REPRESENTATIVES AND FIDUCIARY RESPONSIBILITIES - NOTES ON NOMINEE DIRECTORSHIPS AND LIFE ARRANGEMENTS

By
R P Austin
Minter Ellison

Introduction

There is a perennial debate in the literature of company law about the duties of a 'nominee' director.[1] Discussion is particularly intense in Australia, New Zealand and Canada, possibly because in the relatively small business communities of those countries interlocking corporate relationships are more common than in, say, the United States and the United Kingdom.

Some of the problems about nominee directorships are theoretical legal problems about the nature of fiduciary duties. In particular, can a director accept a duty of loyalty to a nominator bearing in mind his or her duty to act in good faith for the benefit of the company as a whole? When an actual conflict arises between the director's duty to the nominator and the duty to the company, is the director ever free to prefer the former to the latter? Such questions seem important because they imply a tension between legal principle and commercial reality.

However, the practical significance of these questions may be more psychological than operational. One suspects that the real occasions when a director must choose to perform one duty and breach the other are infrequent, apart from cases where the nominator seeks to take over the company or vice versa. But psychologically, the routine performance of directors at board meetings is likely to be affected by whether they regard themselves as being there to represent the interests of the nominator or to make an independent judgment of the company's interests.

There are, however, some applications of the general fiduciary principles which may well have real and immediate practical consequences. They relate to corporate information. Is the company entitled to withhold information from a nominee director whose nominator is thought to be acting contrary to the company's interests? When, if at all, can a nominee director pass on corporate information, acquired in the boardroom, to his or her nominator? Does the nominator possess the information acquired by the nominee in the boardroom,

1 For example: HAJ Ford and RP Austin, *Ford's Principles of Corporations Law* (6th ed, 1992), pp 461-465; RR Pennington, *Company Law* (6th ed, 1990), p 591; Companies and Securities Law Review Committee, *Nominee Directors and Alternate Directors* (Report No 8, 1989); E Boros, 'The Duties of Nominee and Multiple Directors', (1989) 10 *The Company Lawyer* 211; PD Creutchfield, 'Nominee Directors: The Law and Commercial Reality', (1992) 20 *Aust Bus Law Rev* 109; AS Sievers, 'Finding the Right Balance: The 2GB Case Revisited', (1993) 3 *Aust Jnl of Corp Law* 1.

so that the information must be included in the nominator's prospectus for the sale of its holding in the company, or in the nominator's Part A statement for a takeover bid for the company's shares? These are amongst the most pressing questions confronted by the practitioner of company law, as recent events have demonstrated.[2]

The issues which arise out of an apparent collision between representational and fiduciary duties are most acute in the corporate context, because of the commercial setting. It does not often happen that other fiduciaries occupy their positions as nominees outside the corporate sphere.[3] But occasionally the problem crops up - for example, employee representatives might be appointed to the governing body of a statutory board, or to the board of trustees of a superannuation fund. Indeed, the tension between fiduciary and representational duties is cemented into the *Superannuation Industry (Supervision) Act* 1993 (Cth), as we shall see.

The purpose of this paper is to see whether light can be shed on these problems by revisiting the company law cases in the context of a broader inquiry into the equitable duties of a person appointed to a fiduciary position in a representative capacity.

For reasons of space, other issues will not be discussed here, even though they are frequently discussed in the context of nominee directorships and frequently arise as a matter of fact in cases where nominee directorships are present. Thus, we shall not discuss the legal position of the common director of competing companies, the extent to which directors owe a duty to creditors, the potential liability of a nominator as a shadow director, and the application in representational circumstances of the law of statutory oppression.

The Problem of Definition

So far I have used the standard expression, 'nominee' director. But it is essential to note the ambiguity of that expression.

According to the Companies and Securities Law Review Committee,[4] the term 'nominee director' signifies persons who, independently of their method of appointment, are expected to act as directors in accordance with some understanding or arrangement which creates an obligation or mutual expectation

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2 For example, consider the facts of *Austen & Butta Ltd v Shell Australia Ltd* (1992) 10 ACLC 610, a case which is authority for a disappointingly narrow legal proposition, as noted below. Another example arises in the prospectus context. In 1993 the Commonwealth Government issued a prospectus for the sale of 20% of its shareholding in the Commonwealth Bank of Australia. The prospectus was prepared solely on the basis of publicly available information. The document stated that the Bank declined to provide non-publicly available information to the Government (apparently on the ground that co-operation might constitute, under s 205 of the Corporations Law, unlawful financial assistance in connection with the acquisition of the Bank's shares). Although the Secretary to the Treasury is a director of the Bank, the prospectus said that 'statutory confidentiality applies to the information which he receives in that capacity.'

3 PD Finn, *Fiduciary Obligations* (1977), pp 51-52.

4 Report No 8, paragraph [3].

of loyalty to some person or persons other than the company as a whole. This definition seems too wide, because it covers a case where the extraneous duty of loyalty is owed to a person who has not played a part in appointing the director to office. Nonetheless, it captures the central idea that a problem will arise whenever an extraneous duty of loyalty exists.

The facts which create the extraneous duty, and give rise to the director's appointment, are crucially important. There is a wide range of possibilities. First, there are cases where the appointment is made by the nominator pursuant to an empowering provision in the articles of association of the company. Thus, the articles may make provision for a creditor to appoint a nominee to the board, to provide a form of security for the debt. They may give employees a right to appoint, perhaps by an election; or give the government a right to appoint in order to protect a public investment in the entity or to ensure adherence to some public policy which the entity is capable of affecting. Where the company is a joint venture vehicle, the articles may give each of the venturers the right to make appointments to the board. The articles may confer a right of appointment on a substantial minority shareholder.

The CSLRC's concept of 'nominee' extends beyond cases where the right of appointment is written into the articles. The articles may provide, in typical fashion, that directors are elected by the shareholders (perhaps by rotation) and casual vacancies are filled by the board. However, a party other than the majority shareholder may be given the right to have a nominee on the board because of a contract. A shareholders' agreement, for example, may guarantee places on the board for various shareholders, and so long as the agreement does not purport to fetter the company's statutory power to alter its articles, and binds all shareholders, the agreement will be effective.[5]

In another group of cases there is no right of appointment of a nominee in the articles, and no contractual right, but the 'nominator' is in such a position of influence that those who have the power to appoint will accede to the nominator's wish for board representation without being under any strictly legal compulsion to do so.

This variety of circumstances is important because of its legal implications. Since there is no precise meaning for the words 'nominee director', we should not expect a discrete body of legal principles dealing with the nominee director's position. Instead, we should expect that legal analysis will depend upon a close investigation of the facts - the question for discussion is likely to be whether the particular representational circumstances, upon careful analysis, should be taken to have modified the standard legal principles to which any director is subject.

One can imagine that a similarly wide range of circumstances could arise in the case of fiduciaries other than company directors. For example, the

5 *Russell v Northern Bank Development Corp Ltd* [1992] BCLC 1016.

constituting legislation for a statutory board may require that members of the board be appointed as nominees or representatives of particular groups, such as employees or consumers. Short of statutory requirements, the statutory board may adopt representational arrangements for other reasons - for example, to satisfy an authorisation requirement of the Trade Practices Commission. Short of that, the board may implement representational arrangements voluntarily, as a matter of internal procedure.

A board of trustees of a superannuation fund, or the board of directors of a corporate trustee of such a fund, might exemplify any of a similarly wide range of representational circumstances, subject to any relevant legislative requirements. Again, one would expect the precise structure to affect the fiduciary responsibilities.

The Trustee as Representative

There appear to be very few useful cases in the law of trusts. As Sir Robert Megarry remarked when discussing one of the few relevant cases, 'it would have attracted little attention if the territory that it covered had been occupied by a reasonable body of authority; but in England the cupboard was bare.'[6] Textbooks tell us that trustees have a duty not to set up a *jus tertii*, and they present the duty of loyalty to beneficiaries in quite categorical terms.[7] The scarcity of authority could be partly explained by the strictness of the fiduciary principle; partly also by the fact that in the absence of contrary provision in the trust instrument, the trustees must act unanimously and there is no room for divergence of opinion.

In *Newsome v Flowers*[8] some members of a congregation of Baptists seceded from their parent church and subsequently twelve of the breakaway group were appointed as trustees of Baptist church trusts. Those trustees claimed the trust property for the sect. The court set aside their appointment as trustees, on the ground that they were treating members of the sect rather than the Baptist church as their cestuis que trust. Evidently the representative arrangements were treated as incompatible with the trustees' duty.

Cowan v Scargill[9] provides a better factual analogy. The committee of management of the mineworkers' pension scheme comprised ten people, five of whom were appointed by the National Union of Mineworkers. About a third of the contributions to the fund came from members of the fund. The union representatives objected to fund investments in oil and overseas, on political and other non-financial grounds. Megarry J declared that the union representatives were in breach of their duty as trustees. He held that, under a

6 'Investing Pension Funds: The Mineworkers Case', in *Equity, Fiduciaries and Trusts* (TG Youdan, ed, 1989), p 149.

7 For example, HAJ Ford and W Lee, *Principles of the Law of Trusts* (2nd ed, 1990) p 399ff, 414-5; DJ Hayton, *Underhill and Hayton's Law of Trusts and Trustees* (14th ed, 1987) p 563.

8 (1861) 30 Beav 461; 54 ER 968.

9 [1985] Ch 270.

trust for the provision of financial benefits, the paramount duty of the trustees is to provide the greatest financial benefits for the present and future beneficiaries, subject to the statutory duty to diversify investments. There was no scope for modifying the duty by reference to the wishes of the nominator of the trustees, the union.

While the trust cases do not deal directly with questions raised by nominee relationships, they imply that the duty to act in the interests of the beneficiaries would not be qualified by the presence of representational circumstances.

Superannuation and Collective Investment Schemes

Section 52 of the *Superannuation Industry (Supervision) Act* 1993 (Cth) requires that the governing rules of a superannuation entity must contain certain covenants. One of the covenants is to ensure that the trustee's duties and powers are performed and exercised in the best interests of the beneficiaries (s 52(1)(2)(c)). Where the trustee is a corporation, this covenant also operates as a covenant by each director to exercise a reasonable degree of care and diligence for the purpose of ensuring that the trustee carries out its covenant (s 52(8)). The statutory requirement imposes a duty which is unqualified.

Nevertheless the Act requires, in the case of employer-sponsored funds, that there be equal representation of 'employer representatives' and 'member representatives' on the board of trustees (or the board of directors of a corporate trustee): s 89(1). There is no explanation of the relationship between the employer and member 'representatives' and the parties whom they represent. The implication seems to be that the duties arising out of the statutory covenant are paramount, and the cannot be diluted by reference to any extraneous loyalties to the represented groups.

In recent proposals for the reform of the law of collective investments,[10] the view that the duty to investors is paramount is stated expressly. The report recommends that a scheme operator be under an express statutory duty to act in the best interests of investors 'rather than in its own, or anyone else's interest'. Officers of the scheme operator should be subject to a statutory duty not to act in the interests of the operator or of any other person where those interests are not identical with those of investors.

English Company Law

Scottish Co-operative Wholesale Society Ltd v Meyer[11] is regarded as an archetypal case of joint venture oppression. The society formed a subsidiary to manufacture rayon and appoint the respondents joint managing directors. The

10 Australian Law Reform Commission and Companies and Securities Advisory Committee, *Collective Investments: Other People's Money* (Report No 65, 1993, Volume 1), pp 96-97.

11 [1959] AC 324.

respondents held 3,900 shares while the society held 4,000 and appointed three nominees to the board. After the society unsuccessfully attempted to buy out the respondents, it adopted a policy of transferring the company's business to a new department within its own organisation, and the nominee directors assisted in this plan. The respondents successfully partitioned for relief under the statutory oppression provisions. The arrangement between the society and the respondents was recorded in a written agreement and in the articles of the company, which entitled the society to nominate three out of the five directors 'as nominees'.

In the course of considering whether the affairs of the company were conducted in an oppressive manner, Lord Denning referred to the position of nominee directors:[12]

> So long as the interests of all concerned were in harmony, there was no difficulty. The nominee directors could do their duty by both companies without embarrassment. But, so soon as the interests of the two companies were in conflict, the nominee directors were placed in an impossible position. ... it is plain that, in the circumstances, these three gentlemen could not do their duty by both companies, and they did not do so. They put their duty to the co-operative society above their duty to the textile company in this sense, at least, that they did nothing to defend the interests of the textile company against the conduct of the co-operative society. They probably thought that 'as nominees' of the co-operative society their first duty was to the co-operative society. In this they were wrong. By subordinating the interests of the textile company to those of the co-operative society, they conducted the affairs of the textile company in the manner oppressive to the other shareholders.

Lord Denning reiterated his view about the duties of nominee directors in *Boulting v Association of Cinematograph Television and Allied Technicians*,[13] where he said:

> or take a nominee director, that is a director of a company who is nominated by a large shareholder to represent his interests. There is nothing wrong in it. It is done every day. Nothing wrong, that is, so long as the director is left free to exercise his best judgment in the interests of the company which he serves.

The approach taken by Lord Denning in these cases has been described as 'strict interpretation', in the sense that Lord Denning does not acknowledge that the representational circumstances weaken the director's fiduciary duty to act in the interests of the company.[14]

Australian and New Zealand Company Law

There are two principal cases in Australia, and two in New Zealand.

12 [1959] AC at 366-7; see also *Viscount Simonds* at 341.
13 [1963] 2 QB 606 at 626-7.
14 *Sievers*, op cit ibid n 1, at 3.

In *Levin v Clark*[15] the plaintiff purchased a majority shareholding in a company and took a mortgage for purchase monies from the vendor. The articles of the company provided for the appointment of two governing directors. These positions were purportedly occupied, although there had been some irregularities in appointment, by individuals associated with the vendor. It was arranged that they would remain as directors but would not exercise their powers as governing directors unless the plaintiff defaulted under the mortgage. When the plaintiff defaulted under the mortgage the two directors attempted to exercise their powers as governing directors, and the plaintiff sought to restrain them on various grounds, one of which was that they had breached their fiduciary duty by acting in he interests of the mortgagee rather than the company as a whole. Jacobs J rejected this argument, saying:[16]

> I consider that Clark and Rappaport did act primarily in the interests of the mortgagee once they resumed the exercise of their powers as governing directors. However I consider that it was permissible for them so to act. It is of course correct to state as a general principle that directors must act in the interests of the company. There is no necessity to refer to the large body of authority which supports this as a general proposition. However, that leaves open the question in each case - what is the interest of the company? It is not uncommon for a director to be appointed to a board of directors in order to represent an interest outside the company - a mortgagor or other trader of [or?] a particular shareholder. It may be in the interests of the company that there be upon its board of directors one who will represent these other interests and who will be acting solely in the interests of such a third party and who may in that way be properly regarded as acting in the interests of the company as a whole. To argue that a director particularly appointed for the purpose of representing the interests of a third party, cannot lawfully act solely in the interests of that third party, is in my view to apply the broad principle, governing the fiduciary duty of directors, to a particular situation, where the breadth of the fiduciary duty has been narrowed by agreement amongst the body of shareholders.

In *Re Broadcasting Station 2GB Pty Ltd*[17] it was alleged, in a suit complaining of statutory oppression, that the new controller of 2GB, Fairfax, had appointed directors to 2GB's board who were for all intents and purposes the nominees of Fairfax, although the articles did not provide for the appointment of nominee directors. In rejecting the claim of oppression, Jacobs J said:[18]

> I am satisfied that these additional directors were, to all intents and purposes, the nominee of the Fairfax companies would be likely to act and who would be expected by the Fairfax interests to act in accordance with the latter's wishes. At this point I feel that a crucial stage in the analysis is reached. It is my view that conduct of the kind which I have related is not reprehensible unless it can also be inferred that the directors, so nominated, would so act even if they were of the view that their acts were not in the best interests of

15 [1972] NSWR 686.
16 [1962] NSWR at 700.
17 [1964-5] NSWR 1648.
18 [1964-5] NSWR at 1663.

> the company. This is not a conclusion which can likely be reached and I see no evidence in the case upon which I can reach that conclusion. It may well be, and I am inclined to regard it as the fact, that the newly appointed directors were prepared to accept the position that they would follow the wishes of the Fairfax interests without a close personal analysis of the issues ... but I see no evidence of a lack in them of a bona fide belief that the interests of the Fairfax company were identical with the interests of the company as a whole. I realise that, upon this approach, I deny any right in the company as a whole to have each director approach each company problem with a completely open mind, but I think that to require this of each director of a company is to ignore the realities of company organisation. Also, such a requirement would, in effect, make the position of a nominee or representative director an impossibility.

The observations of Jacobs J in these two cases were referred to by Mahon J in the New Zealand case, *Berlei Hestia (NZ) Ltd v Fernyhough*.[19] There an Australian company owned 40% of the shares of a New Zealand company. Under the articles the Australian and New Zealand shareholders could each appoint three directors. When the New Zealand company began to compete with its Australian shareholder in Australia, there was a breakdown between the Australian and New Zealand shareholders. Consequently the New Zealand directors adopted accounting procedures which would cause a loss of dividend to the Australian company, and purported to exclude the Australian directors from management of the company on the ground that they were business rivals. The Australian company sought injunctions to prevent this conduct, and was successful.

In order to determine whether the Australian directors should have access to corporate information, Mahon J had to consider the nature of their fiduciary duty, because the right of access to corporate information is conferred by the law so that the director can perform his or her duty. He said:[20]

> Notwithstanding that the Australian directors are the nominees of the Australian company, they nevertheless have responsibilities to the whole body of shareholders. ... but despite the width of that proposition, there have been attempts to bring this theoretical doctrine of undivided responsibility into harmony with commercial reality, upon the basis that when articles are agreed upon whereby a specified shareholder or group of shareholders is empowered to nominate its own directors, then there may be grounds for saying that in addition to the responsibility which such directors have to all shareholders as represented by the corporate entity, they may have a special responsibility towards those who nominated them. Such a view proceeds on the basis that the articles were so constructed with the intent and belief that the institution of such a special responsibility towards one class of shareholders was conducive to the interests of the company as a whole. [He referred to the two judgments of Jacobs J]. In the present case this business undertaking, stripped of its corporate shell, is a trading partnership between two organisations operating in different countries. They agreed, when the company was incorporated, that each partner nominate three directors, and they impliedly

19 [1980] 2 NZLR 150; [1980] ACLC (CCH) 34,210.

20 [1980] ACLC (CCH) 34,223.

> agreed, as the articles show, that one class of directors was at liberty to bring the board's functions to a standstill when a disagreement arose, and that disagreement would almost certainly have its origin in a dispute between the two sets of shareholders. These consequences were all well known to the corporators when the articles were drawn. As a matter of legal theory, as opposed to judicial precedent, it seems not unreasonable for all the corporators to be able to agree upon an adjusted form of fiduciary liability, limited to circumstances where the rights of third parties vis-a-vis the company will not be prejudiced. The stage has already been reached, according to some commentators, where nominee directors will be absolved from suggested breach of duty to the company merely because they act in furtherance of the interests of their appointors, provided that their conduct accords with bona fide belief that the interests of the corporate entity are likewise being advanced.

In *Trounce and Wakefield v NCF Kaiapoi Ltd*[21] a company (Stevens) was a 20% shareholder in Kaiapoi, under the articles of which it was entitled to appoint two directors. Another company in the Stevens group made a takeover bid for Kaiapoi. The two nominee directors in Kaiapoi were directors of the offeror company. The majority directors of Kaiapoi resolved to exclude the nominee directors from deliberations considering the offer, and established a board committee from which the nominee directors were excluded. The nominee directors succeeded in obtaining an injunction to restrain this conduct.

The critical issue for Heron J was whether the majority directors were entitled to deprive the nominee directors of their rights to participate in the affairs of the company - the same issue as in *Berlei Hestia*. As in that case, Heron J found it appropriate to refer to the case law on nominee directors. He found that it could not be assumed, simply because the two directors were appointees of Stevens, that they would act in the interests of the Stevens Group rather than in the interests of the company as a whole. Since the articles gave Stevens the right to appoint two directors, it must have been contemplated that those directors would participate in all matters relating to the future of the company. Even if a situation arose where a matter before the board (for example, the introduction of a new shareholder) would make the Stevens takeover more difficult, the court should not anticipate that information regarding that matter would be used by the nominee directors in breach of fiduciary duty.

The Australian and New Zealand cases[22] have been described as adopting a 'pragmatic approach', in contrast with the strict approach of the English cases.[23] Certainly the statements of principle quoted above have a different flavour from the pronouncements of Lord Denning. The question is whether there are real differences of principle and application, or whether the differences in flavour can be explained by close analysis of the facts of the cases.

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21 (1985) 2 NZCLC 99,422.

22 To which may be added various dicta reiterating the central propositions of the cases discussed here: for example *Morgan v 45 Flers Avenue Pty Ltd* (1986) 10 ACLR 692.

23 Sievers, op cit ibid n 1, p 4.

Statutory Bodies

Two more cases should be noted. *Bennetts v Board of Fire Commissioners of New South Wales*[24] involved a board constituted by statute, comprising a president and four other members, each elected by a separate constituency. One of the members was elected by members of the Fire Brigade Employees' Union. The board had to consider, on the basis of a finance committee recommendation after receipt of counsel's advice, whether to appeal from an Industrial Commission decision relating to the Union's application for a new award. Two members of the board who were members of the Union took proceedings to compel the president to release counsel's legal opinion and to invalidate the board's decision to appeal.

The issues for the court again related to access to information. It was relevant to make observations about the duty of board members because the right to information is linked to the discharge of the fiduciary duty. Street J said:[25]

> By the terms of their statutes, boards such as this comprise a number of persons nominated or chosen by various groups, each of which nominating or choosing groups has a direct interest in the public undertaking controlled by the board. Each of the persons on such a board owes his membership to a particular interested group; but a member will be derelict in his duty if he uses his membership as a means to promote the particular interests of the group which chose him. ... The consideration which must in board affairs govern each individual member is the advancement of the public purpose for which parliament has set up the board. A member must never lose sight of this governing consideration. His position as a board member is not to be used as a mere opportunity to serve the group which elected him. In accepting election by a group to membership of the board he accepts the burdens and obligations of serving the community through the board. This demands constant vigilance on his part to ensure that he does not in the smallest degree compromise or surrender the integrity and independence that he must bring to bear in board affairs. ... In particular, a board member must not allow himself to be compromised by looking to the interests of the group which appointed him rather than to the interests for which the board exists. He is most certainly not a mere channel of communication or listening post on behalf of the group which elected him.

In *Molomby v Whitehead*[26] Molomby was a director of the Australian Broadcasting Corporation. He was appointed to the board on the nomination of the Minister in consequence of an election held by staff of the ABC. He sought access to ABC documents relating to claims for legal fees and other matters, and was successful in the Federal Court. Beaumont J held that prima facie, Molomby was entitled to information relating to the management and affairs of the ABC, and proceeded:[27]

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24 (1967) 87 WN (Pt 1) (NSW) 307.
25 (1967) 87 WN (Pt 1) (NSW) 310
26 (1985) 63 ALR 282.
27 63 ALR at 294.

> Short of a situation such as arose in *Bennetts'* case, involving a clear conflict of interest on the part of the director, and no such conflict was established here, it is not open to the managing director to deny Molomby access to corporate documents on his assertion that they 'confidential'.

Commentators have tended to treat the *Bennetts'* case as an example of the 'strict' English view, while *Molomby's* case is, if anything, seen as an example of the more pragmatic approach.[28]

A Suggested Reconciliation

Generally speaking, Australian judges have not shown much inclination to soften or attenuate fiduciary principles in order to cater for commercial circumstances. If a duty of loyalty exists, Australian law will normally enforce the duty rigorously.[29] Outside the field of company law, the fiduciary's duty not to set up a *jus tertii* appears to be a particularly strict component of fiduciary responsibility, as we have seen. There is no good reason *in principle* to treat the commercial circumstances of the company law cases as justifying a departure from the normal rule. We must therefore treat with an initial scepticism the claims that Australian courts have taken a lenient, 'pragmatic' approach to nominee directors.

As fiduciaries, directors must not put themselves in a position where their duty to the company conflicts, or there is a real sensible possibility that it may conflict, with their personal interest. A nominee director could fall foul of this principle if he or she has a substantial personal stake in the nominator. Where that is so (and assuming no attenuation in articles of association), the duty is not just to avoid actual conflict by excluding oneself from a decision which will benefit the nominator. It is a duty to avoid any significant possibility of conflict. A person who is both a director and a significant shareholder of the nominator should simply not be nominated to the board of the other company. While this principle is obviously important, and is acknowledged by Bowen CJ in *Re Cumberland Holdings Ltd*,[30] the cases discussed in this paper do not appear to be cases about conflict between interest and duty.

A director must also avoid situations of *actual* conflict between his duty to the company and an extraneous duty, such as the duty to act in the interests of the nominator.[31] Properly analysed, the *Scottish Co-operative* case is an example of nominee directors being in a position of actual conflict between their duty to the company and their duty to their nominator. A decision to divert the business of a profitable enterprise from the subsidiary to the parent inherently raised a conflict for the nominee directors. Lord Denning took the view that in the circumstances, their duty to the company was to protect against

28 Sievers, op cit ibid n 1, at 3,10.

29 See, generally, the analysis by PD Finn, 'The Fiduciary Principle', in *Equity, Fiduciaries and Trusts* (TG Youdan, ed, 1989), p 1.

30 (1976) 1 ACLR 361 at 375.

31 See *Commonwealth Bank of Australia v Smith* (1991) 102 ALR 453; Finn, op cit ibid n 3, p 54-55.

the conduct of the co-operative society, even if a protest would have been ineffective.[32] Clearly their duty to the nominator was to facilitate the transfer of business.

The remarks of Street J in the *Bennetts'* case, quoted above, are also directed towards a situation where a direct conflict of duty and duty has arisen. A board member who uses his membership as a means to promote the particular interests of the group which chose him, is clearly in a position of conflict and is preferring his duty to the nominator to his duty to the board. Mr Bennetts' unusual admission that 'as the representative of the permanent firemen I have an obligation to those firemen, and it would be incumbent on me to make a report to my State Council upon any determinations of the board'[33] demonstrates that he saw himself in a position of conflict between duty and duty, and intended to prefer the extraneous duty to the fiduciary duty.

In contrast, there was no evidence that Mr Molomby was doing anything more than pursuing information which was relevant to the discharge of his fiduciary duty. There was no basis for an assertion that a conflict between duty and duty had arisen. Equally in *Berlei Hestia*, although the Australian company was in competition with the New Zealand company, there was no evidence that the Australian nominee directors were under any duty to their nominator which would be incompatible with discharge of their duties to the company.

In the *Trounce* and *Wakefield* case Heron J was even prepared to find that a conflict between duty and duty had not necessarily arisen when the nominee directors of the target were also directors of the offeror, although presumably various conflicts would arise from time to time during the course of the bid.

The director's duty to avoid actual or possible conflicts of interest can be attenuated by unanimous agreement of shareholders of a provision in the articles of association of the company, subject to the limitation imposed by s 241 of the Corporations Law, which prevents an exemption from duty.[34] The obligation to avoid a conflict between duty and duty can also be attenuated by unanimous agreement or a provision in the articles.[35] Obviously, ss 232(5) and (6) impose statutory duties regarding improper use of information and position which cannot be altered, although a modifying article would presumably influence what is 'improper' for the purposes of those subsections.

Once one recognises that the articles may attenuate these duties, the importance of analysing the nature of the nominee arrangements in the instant case becomes obvious. If the nominee relationship derives from the articles,

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32 [1959] AC at 367.
33 (1967) 87 WN (Pt 1 (NSW) at 312.
34 See *Movietex Ltd v Bulfield* [1988] BCLC 104; there is an excellent analysis of the tangled law on this subject in *Fiduciary Duties and Regulatory Rules: A Consultation Paper* (The Law Commission (UK), Consultation Paper No 124, 1992), p 76ff.
35 See *Whitehouse v Carlton Hotel Ltd* (1987) 5 ACLC 421 at 425 per Mason CJ, Deane and Dawson JJ.

which permit the nominator to make a direct appointment to the board and expressly or impliedly authorise the director to act in the role of 'nominee', there may well be an implied attenuation of the fiduciary duty to the company, allowing the nominee director in certain circumstances to prefer his or her duty to the nominator. Where this occurs there is no weakening of the fiduciary principle, but rather a confirmation that the content of the duty may be affected by the consensual circumstances in which it arises.

Properly understood, this is Jacobs J's point in *Levin v Clark*. In that case the articles, coupled with the sale and mortgage arrangements, clearly constituted an attenuation of the fiduciary duty of the two nominee directors to the company. The attenuation was sufficient to permit them to act primarily in the interests of the mortgagee once they resumed their powers as governing directors upon default by the mortgagor. As Jacobs J stated, 'the breadth of the fiduciary duty has been narrowed by agreement amongst the body of the shareholders'.[36]

Such an attenuation of duty as was found in *Levin v Clark* was sufficient to allow the nominee directors to act in the mortgagee's interest. The attenuation would presumably not have been sufficient to allow them to embark upon a course of oppressive conduct designed to injure the minority shareholders by destroying the company's business. This factual distinction is what separates *Levin v Clark* from the *Scottish Co-operative* case. Lord Denning's denial of the view that the first duty of the nominees was to the co-operative society comes in a paragraph in which his Lordship analyses the facts, and asserts that their nominee relationship with the society did not entitle them to so subordinate the interests of the textile company that they conducted its affairs in an appressive manner.[37]

Bennetts is an easier case because there, the statutory arrangements for election of members of the board were held not to reduce the fiduciary duty at all.[38]

The *2GB* case does not fit into the analysis presented so far. It cannot readily be treated as an attenuation case, because Fairfax was not exercising any special right of appointment under the articles, nor relying on any other consensual arrangement which would bind all shareholders. Fairfax was simply exercising its majority power to appoint its 'nominees' to fill vacancies on the board.

It is submitted that the case raises different principle which distinguishes it from the other decisions on nominee directors. The central fact for Jacobs J was that Fairfax was a majority shareholder whose nominee directors were

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36 [1962] NSWR at 700. See also *Whitehouse v Carlton Hotel Ltd* (1987) 5 ACLC 421 at 437-8, where Brennan J specifically treats *Levin v Clark* as an attenuation case.

37 [1959] AC at 367.

38 (1967) 87 WN (Pt 1 (NSW) at 310.

accused of acting in the interests of the *controlling shareholder*. The case relates to the duty of directors of a subsidiary in a corporate group, and should be seen as part of the long line of 'corporate group' cases rather than a case on nominee directors as such.[39] As Jacobs J analysed the facts, the nominee directors were prepared to follow the wishes of their parent company without a close personal analysis of the issues. That is, they did not consciously or subjectively consider the interests of the subsidiary as a separate corporate entity. However, he found no evidence of any lack of bona fide belief that the interests of the subsidiary were serviced by their conduct.

The formulation of the duty of directors of a subsidiary in a corporate group is a matter of controversy. In *Walker v Winborne*[40] Mason J took the view that it is the duty of the directors of a subsidiary to consider the interests of that entity and that entity alone. He seemed to have in mind the directors' subjective determination. A similar approach was taken by Cole J in *Spedley Securities Ltd v Greater Pacific Investments Pty Ltd (in liq)*[41] and by Southwell J in *Linter Group Ltd v Goldberg*.[42]

In *Charterbridge Corporation Ltd v Lloyds Bank Ltd*[43] Pennycuick J adopted a different formulation. Recognising that commercial decisions are likely to be taken having regard to group interests, without sole attention being paid to the interests of the subsidiary as a separate entity, he thought the question to be asked was whether an intelligent and honest man in the position of the director could have reasonably believed that the transaction was for the benefit of the subsidiary. Jacob J's approach in the *2GB* case seems closely related to Pennycuick J's in *Charterbridge*.

The debate about whether, in the group context, a subjective or objective test is appropriate, is continuing, and the *Charterbridge/2GB* approach seems to be losing ground.[44] But whatever the outcome, the *2GB* case should not be seen as a special attenuation of duty for nominee directors.

Corporate Information

The Australasian cases on nominee directors have established one principle very clearly. Attached to the director's fiduciary duty is a correlative right of access to corporate information. Quite apart from statutory provisions, the director is entitled at general law to such corporate information as is necessary to enable him or her to discharge the fiduciary duty, and therefore may restrain the board or management from withholding such information, unless it is clear that the director will misuse the information contrary to the interests of the

39 See RP Austin, 'Problems for Directors within Corporate Groups', in *The Law Relating to Corporate Groups* (M Gillooly, ed, 1993), 133.
40 (1976) 137 CLR 1 at 6-7.
41 (1992) 7 ACSR 155, 164.
42 (1992) 7 ACSR 580 at 589-90.
43 [1970] 1 Ch 62 at 74.
44 *Equiticorp Fiance Ltd (in liq) v Bank of New Zealand* (1993) 11 ACLC 952, at 1018-1019 per Clarke and Cripps JJA.

company.[45]

In the *Berlei Hestia* case the court held that the majority directors could not deprive the nominee directors for the 40% Australian shareholder of access to corporate information, even though the Australian shareholder had become a competitor of the New Zealand company. This principle has even been held to prevent a target company from establishing a subcommittee of the board to respond to a takeover, if the subcommittee is structured so as to exclude the directors who are nominees of the offeror.[46] The effect of the cases is that the board is entitled to refuse to supply information to an individual only very rarely.[47]

The facts of the *Bennetts* and *Molomby* cases provide an interesting contrast. In *Molomby* there was no evidence that Molomby intended to misuse the information which he sought. He was seeking to obtain information about fees for legal advice, an investigation quite appropriate to his position as a staff representative on the board of the ABC. In *Bennetts*, on the other hand, the union representative on the board was asked to undertake that he would not supply counsel's advice to the union which he represented, since the union was the other party to the proposed appeal. He said 'I cannot give this assurance. You know my position.' This response gave the board clear evidence that he intended to act contrary to his fiduciary duty.

Another problem which frequently arises when there are nominee directors on the board is whether the nominee may transmit boardroom information to the nominator. Surprisingly, the answer is unclear, though the general principles are plain enough.

There may be express or implied contractual constraints on passing on information. For example, the arrangements which create the right to nominate a director may deal expressly with the question of information, or else an implied contractual term might arise out of the circumstances of appointment. Contrast a situation where a significant minority shareholder is invited to propose someone to fill a vacancy which has arisen on the board, with a situation where the company is a joint venture between equal stakeholders. One would expect significant constraints on information flow in the first case, but very few or none in the second.

In the absence of express or implied contractual terms, there seems to be no general principle that information derived by a person in his or her capacity as a director is necessarily confidential information, even if it is contained in board papers. However, apart from contract there are two significant,

45 *Edman v Ross* (1922) 22 SR (NSW) 351; *Conway v Petronious* [1978] 1 All ER 185; *Berlei Hestia (NZ) Ltd v Fernyhough* [1980] 2 NZLR 150.

46 *Trounce and Wakefield v NCF Kaiapoi Ltd* (1985) 2 NZCLC 99,422.

47 If nominee directors were under a specially limited form of fiduciary duty, their right of access to information would be more limited than the right of access of other directors, because access is made available only to permit the director to discharge the fiduciary duty. But this appears not to be so, particularly in light of the two New Zealand cases.

overlapping constraints which need to be considered.

First, a person (whether a fiduciary or not) may become subject to an equitable duty not to misuse information if it was confidential information disclosed to him in circumstances which imposed on him an obligation to respect its confidential status.[48] Presumably Street J had in mind the equitable duty when he referred in *Bennetts* case to 'the ordinary obligation of respecting the confidential nature of board affairs where the interests of the board itself so require'.[49] On this principle, board information is not necessarily confidential, but a confidential character might arise from the particular circumstances of its disclosure or the general practices of the board.

The second constraint is the fiduciary duty. Whether the information is intrinsically confidential or not, the director's fiduciary duty to the company requires him or her to act in good faith in the company's interests. If, for example, a director were to become involved in a battle for election of the kind which arose in *Advance Bank of Australia Ltd v FAI Insurances Ltd,*[50] a breach of fiduciary duty could be involved if the director were, inappropriately, to circularise shareholders with boardroom information.

The contractual and equitable constraints on a director passing information to his or her nominator are supplemented by s 232(5) of the Corporations Law, which prevents an officer from making improper use of information acquired by virtue of his or her position to gain directly or indirectly an advantage. In *Rosetex Co Pty Ltd v Licata*[51] Young J held that for the purposes of the section, 'information' means the sort of information which equity would protect by injunction if a director were to use it in breach of his or her fiduciary duties. On this view, s 232(5) does not impose any restriction different from the general law principles.

As a practical matter, the lesson here is that the director's right to pass on information should be addressed contractually at the time of his or her appointment. Companies are increasingly adopting articles of association which make it clear that boardroom information is to be treated by directors as confidential information in all cases.

Acutely difficult problems arise in reconciling the position of the nominee director with respect to corporate information, with the law concerning takeovers and insider trading. In *Austen & Butta Ltd v Shell Australia Ltd*[52] Shell made a takeover offer for the shares of Austen & Butta. Shell lodged a Part A statement with the Commission and served it on Austen & Butta. The statement contained some information confidential to Austen & Butta, which Shell had obtained by virtue of its board positions. Austen & Butta obtained an injunction

48 See F Gurry, 'Breach of Confidence', in *Essays in Equity* (PD Finn, ed, 1985), p 111.
49 (1987) 87 WN (Pt 1) (NSW) at 310.
50 (1986) 11 ACLR 38.
51 (1994) 12 ACLC 269.
52 (1992) 10 ACLC 610.

to restrain service of the Part A statement and ultimately, Shell consented to interlocutory relief.

The facts presented an exquisite problem. Austen & Butta alleged that the information was received by Shell's nominee directors subject to an obligation of confidentiality. As a takeover offeror, however, Shell was subject to a statutory duty to include in the Part A statement any information known to the offeror which is material to the decision of target shareholders whether to accept the offer: s 750, Parts A, cl 17. Further, unless the information were to become generally available, Shell might be prevented from proceeding with he bid because of the insider trading provisions, particularly ss 1002G, 1002K and 1002L.

Brownie J's principal ground for dismissing Shell's motions to vary the injunctions was that, Shell having consented to them, it was necessary for Shell to show a significant change of circumstances or new facts, and it had failed to do so. Brownie J touched on issues of more substance, but inconclusively. In particular, he said:[53]

> It may also be that, in other circumstances, an offeror who is in possession of information which is confidential to the target company cannot make a Part A statement without offending against the provisions of s 750 Part A clause 17, or without exposing himself to some claim by the target company for relief; and it may follow that, in such a case s 750 means that he cannot make a takeover offer at all ... .

In these circumstances, it will be particularly important to determine whether the nominator is deemed to possess all information acquired by the nominee director, whether or not the information is acquired subject to a duty of confidentiality. At least in the context of Chapter 7 of the Corporations Law,[54] the position seems to be that if the nominator is a body corporate and the nominee director is its agent acting within the scope of his or her actual or apparent authority, the nominee director's knowledge will be attributed the nominator even if the nominee director is precluded from passing it on. The position may not be much different at general law, even without the aid of statutory provisions.[55] The lesson for the nominator is to think very carefully before accepting arrangements in which the nominee director is required to treat information as confidential. From the nominator's point of view, there should either be a free flow of information, or the director should not be a nominee or agent of any kind.

53 (1992) 10 ACLC at 615.

54 See ss 762(3) and (7) and s 1002E.

55 See *Harrods Ltd v Lemon* [1931] 2 KB 157; *Lloyds Bank Ltd v E B Savory & Co* [1933] AC 201; *Standard Investments Ltd v Canadian Imperial Bank of Commerce* (1986) 22 DLR (4d) 410; RP Austin, 'The Corporate Fiduciary', (1986-87) 12 *Can Bus LJ* 96; J Zeigel, 'Bankers' Fiduciary Obligations and Chinese Walls', (1986-87) 12 *Can Bus LJ* 211. See the excellent analysis in *Fiduciary Duties and Regulatory Rules: A Consultation Paper* (The Law Commission (UK), Consultation Paper No 124), p 22ff.