fact that the hypothesised transfer of shares has not arisen as a problem in Australia, or the United Kingdom, it would not be beneficial to include a subsection which limits transfers of shares by excluded persons. Principally this is a matter which is best regulated by a company's constitution or a shareholders' agreement.

**Issue and allotment of new shares**

A board of directors could issue and allot new shares to a person outside of the definition of excluded person, which would have the effect of creating a new majority for the purpose of ensuring that a resolution concerning an Excluded Matter was approved. The issues in this instance concern the conduct of the board of directors are different from the issues raised in the previous section concerning the transfers of shares by a shareholder.

The shareholders would in these circumstances have no different legal rights than they currently have. For example, a shareholder in these circumstances could seek relief against the company for an alleged improper purpose of the directors when they approved the issuance of the new shares and apply for an interim injunction to prevent a meeting of the shareholders from being conducted before the determination of the disputed issuance of new shares.

The proposed section therefore does not limit any existing legal protections for shareholders.

**Constitutional provisions and shareholders' agreements**

The proposed section seeks to expressly preserve constitutional provisions and shareholders' agreements. This is intended to ensure that companies with existing arrangements for managing ratification resolutions can continue to apply those specific provisions. As an example, a company's constitution may adopt a wider definition of an 'excluded person'.

The shareholders of a company cannot simply contract out of the proposed section because the proposed section is not a replaceable rule. A provision which is contrary to the proposed section would be invalid.[608]

Whether a particular company's constitutional provision or a shareholders' agreement can operate wholly or partially under the new proposed section will always be a question of interpretation[609] of the statutory provision and the constitutional provision or shareholders' agreement. One principle of law which could interfere with a constitutional provision or shareholders' agreement is a person cannot raise an estoppel to frustrate or negate the operation of a statutory provision.[610]

It would therefore be open to a court to invalidate a constitutional provision or a clause in a shareholders' agreement where the provision or clause is wholly or partially contrary to the proposed section.

## E. *Other law reform issues*

**Relevance of ratification to a responsible entity for a managed investment scheme**

Ratification may not be of significance to managed investment schemes regulated under Chapter 5C of the Corporations Act.

Managed investment schemes were first regulated by the Commonwealth from 1 July 1998 following the enactment of the *Managed Investments Act 1998* (Cth) which amended the former Corporations Law. Generally, managed investment schemes were established as unit trusts, however the definition of 'managed investment scheme'[611] does not restrict the structure

[608] *Corporations Act 2001* (Cth) s 135(2).

[609] See, especially, *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355.

[610] *Lukey v Stonehouse* [2009] WADC 92 (Principal Registrar Gething); *Overmyer Industrial Brokers Pty Ltd v Campbells Cash & Carry Pty Ltd* [2003] NSWCA 305 (Young CJ); *Ryde Developments Pty Ltd v The Property Investors Alliance Pty Ltd (No 4)* [2017] NSWSC 436 (Ball J). See generally LexisNexis, *Halsbury's Laws of Australia* (28 March 2018) 'General nature and principles of estoppel' [190 – Estoppel].

[611] *Corporations Act 2001* (Cth) s 9 definition ('managed investment scheme').

which may be employed to allow people to contribute to the scheme. Some entities, such as partnerships of more than 20 members, body corporates, franchises and statutory funds maintained under the *Life Insurance Act 1995* (Cth), are specifically exempted from the definition.

There is limited authority on the point, however pursuant to section 601FD(1) of the Corporations Act, it appears that officers of responsible entities of a registered managed investment scheme are subject to fiduciary duties by reason that the duties established by section 601FD(1) are in addition to the statutory duties imposed on officers of a company.[612]

These duties are owed to the *members* of the registered managed investment scheme.[613] Such a conclusion follows from at least the following two points:

(i) a comparison of the relevant sections imposing the duties. Section 181(1)(a) of the Corporations Act, which requires 'a director or other officer of a corporation must exercise their powers and discharge their duties in good faith in the best interests of the corporation', and section 601FD(1)(c) of the Corporations Act, which states that 'an officer of the responsible entity of a registered scheme must act in the best interests of the members and, if there is a conflict between the members' interests and the interests of the responsible entity, give priority to the members' interests'; and

(ii) section 601FC(2) establishes that '[t]he responsible entity holds scheme property on trust for scheme members'.

[612] *Corporations Act 2001* (Cth) s 601FD(2). A duty of an officer of the responsible entity under subsection 601FD(1) overrides any conflicting duty the officer has under Part 2D.1 of the *Corporations Act 2001*. See also section 601FC(3) which establishes that '[a] duty of the responsible entity under subsection (1) or (2) overrides any conflicting duty an officer or employee of the responsible entity has under Part 2D.1'. See *Alpha Wealth Financial Services Pty Ltd v Frankland River Olive Company Ltd* [2005] WASC 189, [33] (Hasluck J) described the duties imposed by s 601FD(1) as "essentially fiduciary". See also *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liq) (Controllers appointed) (No 3)* [2013] FCA 1342.

[613] See *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liq) (Controllers appointed) (No 3)* [2013] FCA 1342. Section 601FD(1)(c) states that an officer of the responsible entity of a registered scheme must act in the best interests of the members and, if there is a conflict between the members' interests and the interests of the responsible entity, give priority to the members' interests.

Since the duties are owed by a trustee to the members who are the beneficiary of the trust, it was suggested in *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liq) (Controllers appointed) (No 3)*[614] that the duties may be more demanding.[615] The duties established by section 601FD(1) do not mirror the duties established by Chapter 2D.1, rather the duties expand the duties imposed upon the officers of the responsible entity of a registered managed investment scheme.

On the basis of the decision in *Angas Law Services*,[616] and for the reasons described above concerning sections 601FD(1)(c) and 601FC(2), it will not be possible for a majority of the members of the managed investment scheme to ratify a breach of fiduciary or statutory duties by the officers of the responsible entity principally because the duties are owed to each member and not to the company. Any ratification by some members by deed would likely result in an argument that those members who ratified the conduct are unable to maintain an action against a director because there has been a release.[617]

**State and Territory body corporates**

Separate to companies governed by the Corporations Act, there are body corporates which are incorporated under State and Territory legislation which include; incorporated associations, strata companies, co-operatives and trade unions.[618] The fiduciary duties owed by officers of these body corporates, subject to any specific statutory duties established by a particular Act, are considered to be the same, or similar to the general law fiduciary duties owed by directors of companies governed by the Corporations Act. There is however no Australian authority on the point.[619] Accordingly, the doctrine of ratification remains entirely relevant to all body

[614] [2013] FCA 1342
[615] *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (Receivers and Managers appointed) (in liq) (Controllers appointed) (No 3)* [2013] FCA 1342, [524] (Murphy J).
[616] *Angas Law Services* (n 5).
[617] See eg. *Miller* (n 87).
[618] For example in Victoria, body corporates are incorporated under the *Associations Incorporation Reform Act 2012* and the *Owners Corporations Act 2006*.
[619] Leigh Warnick, *Incorporated Associations: Liability of Board/Committee Members* (PDF, 1 June 2005).

corporates incorporated under State and Territory legislation, especially in circumstances where no statutory duties have been enacted. It is outside of the scope of this Thesis to consider the ratification of breaches of duty in respect of bodies corporate incorporated under State and Territory legislation. However, the following discussion identifies the issues which any future law reforms which would need to be considered.

Whether any officer's duties firstly have been codified, secondly whether a breach of those statutory duties give rise to criminal offences and thirdly whether those statutory duties cover some or all of the fiduciary duties of the officers, depends upon the proper construction of the relevant provisions of the Act governing the body corporate. Further, an incorporated body's constitution may modify the fiduciary duties owed by the officers.[620] The relevant Act may also require that the members of the body corporate in general meeting approve a ratification resolution.[621]

In relation to incorporated associations, each State and Territory has enacted legislation which have at least partially codified the duties of officers, thus there remains some reliance on the general law duties.[622] To the extent that officers' duties are covered by the general law, *Foss v Harbottle*[623] continues to apply.

In connection with State and Territory legislation, the States and Territories may, pursuant to section 5F(1) of the Corporations Act, declare that none of the Corporations Act provisions apply to any legislation. This would relevantly include the operation of the statutory derivative action under section 236 of the Corporations Act.[624]

In the case of incorporated associations there may be no limits on exemptions and indemnities which apply to companies pursuant to section 199A of the Corporations Act. Accordingly, an incorporated association may adopt a constitution which discharges the committee members

[620] *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285.
[621] See eg. *The Owners - Strata Plan No. 2187 v Astoria Asset Management Ltd* [2011] NSWDC 259
[622] See generally Charles Parkinson, 'Duties of committee members under the Associations Incorporation Acts' (2004) 30(1) *Monash University Law Review* 75.

[623] (1843) 2 Hare 461.
[624] See especially *Eastmark Holdings Pty Limited v Kabraji* [2012] NSWSC 802 in relation to litigation concerning a strata company incorporated under the *Strata Schemes Management Act 1996* (NSW).

from liability for breaches of their duties to the association and/or indemnify the committee members against liability to third parties.[625] At least in Western Australia, it does not appear possible for committee members to rely on the protection of the *Volunteers (Protection from Liability) Act 2002* (WA) to the extent that they lack good faith.[626]

In relation to body corporates which have been incorporated under State or Territory legislation, subject to the relevant Act, a ratification resolution will therefore be relevant to firstly whether the body corporate is bound by the conduct of the officer and secondly the extent of the ratification applicable to an officer and therefore what rights may the body corporate and minority of members have in the circumstances.

The legislation in the eight States and Territories in relation to each of these body corporates is not uniform and accordingly, any future proposed legislative reforms which arise in the context of a particular Act based on the identified problems (which will inevitably be different to the issues related to companies governed by the Corporations Act), would not likely be wholly suitable as a series of reforms in respect of other types of body corporates, or suitable to other jurisdiction's problems for the same type of body corporate. The legislative reforms to the Corporations Act proposed by this Thesis will, however, provide general guidance for possible future reforms to State and Territory legislation.

## F. ***Conclusion***

This Thesis proposes a novel statutory approach to modify the operation of the doctrine for companies governed by the Corporations Act. Central to the proposal is a requirement that only independent shareholders vote on Excluded Matters. This proposed reform will create a significant practical barrier to a director/shareholder obtaining the benefit of a ratification resolution, however, it is argued by this Thesis that this is an appropriate measure.

In light of the concerns raised in Chapter 6 and this Chapter about the problems with section 239 of the *Companies Act 2006* (UK), this Thesis adopts many features of the law in the United Kingdom and improves upon them. In this sense, the limited proposed law reform is argued to

[625] See generally Warnick (n 619).
[626] See *Volunteers (Protection from Liability) Act 2002* (WA) s 6; Warnick (n 619).

be the minimum reforms required to achieve the corporate law policy outcome of ensuring only independent shareholders vote on a resolution concerned with an Excluded Matter.

As discussed in Chapter 6, the United Kingdom has modified by statute the operation of the doctrine to implement a corporate law policy that only independent shareholders can vote on a resolution concerned with ratification. The State of Delaware in the United States of America and Canada recognised this corporate law policy in the interpretation of their law far earlier than the United Kingdom.

The implementation of a corporate law policy in support of ensuring that only independent shareholders can vote on an Excluded Matter by amending the Corporations Act has been argued by this Thesis to be the single most effective measure to avoid or limit as far as possible the inherent problems with the operation of the doctrine of ratification.

This limited law reform directly deals with the primary criticism of the doctrine which was discussed in Chapter 4, whilst retaining all the benefits of the doctrine which were discussed in Chapter 3. Implementing that corporate law policy would be to follow the law in the United Kingdom, the United States of America and Canada.

The proposed section will have an impact on the interpretation of section 239(2) of the Corporations Act when a court is considering how well-informed the shareholders were when deciding whether to ratify or authorise the conduct of a director. Further, there will be a stronger basis for a court to take into account a ratification resolution because the resolution was approved by independent shareholders.

The limited law reform does not impose any significant financial barrier to a director seeking the benefit of a ratification, authorisation or attenuation resolution. It merely seeks to regulate who can vote and the minimum procedural requirements for a valid resolution concerning an Excluded Matter.

The proposed section will have a negative impact upon some companies with directors who are also shareholder because they are unable to obtain the benefits of ratification in certain circumstances. This negative outcome needs to be considered against the benefits from limited law reform which have been argued in this Thesis. As discussed in this Chapter, the benefits from limited law reform significantly outweigh the negative effect on some small companies.

It is possible that some directors of companies may seek with their legal advisers to avoid or limit the effect of the proposed section, and a number of potential issues with the proposed section were discussed in this Chapter. Any legislative amendment will raise questions of interpretation because of matters which were not in contemplation at the time of implementation. The proposed section set out in this Chapter and discussed above is expected to be no different in this regard, despite the benefit of the proposal being drafted in the knowledge of the 'sharp' practices of company directors, the criticisms and uncertainties of the doctrine and the criticisms of legislative measures which have been enacted in the jurisdictions discussed in Chapter 6.

# CHAPTER 9 – CONCLUSION

## A. *Introduction*

This Thesis considered the question whether the doctrine of ratification was in need of reform to remain relevant and appropriate to companies governed by the Corporations Act. The primary issue under consideration was whether there were substantial legal and/or corporate law policy reasons to amend the Corporations Act to prevent a self-interested director from voting as a shareholder to ratify their own breach of duty?

To examine the legal and corporate law policy issues, it was necessary in Chapter 2 to consider the scope and application of the doctrine and in Chapter 3 assess the benefits of the doctrine to companies and minority shareholders. This Thesis argued in Chapter 3 that the benefits of the doctrine should be retained. Unless the benefits of the doctrine were retained, additional legislative amendments would be required, which could result in new legal issues emerging for resolution by Australian courts.

The identified criticisms and uncertainties in the operation of the doctrine which were discussed in Chapter 4, the possibility of the attenuation of statutory duties discussed in Chapter 5 and the review of the other common law jurisdictions discussed in Chapter 6 are also a basis for law reform in relation to strata companies, trade unions, co-operatives and other body corporates which are regulated under State and Territory laws and Managed Investment Schemes which are regulated under Chapter 5C of the Corporations Act.

Notwithstanding earlier law reforms to the former Corporations Law and the Corporations Act which affected the operation of the doctrine in relation to companies governed by the current Corporations Act, this Thesis has established through the analysis of the legal and corporate law policy issues a basis for limited law reform to the doctrine of ratification to reduce the problems which arise when a self-interested director votes to ratify their own breach of duty to a company.

Before any such corporate law policy could be adopted, the further question was what limited law reform(s) would remedy the problems related to a self-interested director voting rights and would those limited law reform(s) result in benefits to companies and minority shareholders but not introduce new legal problems?

In Chapter 6, the legal problems which had emerged or were likely to emerge in the other common law jurisdictions provided a basis for modelling Australian law reforms which took into account those identified legal problems. The proposed definition of which shareholders are excluded from voting has drawn primarily on the law in the United Kingdom, where only independent shareholders are permitted to vote on a ratification resolution. That definition was adapted by using definitions of terms which are already present in the Corporations Act. By using existing definitions of the Corporations Act, any law reforms will be less likely to give rise to questions of statutory interpretation.

There will be cases where the proposed definition of an 'excluded person' is not broad enough and a ratification resolution is approved which prevents a company from pursuing a *bona fide* claim against a director. Importantly however, this Thesis argues for a definition of 'excluded person' which aligns with the existing definition of related party in section 228 of the Corporations Act and accordingly, seeks to go no further than the current interference with a shareholder's right to vote on a related party transaction with respect to a public company or a company controlled by a public company. By utilising the definition of related party, the existing corporate policy which restricts certain shareholders of a public company is extended to proprietary companies but only in the context of the doctrine of ratification.

A key beneficial outcome is that the proposed law reforms result in independent shareholders voting on ratification, authorisation and attenuation resolutions and this is anticipated to limit future director and shareholder disputes based on the limited number of disputes which have been reported since the law reforms in the United Kingdom were enacted since 2007.

## B. *The key issues and the significance of the findings*

The key issues identified in this Thesis which relate to the limited law reform of the doctrine argued for in this Thesis are discussed below.

**Relevance of ratification**

Ratification of a breach of duty remains relevant to companies governed by the Corporations Act. The doctrine serves a number of important functions and is accordingly beneficial to companies, directors, shareholders and third parties dealing with companies.

The beneficial aspects of the doctrine, if jettisoned from the common law would give rise to new uncertainties for each of those aforementioned parties and that would be a retrograde step, which has been avoided in each of the other common law jurisdictions considered in Chapter 6. This is significant because any law reform proposal with an objective of preventing the doctrine from operating with respect to companies would need to consider what additional law reforms would be required to address each of those beneficial aspects of the doctrine.

This Thesis' argument that the beneficial aspects of the doctrine should continue to operate in relation to companies gives rise to a conclusion that any law reform to the doctrine must be limited in its scope to ensure the retention of all of the doctrine's beneficial aspects.

**Limiting the rights of self-interested directors**

Previous law reforms to the Corporations Law and Corporations Act have been designed to curtail the operation of the doctrine, including; the enactment of directors' statutory duties ( including the enactment of criminal offences for the conduct of directors in breach of their statutory duties), the creation of shareholder statutory rights under Part 2F.1 (the statutory oppression remedy) and Part 2F.1A (derivative proceedings on behalf of companies) of the Corporations Act, and the limitations imposed on public companies by Chapter 2E (concerning

related party transactions), in particular the voting restrictions imposed on (i) directors of public companies under section 195 of Chapter 2D and (ii) related parties under section 228 of the Corporations Act. However, the primary issue of the voting power of self-interested directors has not been addressed in Australia in the context of ratification, in particular for proprietary companies.

It was identified in this Thesis that the voting power of self-interested directors of proprietary companies can result in private benefits being obtained by the self-interested directors, and/or their related parties because only public companies are subject to the requirements of Chapter 2E of the Corporations Act. The obtaining of the private benefit by those directors (or their related parties) can be to the disadvantage of the company and ultimately the shareholders.

The current law concerning fiduciary duties has resulted in circumstances where shareholders have been unable to commence, or maintain, derivative proceedings against a director as a result of the approval of a ratification or authorisation resolution.

The common law recognises the right of a director to exercise their right to vote as a shareholder. Significantly, this Thesis did not identify a compelling justification why a self-interested director should have a right to vote to approve their own breach or prospective breach of duty to a company. Rather this Thesis identified that the law in the United States of America was interpreted that a director/shareholder had a conflict of interest by voting on a ratification or authorisation resolution with respect to their own breach of duty and accordingly that shareholder was prohibited from voting as a result of the conflict of interest.

**Risk of the attenuation of statutory duties**

This Thesis concluded that there is a legal argument that a director's statutory duties could be attenuated. The question has not been addressed by a court in Australia, however, should the matter need to be resolved, there are conflicting policy arguments concern the allowance of the attenuation of a director's duties.

It was argued in this Thesis that in the event that a director's statutory duties were attenuated, a company may have no cause of action against a director. In that event, the company does not have adequate legal protection against the conduct of a director. This problem was addressed by the proposed law reform including an attenuation resolution as an Excluded Matter which was required to be approved by independent shareholders.

**Corporate law policy**

Shareholder primacy theory is important to the issues of law reform to the doctrine of ratification because of its historical influence in the development of corporate law policy in Australia and it is an essential theoretical lens to consider the limits of shareholders' powers and shareholder remedies.

There are significant corporate law policy arguments in support of both retaining the beneficial aspects of the doctrine and reforming the doctrine. It was a finding of this Thesis that the criticisms and uncertainties of the doctrine remain unresolved and the policy issue of only permitting independent shareholders to vote on a ratification or authorisation resolution has not been addressed as a solution to the problem of a director/shareholder, their family members and their associates from voting on a ratification resolution.

**Other jurisdictions**

Not all of the other common law jurisdictions reviewed found it necessary to amend companies' legislation to prevent self-interested directors from voting to ratify their own breach of duty. In particular, New Zealand has adopted a legislated policy of expressly allowing ratification to operate as it does under the common law. New Zealand's approach is contrary to the legislative reforms in the United Kingdom in 2007, which has restricted self-interested directors and persons connected with them from voting on a ratification resolution and the legal position in Canada and Delaware in the United States of America, which adopts an independent shareholder approach.

There is no empirical evidence to conclude whether the law reforms to the doctrine in New Zealand are effective or ineffective. This is because there are no reported cases which concern the ratification of a breach of a director's duty and accordingly, future research should be conducted to determine whether the law reforms in New Zealand should be preferred to the approach taken in the United Kingdom, Canada and the United States of America.

Similarly, there is insufficient empirical data concerning the United Kingdom's law following the implementation of the independent shareholder voting requirements in 2007 to conclusively state that the law reforms were effective to reduce legal disputes between companies, shareholders and directors. This could be primarily because there has been insufficient time for disputes to arise or alternately the changes to the law has been largely effective to limit disputes arising. The evidence may emerge in the future, depending on the dispute rate which could take decades to emerge. There is a weak trend that the numbers of disputes are reducing and the disputes have been limited to factual and legal issues which concern whether a shareholder is permitted to vote on a ratification resolution.

**Injunctions and declarations**

An important aspect of the proposed law reform is that a breach of the proposed section is a contravention of a civil penalty provision. This is significant because the proposed section establishes a new mechanism for a shareholder to apply for an injunction to prevent a contravention of the Corporations Act.

Similarly, a shareholder seeking a declaration of invalidity of a shareholders' meeting or the invalidity of a ratification, authorisation or attenuation resolution pursuant to section 1322 of the Corporations Act would need to establish that a procedural irregularity caused or may cause substantial injustice which could not be remedied by any order of a court.[627]

[627] *Corporations Act 2001* (Cth) s 1322(2).

## C. ***Conclusion***

The doctrine of ratification has been recognised as a part of corporate law since 1887. There are clear benefits to companies by retaining the doctrine and this Thesis argues for its retention in a modified form. There are robust legal and policy arguments for limited law reform to the doctrine to address its problems as addressed by this Thesis. A significant conclusion is that only independent shareholders should be permitted to vote on the Excluded Matters.

The proposed law reforms to the Corporations Act are relatively limited because the adoption of the policy of only allowing independent shareholders to vote on an Excluded Matter is a simple, clear and effective proposal which takes advantage of existing definitions in the Corporations Act. If the law reforms are adopted, the significant benefit achieved will be to prevent a director/shareholder, their family members and associates from voting on an Excluded Matter.

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