

## Directors' Financial Relationships with the Company

This chapter discusses the benefits directors may derive from office. Provisions dealt with elsewhere also have a bearing on this — notably, s 228 of the Code on disclosure of contracts, s 229 on dishonesty, s 542 on what was known as misfeasance and ss 128–130 of the *Securities Code* on insider trading. This chapter deals with directors' remuneration, service contracts between directors and their companies, termination payments or benefits, loans to directors, indemnification of directors and the disclosure of directors' benefits. There is an unfortunate lack of uniformity of approach by the legislature to these various matters. Professor Austin regrets the absence of 'an underlying philosophy of regulation'. Unfortunately, different provisions dealing with directors' benefits attach different consequences to breaches, attack different ranges of persons, allow different persons and groups to complain or seek redress and let some breaches and not others be forgiven or ratified.<sup>1</sup> Directors who seek clear and succinct guidelines from the legislature on their responsibilities in this area will be disappointed. It is apparent that the legislature is concerned about self-dealing transactions, but the accepted categories of transactions are wide, and the burden of proving unfair transactions rests on the shareholders.

### Directors' remuneration

A director, in his capacity as a director, is not an employee of the company. Instead, as Bowen LJ concluded in his oft-cited passage, 'He is a person doing business for the company, but not upon ordinary terms. It is not implied from the mere fact that he is a director, that he is to have a right to be paid for it'.<sup>2</sup> He has no inherent right to be paid for his services.<sup>3</sup> However, it is accepted that he should be compensated for

1. Address by Professor Austin (University of Sydney) entitled 'Directors' Benefits', delivered to the Confederation of Australian Industry Companies and Securities Workshop (1982).
2. *Hutton v West Cork Railway* (1883) 23 Ch D 654 at 672. See also *Re George Newman & Co* [1895] 1 Ch 674 at 686. Cf *Craven-Ellis v Canons Ltd* [1936] 2 KB 403, which concerned a managing director.
3. *Re George Newman & Co*, *ibid* at 686.

acting as a director if he gives substantial attention to the company's business.

The articles usually say that the directors, *qua* directors, shall be paid such remuneration as the general meeting shall determine,<sup>4</sup> plus all travelling and other expenses properly incurred in attending board meetings, general and other company meetings and otherwise in pursuing the company's business.<sup>5</sup> But this power to pay for travelling and other expenses must be in the articles; otherwise it is assumed that the director's remuneration includes a component for travelling to and from the board room and associated accommodation. 'It is the chief part of the ordinary business of a director to attend board meetings.'<sup>6</sup>

The directors themselves, however, usually determine what remuneration<sup>7</sup> (such as salary, commission or participation in profits) a *managing director* will receive. Many directors are also employees of the company, being executive directors with service contracts with their company. They have their normal contractual rights to remuneration as *employees*.

It seems that, where the articles expressly set out the method of determining the remuneration of directors for acting as the board, a director cannot claim remuneration on the basis of *quantum meruit*<sup>8</sup> (that is, on the basis that services as a director have been performed and the company has impliedly accepted them).

Although the possibilities of abuse are obvious, the articles sometimes say that the directors shall determine their own remuneration.<sup>9</sup> The board may be well qualified to do this (better qualified in fact than the general meeting), but the final decision should rest with the shareholders.<sup>10</sup> This would reduce the danger of 'one of the most common abuses, namely running companies for the sole benefit of the directors who take everything by way of remuneration leaving nothing for shareholders'.<sup>11</sup> Where the board is empowered to decide the directors remuneration, or the articles specify a set annual amount, the directors can sue for or claim their money as a debt once it is declared or earned.<sup>12</sup>

4. See reg 63(1) of Table A. Such an article was at issue in *Re Dale & Plant Ltd* (1889) 43 Ch D 255; *Ex parte Cannon* (1885) 30 Ch D 629.

5. See reg 63(3) of Table A. Travelling costs were at issue in *Young v Naval and Military Co-operative Society* [1905] 1 KB 687.

6. Farwell J in *Young's case*, *ibid* at 695.

7. See reg 80 of Table A.

8. See *Re George Newman & Co*, above n 2 at 686; *Re Richmond Gate Property Co Ltd* [1964] 3 All ER 936 at 938. Cf *Craven-Ellis v Canons Ltd*, above n 2. A quantum meruit claim was rejected in *Re Bodega Co Ltd* [1904] 1 Ch 276 at 287-288 because, if the true facts of self-dealing by the 'director' had been known, that person's services would never have been accepted.

9. As in *Nell v Atlanta Gold and Silver Consolidated Mines* (1895) 11 TLR 407.

10. 'As an alternative the courts might make an exception to the rule that directors' action is not binding unless there is a disinterested majority and sustain the salaries voted by the board if it finds them to be fair': Palmer, 'Directors' Powers and Duties', Ch 12 in *Studies in Canadian Company Law* (Ziegel (ed), 1967) at 382.

11. Gower's 1961 *Report on the Ghanaian Companies Code* at para 194.

12. *Re New British Iron Co* [1898] 1 Ch 324 at 326; *Nell v Atlanta Gold and Silver Consolidated Mines*, above n 9 at 408.

Where the articles say that the general meeting must vote any remuneration, the director can only claim or sue for it once these contractual terms have been fulfilled. If the company is wound up before such a vote, the director is not entitled to recover for services he may have performed.<sup>13</sup>

The favoured view is that remuneration is payable to a director, not as a 'special' member of the company, but as a creditor.<sup>14</sup> Therefore, if the company goes into liquidation, a director who is owed arrears of remuneration ranks with and is payable rateably with the company's other creditors and is not deferred.<sup>15</sup>

The articles usually say that a director's remuneration accrues from day to day.<sup>16</sup> So a director who has served only part of the year cannot be denied payment simply because he has not served a full year. Such claims have been made where the articles said only that the directors shall be paid a certain sum per annum. In *Moriarty v Regent's Garage Co*,<sup>17</sup> the agreement with the plaintiff was that 'his fees for so acting [as a director] shall be one hundred and fifty pounds per annum'. Two members of the Court of Appeal found that unless he had served for the full year he was not entitled to any payment.<sup>18</sup> Similarly-worded articles will probably be interpreted in this manner.<sup>19</sup> Generally, though, a proportionate fee for a proportion of a year's service is reasonable, and articles worded, for example, 'at the rate of \$Y per year' will be so interpreted.<sup>20</sup>

There are a variety of ways of calculating directors' remuneration. The general meeting may vote them sums individually, or the board as a whole may get a global sum, which it distributes in its wisdom.<sup>21</sup> Once the fee has been voted and its quantum determined, it is payable, even though the company may not have any profits. Alternatively or additionally, directors may, on an incentive system, receive a proportion of the company's profits or net profits.<sup>22</sup> Calculating the 'profits' may, however, be difficult.<sup>23</sup>

13. *Gore-Browne on Companies* (Boyle and Sykes (eds), 44th ed) at para 25.3.

14. See *Re Dale and Plant Ltd*, above n 4 at 258–260, per Kay J; Pennington, *Company Law* (3rd ed, 1973) at 494; *Gore-Browne*, *ibid*. Cf *Ex Parte Cannon*, above n 4. See also McPherson, *The Law of Company Liquidation* (2nd ed, 1980) at 328.

15. *Re New British Iron Co*, above n 12.

16. See, for example, reg 63 (2) of Table A.

17. [1921] 2 KB 766.

18. Lord Sterndale M R, *ibid* at 774; Younger L J, *ibid* at 781.

19. See *Gore-Browne on Companies*, above n 13 at para 25.3.1, Pennington, above n 14 at 492.

20. For example, *Inman v Ackroyd and Best Ltd* [1901] 1 KB 613; *Healey v S A Françoise Rubastic* [1917] 1 KB 946.

21. As in *Re New British Iron Co*, above n 12; also *Re Bodega Co Ltd*, above n 8.

22. On ways of calculating director's remuneration see *Gore-Browne on Companies*, above n 13 at para 25.3.2, and Boyle and Birds, *Company Law* (1983) at 542–543.

23. See Pennington, above n 14 at 493. *Frames v Bultfontein Mining Co* [1891] 1 Ch 140 said that a percentage of the profits did not mean or include a share of the profits on the sale of the business itself.

A director who is not validly appointed cannot claim director's remuneration,<sup>24</sup> although a person purportedly appointed as a managing director has been able to claim successfully on a *quantum meruit*.<sup>25</sup> Amounts paid for periods of time after the articles have, by automatic operation, vacated the office of director may be claimed back in some circumstances.<sup>26</sup>

Can a director, who is executor or trustee of an estate, accept remuneration when he is appointed to the board by virtue of the estate's holding in the company? One commentary succinctly summarises the position:

. . . for the trustee cum director to retain director's fees for a directorship he holds by virtue of the trust he must be able to point to a clear-cut authority in the instrument appointing him (or creating the trust) enabling him so to do: for the nominee-director to retain director's fees from a board on which he is requested to sit by another company he must be able to show some agreement to that effect by the nominating company.<sup>27</sup>

#### *Amount of remuneration for directors*

Executive directors often do not receive a fee or retainer payment in addition to their salaries. On the other hand, non-executive directors, not being employees, do not receive salaries; they are usually paid a set annual fee or retainer. Some companies now pay outside or non-executive directors on a scale, depending on the time that they devote to the company's affairs or how many meetings they attend. Large companies may pay as much as \$1000 or more per day.<sup>28</sup> A non-executive director may work, say, two days per month on one company's affairs. Another person may hold as many as 10 or more such directorships in different companies. The 1983 Survey of Australian Public Company Boards by the Institute of Directors, noted:

The average payment to non-executive directors, including the Chairman, was \$9,185. . . . The maximum payment reported for a non-executive director was \$60,000. The average payment to the chairmen of responding boards was \$15,056. Interestingly, the maximum payment to a chairman was \$52,000.

24. *Woolf v East Nigel Gold Mining Co* (1905) 21 TLR 660.

25. *Craven-Ellis v Canons Ltd*, above n 2.

26. *Re Bodega Co Ltd*, above n 8, where a director became secretly involved in a contract with the company and thus automatically or ipso facto vacated his office as director.

27. CCH, *Duties and Responsibilities of Company Directors in Australia* (5th ed, 1984) at 79. See *Re Dover Coalfield Extension Ltd* [1908] 1 Ch 65 at 69-70 where a director, who held his qualification shares as a trustee for another company, was held to be entitled to retain the remuneration paid. He was not accountable to the original company for remuneration received.

28. See Mace, 'Creative Corporate Policy and Strategy: Designing a Plan for the Ideal Board' (1979) 9 *Australian Director* 14 at 21.

A variety of additional benefits [car expenses, personal loans, club subscriptions, etc.] were found to apply to board members.<sup>29</sup>

Smaller companies may pay nominal fees only to outside or part-time directors. Several years ago, Sir John Dunlop argued that \$10,000 should be the minimum annual fee

. . . that any good company should pay to any non-executive director from whom it expects competence and vigilance and the discharge of responsibilities. Special services (such as committees) should be separately paid for, additionally. The Chairman should get at least double the ordinary fee. In large companies, the minimum should be \$15,000. And there should be regular reviews.<sup>30</sup>

Certainly, if Australian shareholders expect the highest standards of honesty, fidelity and competence they should expect to pay their directors adequately.

*Rydge's* in 1981 noted that United States' manufacturing companies pay their non-executive directors in public companies \$10,175 (annual mean) and in private companies, \$5225.<sup>31</sup> The median fee paid to Australian non-executive directors is slightly higher. Non-executive board chairmen get about twice that amount. Australian executive directors may receive (on top of their salaries) a payment of between \$2500–\$5000 pa. One survey concluded that about 50–60% of executive directors receive such payments in addition to their salaries.<sup>32</sup>

### *Disclosure of directors' benefits*

Members and others can find out how much their directors are paid. Under s 235 of the Code, if at least 10% of the members, or the holders of 5% by value of the nominal capital, by a notice require the directors to disclose 'the emoluments<sup>33</sup> and other benefits received by the directors', the company must prepare the appropriate statement. It must be audited and show the total amount of salary and benefits paid to or received by each director of the company or its subsidiaries, and it must

29. (August 1984) 14 *Australian Director* at 12–18, survey by Dr Blair Hunt. The Chairman of the insurance study committee of the Australian Company Directors' Association expressed concern (in *Rydge's*, May 1982, at 30) for directors who receive low fees:

Many thousands of executives serve their companies and shareholders as directors, in addition to their management responsibilities, with little or no extra remuneration. Up until now they had no protection for their families and personal assets if they made a mistake. Also many other people serve as outside directors for generally very modest remuneration, and again even the smallest legal action, with the attendant fees, can wipe out the fees for the entire time he or she served the company, no matter whether he or she is right or wrong.

The legal costs of a large case is a nightmare faced by all directors who accept the fiduciary responsibility of a seat on the board, as it can mean personal ruin.

30. In (January 1981) 11 *Australian Director* 13 at 14.

31. (January 1981) 'What [US and Australian] Directors Are Paid', at 28–30.

32. See Greenwood Salary Survey, March 1980, reported in *Rydge's*, above n 29.

33. Defined in s 5(1) of the Code.

be sent to all persons entitled to receive notices of general meetings and laid before the next general meeting.

Until 1986, the company's accounts or group accounts had to disclose only the total of the emoluments received, or due and receivable (whether from the company or from a related corporation) by the directors, whether or not they were executive directors. This disclosure did not (as s 235 does) require disclosure of the fixed salaries received by directors as employees. Greater automatic disclosure to shareholders in the accounts was justified, at least to the extent of the information that can be sought under s 235 (that is, the aggregate amount of remuneration including salary, paid to each director). Further, as suggested earlier, the general meeting should approve, by ordinary resolution, the remuneration paid to directors — both *qua* directors and as employees. This is not a novel suggestion; nor should it be too onerous or restrictive.<sup>34</sup>

The new Schedule 7 of the Companies Regulations (1 October 1986) demands more disclosure. Under cl 24 all companies (except exempt proprietary companies) must note in the accounts all remuneration (bonuses, commissions and salaries included) received by *each* director, whether directly or indirectly, from the company or any related corporation. Further, under cl 28, listed companies must reveal the names of the five most highly remunerated executive officers and the aggregate total of all remuneration paid to them.

## Directors and service contracts

The chief executive officers of companies are often its managing directors. They are usually paid the top salaries. They are employees as well as directors. Managing directors invariably have contracts — called service or executive contracts — with their companies, upon which they depend for their livelihood. That is, in addition to being directors (a non-contractual position for which they normally receive payment of a fee), they are managers contracted to the company as salaried employees (company executives).

The articles usually provide that a managing director may be dismissed from that post *by the board*. Typical of such articles is reg 79(1) of Table A:

The directors [may appoint a managing director] . . . and, subject to the terms of any agreement entered into in a particular case, may revoke any such appointment.

34. See (1959) 33 ALJ 173–174; Gower's 1961 *Report on the Ghanaian Companies Code*, draft s 194. Cf Institute of Law Research and Reform, Edmonton, Alberta, 'Proposals for a New Alberta Business Corporations Act', Report No 36, 1980, Vol 1, pp 68–69: 'We do not think, however, that we are prepared to go so far as to require the remuneration of director-officers to be fixed by ordinary resolution. For one thing, such a provision would make it very difficult for a company of substantial size to recruit a member of senior management who is unwilling, until he is assured of his terms of employment, to publicize or even to form, an intention of leaving his current employer. . . .'

Regulation 79(1) tells us that a well-drawn service contract, giving a duration for the managing director's appointment, will insulate him in the event of premature dismissal. In other words, the use of 'subject to the terms of any agreement' protects his right of action for breach of the contract of service. However, he is not protected from dismissal itself. Removal from the board by the board or the general meeting may, by force of an article such as reg 79(2) of Table A, remove him from his position as managing director. Under s 225, the general meeting of public companies may remove directors 'notwithstanding anything in its articles or in any agreement between it [the company] and him'. However, s 225(7) specifically preserves a dismissed director's right to seek compensation or damages for the termination of his appointment as director or of 'any appointment terminating with that as director'.

The same subsection also preserves any other power to end his appointment outside s 225 (that is, under the term of his service contract (if any) or under the articles). Thus, if there is a removal power in the articles, and it is not qualified as being subject to the contractual right to seek compensation for loss of office (as reg 79(1) is), a director entering a service contract for a specified term should ensure that his contract specifies a right to damages for premature dismissal should the powers of dismissal in the Code *or* in the articles be used.<sup>35</sup>

What, then, is the position of a managing director who has been appointed under contract for a fixed term of years and who, without just cause, loses his position prematurely, either by direct dismissal or by removal from the board which may automatically terminate his appointment? As already noted, the managing director can generally sue for damages for breach of contract. Understandably, only in rare situations will the court order specific performance of service contracts at the instance of employee or employer.<sup>36</sup> The court will also not prevent the company from altering the articles, even though the alteration will affect the managing director's service contract and facilitate his dismissal. Such an alteration is not in itself a breach of contract. If relied upon, though, it may result in an actionable breach of contract.<sup>37</sup>

In *Southern Foundries (1926) Ltd v Shirlaw*,<sup>38</sup> Shirlaw was appointed managing director for 10 years under a service contract. One of the existing articles (similar to reg 79(2) of Table A) provided that the managing director, whilst entitled to the benefit of 'the provisions of any contract between him and the company', was also 'subject to the same provisions as to . . . removal as the other directors . . . and if he ceases to hold the office of director he shall ipso facto and immediately cease to be a managing director'. After Shirlaw took up his position, the articles

35. See discussion below of *Read v Astoria Garage (Streatham) Ltd*.

36. *Bentley-Stevens v Jones* [1974] 1 WLR 638; see Note, (1960–1961) 109 U Pa L Rev 224 at 240–242.

37. *Allen v Gold Reefs of West Africa* [1900] 1 Ch 656 at 673, per Lindley M R; *Southern Foundries* [1940] AC 701 at 740–741, per Lord Porter.

38. *Ibid.*

were altered to give the new controllers of the company, Federated Foundries Ltd, the power to remove directors from office. This power was subsequently used against Shirlaw. The House of Lords, by majority, confirmed that it would be unlawful for the company to remove him as director and thus, ipso facto, as managing director:

Apart from Government interference or the like, the contract can only rightfully be dissolved by the will of the parties who entered into it. . . . But nothing of the sort can be shown by the appellants. . . . The alteration of the articles did not constitute a breach of contract by the appellant company as against the respondent, but his removal the following year did, and entitled him to damages.<sup>39</sup>

Lord Porter added:

A company cannot be precluded from altering its articles thereby giving itself power to act upon the provisions of the altered articles — but so to act may nevertheless be a breach of contract if it is contrary to a stipulation in a contract validly made before the alteration.

Nor can an injunction be granted to prevent the adoption of the new articles and in that sense they are binding on all and sundry, but for the company to act upon them will none the less render it liable in damages if such action is contrary to the previous engagements of the company. If, therefore, the altered articles had provided for the dismissal without notice of a managing director previously appointed, the dismissal would be *intra vires* of the company but would nevertheless expose the company to an action for damages if the appointment had been for a term of (say) ten years and he were dismissed in less.<sup>40</sup>

Such reasoning harks back to Cockburn C J's words in *Stirling v Maitland*:

[I]f a party enters into an arrangement which can only take effect by the continuance of a certain existing state of circumstances, there is an implied engagement on his part that he shall do nothing of his own motion to put an end to that state of circumstances, under which alone the arrangement can be operative.<sup>41</sup>

*Shindler v Northern Raincoat Co Ltd*<sup>42</sup> followed *Shirlaw*. The plaintiff held a 10-year service contract as managing director. A new holding company took control of the defendant company, exercised its voting power and dismissed the plaintiff. The articles provided for such removal of directors by general meeting. They contained the same sort of clause that was at issue in *Southern Foundries Ltd v Shirlaw* (that is, that removal from the board meant loss of the position of managing director). Diplock J held that the plaintiff was entitled to damages for wrongful dismissal, notwithstanding the dismissal provision in the articles. It was an implied term of the plaintiff's contract that the company would not remove him.

39. *Ibid* at 729, per Lord Wright. See *Bold v Brough, Nicholson & Hall Ltd* [1964] 1 WLR 201 for method of calculating damages under various headings.

40. *Ibid* at 740–741.

41. (1864) 5 B & S 840 at 852; 122 ER 1043 at 1047.

42. [1960] 1 WLR 1038; [1960] 2 All ER 239.

Correspondingly, it was an implied term that the plaintiff would not resign before the end of the 10 year period.

In *Read v Astoria Garage (Streatham) Ltd*,<sup>43</sup> the plaintiff, already a director, was appointed managing director at a salary of seven pounds per week. By comparison no duration was specified in his contract, but the appointment was, under the articles, 'subject to determination ipso facto if he ceases for any cause to be a director, or if the company in general meeting resolve that his tenure of the office of managing director . . . be determined'. The board resolved to remove him as managing director. The company in general meeting approved the dismissal. The Court of Appeal held that there was no wrongful dismissal and thus no right to damages, essentially because the plaintiff could not point to any contractual term with the company that was inconsistent with the company's exercise of the removal power set out in the articles. In other words, the articles were impliedly incorporated into the service contract.<sup>44</sup> In *Shindler and Southern Foundries*, on the other hand, in the service agreements at issue there were terms inconsistent with the company's exercise of the removal power. Conflicting provisions outside the articles (that is, in the service agreements) protected the managing directors.<sup>45</sup>

Further complexity arose in *Carrier Australasia Ltd v Hunt*.<sup>46</sup> The managing director had a five-year service contract as managing director, 'subject to the company's articles of association'. The contract added that . . . notwithstanding anything hereinbefore contained the company shall be at liberty to terminate the term by notice to that effect if the managing director ceases to be a director of the company.

The articles also provided that should the managing director cease to be a director, he should also cease to be a managing director, and article 91 provided that the company could dismiss a director by extraordinary resolution. But this was expressed to be 'Subject to the provisions of any agreement for the time being subsisting'. The company in general meeting amended article 91 by deleting these quoted words and removed the director by extraordinary resolution. The plaintiff director sued successfully in the Supreme Court of New South Wales for damages for wrongful dismissal. The High Court, on appeal, was equally divided (2:2), so the lower court finding stood.

In the High Court, Starke J (along with Rich J) thought that the appeal should have been allowed because

. . . the agreement relied upon in this case is made subject to the provisions of the company's articles of association, which were alterable, and subject also to the express provisions of clause 7 [which empowers termination of appointment if the appointee ceases to be a

43. [1952] Ch 637.

44. See Note by Gower, (1953) 16 MLR 82 at 84.

45. See Jenkins L J in *Read's* case, above n 43 at 643.

46. (1939) 61 CLR 534.

director], which is not expressed to be subject to the terms of existing contracts. . . .<sup>47</sup>

His Honour also cited Atkin L J in *Shuttleworth's* case:

In other words, it is a contract made upon the terms of an alterable article, and therefore neither of the contracting parties can complain if the article is altered.<sup>48</sup>

Evatt J, on the other hand, argued:

By that alteration [ie, the removal of the words from article 91] the defendant armed itself with power to remove the plaintiff from the position of director. But having regard to the interpretation which I place upon the plaintiff's contract, the company's subsequent exercise of the power of removal meant only this, that the final act of 'terminating' the plaintiff's contract was indubitably the act of the defendant, leaving the plaintiff at liberty to pursue his action for damages for breach.<sup>49</sup>

His Honour thought that *Southern Foundries* supported this conclusion,<sup>50</sup> and McTiernan J agreed:

When a contract with a company is outside the articles of association, it is not an implied term of the contract that the company has the right to exercise any power which it has under the articles to alter or put an end to contracts, to alter or put an end to that contract. . . . On the other hand, if the respondent's appointment as managing director has been made subject to the articles *simpliciter*, the contract, if any, between him and the company would have depended on alterable articles . . . .

It would be inconsistent with the expressed provisions of the contract which gave the respondent a fixed term of employment to imply in the provision making the contract subject to the articles a term that the company is to have the right to make the respondent cease to be a director at any time and in that way to terminate his employment as managing director.<sup>51</sup>

In summary, the wording of the articles and service contracts<sup>52</sup> (if any) are decisive. In general, the company is in breach of contract and liable in damages if it prematurely dismisses a managing director or exercises its power to alter the articles to vary or overthrow the terms of a separate contract of service. As was pointed out in *Shuttleworth v Cox*,<sup>52</sup> however, if the managing director holds office under the articles only, and there is no service contract separate from the articles, then his

47. *Ibid* at 547.

48. [1927] 2 KB 9 at 26.

49. Above n 46 at 550.

50. The judgment in *Southern Foundries v Shirlaw* appears to have become available only after argument had concluded, but all four judges referred to it.

51. Above n 46 at 553–554.

52. Above n 48 at 26, per Atkin L J.

employment can be terminated by a simple alteration to those articles. No breach of contract is involved.

### *Mitigation of damages*

A managing director who claims damages for wrongful dismissal is subject to the general contractual rule, sometimes called a duty,<sup>53</sup> that he must try to mitigate his losses, (for example, by making reasonable efforts to seek comparable work elsewhere or by not refusing reasonable offers of alternative employment by the company). The plaintiff's efforts to mitigate are taken into account in assessing damages.<sup>54</sup> In *Yetton v Eastwoods Froy Ltd*,<sup>55</sup> the managing director was held to be entitled to refuse an alternative post because it meant a loss of prestige.<sup>56</sup> Reduced salary or prestige and the likelihood of friction have been accepted as reasonable grounds for refusing alternative employment on dismissal. Some executives' service contracts contain duty to mitigate provisions.

### **State industrial legislation: remedies on dismissal**

In South Australia, Western Australia, and probably Victoria, employees can personally initiate claims for reinstatement (elsewhere, a trade union or organisation must, in the usual course, initiate action). In those States, dismissed executive directors, who are employees as well as directors, may, in addition to or instead of their common law rights to damages for wrongful dismissal, look to the States' industrial legislation for a remedy.<sup>57</sup> For example, s 31(1) of the *Industrial Conciliation and Arbitration Act 1972* (SA) and s 29(2) of the *Industrial Arbitration Act 1979* (WA) allow individuals to apply to their State's Industrial Commission for reinstatement orders. Lawful and unlawful dismissals may be the subject of reinstatement proceedings. The criteria for reinstatement is not whether or not the dismissal is lawful, but whether it is 'harsh, unjust or unreasonable'.

Executive directors usually have contracts of employment with their companies. Just as it is most unlikely that a dismissed director (especially a fixed-term employee) would obtain an order for specific performance from a court at common law, it is unlikely that he would obtain a reinstatement order from a Commission because of the personal nature of the executive director's employment contract. However, an employee can receive an award of damages in lieu of reinstatement. Also, a dismissal

53. *Falio v James McEwan & Co Pty Ltd* [1977] VR 447; *Jamal v Moolla Dawood Sons & Co* [1916] AC 175 at 179; cf Lindgren, *Contract Law in Australia* (1986) at para 2135.

54. In *Brace v Calder* [1895] 2 QB 253, an employee received nominal damages only for wrongful dismissal. He had been offered employment on the same terms and salary as before, but had declined to serve (see at 261, per Lopes L J).

55. [1967] 1 WLR 104.

56. See also *Shindler v Northern Raincoat Co Ltd*, above n 42, and *Burton v Litton* (1977) 16 SASR 162 at 168-169.

57. See similar position in UK under the *Employment Protection Act 1978*, Part V (as amended) explained by Boyle and Birds, above n 22 at 545.

which is not wrongful at common law may well be harsh, unjust or unreasonable within the industrial legislation.<sup>58</sup>

## Payments to executive directors on loss of office

It is commonplace to offer financial inducements to obtain and keep good officers. These inducements come in a range of guises — from the 'traditional', but now effectively taxed,<sup>59</sup> perks of concessional rates of interest for home loans and company cars, to retirement benefits and compensation payments for loss of office. Section 230 and its general prohibition on loans by companies to their directors, and the exceptions to that prohibition, are discussed below.

As noted earlier, the company's articles usually give the directors explicit power to appoint managing directors and other executives on such terms as the directors think fit. Understandably, managing directors and other executive (inside or working) directors seek long-term job security. Often they are able to negotiate long-term agreements with a company eager to obtain their services. But, the fortunes and controllers of companies change. New controllers may dismiss directors. Service contracts therefore commonly contain compensation provisions to buffer the effects of premature dismissal. The departing or ousted executive director may receive what has been coined a 'golden handshake' or 'golden parachute' — compensation payments — whether under some specific compensation clause in his contract or as settlement for the breach of a service contract.<sup>60</sup> These payments were attractive also because of the favourable tax treatment they received.<sup>61</sup>

### *Section 50 of the Takeovers Code*

Whilst a well-advised director will seek an advantageous 'package', including a lengthy service agreement, he must keep in mind s 50 of the *Companies (Acquisition of Shares) Code*. Under that section, a court may set aside any contracts, payments or benefits made at a time when a takeover was imminent or in the 12 months after a bid, if the court thinks that the agreement, payment or benefit is 'unfair or unconscionable having regard to the interests of the corporation'.<sup>62</sup> This is to counter a target company's

58. See *R v Industrial Court; Ex parte Mount Gunson Mines Pty Ltd* (1982) 30 SASR 504 at 506, 510; *R v Industrial Court; Ex parte Australian Government Workers Association* (1980) 24 SASR 199 at 200.

59. See the *Fringe Benefits Tax Assessment Act 1986*.

60. See discussion of typical terms of executive employment contracts by Profusek, 'Executive Employment Contracts in the Takeover Context' (1983) 6 Corp LR 99.

61. Before 1 July 1983 such payments, or part of them, may have been tax-free as capital payments, or assessable as to 5% only under s 26(d) of the *Income Tax Assessment Act 1936* (as amended). Now, under ss 27A–27J of the *Assessment Act*, which replaces the old rules, 'eligible termination payments' relating to service after 30 June 1983 are, broadly-speaking, subject to a standard flat rate of 30% tax. See CCH *Australian Income Tax Guide*, Vol 1, at paras 2–275ff.

62. Section 50(4) of the *Companies (Acquisition of Shares) Code*.

defensive device of creating long and generous service contracts for directors. Such contracts force the potential bidder to contemplate either hefty compensation payments for dismissal, or working with directors it may not want, and so may discourage bids. Section 50 seeks to stop such actions. It does not apply to agreements, payments or benefits that a target company approves by ordinary resolution, providing that the beneficiary (or any associate) did not vote on the resolution.<sup>63</sup>

### *Section 233 benefits*

It seems reasonable that, where the board enters compensation payment contracts or otherwise offers a 'golden handshake', these should be disclosed to the shareholders and approved by the company in general meeting. It is the directors themselves, exercising their powers of management, who commit the company to such contracts or payments. The possibility of self-interest is evident, and at times must test the directors' commitment to act in good faith in the company's best interests.

The complex provisions of s 233 make it unlawful for a company, its superannuation fund and its 'associates' to give benefits in connection with the retirement of a person from a prescribed office in relation to the company without disclosure to the members and the approval of the general meeting.

Section 129(1) of the *UCA*, the predecessor of the 1985 version of s 233, was differently-worded, and still applies to compensation provisions in service contracts entered into before the 1981 Code came into force.<sup>64</sup> It said, in part, that it was unlawful for a company 'to make to any director any payment by way of compensation for loss of office as a director of that company or of a subsidiary of that company or as consideration for or in connection with his retirement from any such office' without general meeting approval.

In *Taupo Totara Timber Co Ltd v Rowe*,<sup>65</sup> the managing director's service agreement, in which he was described as an 'employee', gave him a five-year term. It also provided that if the company should be taken over in that time, he was entitled, any time within 12 months after takeover, to resign and to receive a tax-free lump sum payment of five times his annual salary. A takeover occurred, and the managing director duly resigned and left. But the company refused to pay the lump sum, arguing that the equivalent of s 129 of the *UCA* had not been observed. The Privy Council ruled that the sum should be paid over because the New Zealand equivalent of s 129 of the *UCA*<sup>66</sup> only required general meeting approval for uncovenanted payments to directors *in connection with the office of director*, and not with the office of managing director or any other 'employee' post they may have fulfilled in their companies. Nor

63. Section 50(3). See also AASE Listing Requirements, s 3J(16) and s 3C(2)(d).

64. See s 233(7) and the definition of 'exempt benefit' in para (b).

65. [1977] 3 WLR 466 (PC).

66. Section 191 of the *NZ Companies Act 1955*.

did the section apply to payments which the company was *contractually obliged* to make; it prohibited only uncovenanted payments. Because there was no question about the bona fides of the directors in appointing the plaintiff and entering the service agreement containing the compensation provision, the Privy Council upheld the service agreement. Section 191 (NZ) did not apply.

The Privy Council in *Taupo Totara* relied on *Lincoln Mills (Aust) Ltd v Gough*<sup>67</sup> concerning a managing director in similar circumstances. Even though payment was made coincidentally with the loss of office as director, it was still outside the wording of s 129 of the UCA. The section, then, did not extend to payments made to persons who, although they were also directors, received their payments as employees (for example, as managing directors).

These decisions have been criticised.<sup>68</sup> Section 129 of the UCA was drafted in wide terms and a broader view could possibly have been taken. However, because of the narrow interpretations, one could easily escape the provision by arranging for what is in effect a retirement bonus to be given at the loss of some position in the company other than that of director.

The Jenkins Committee<sup>69</sup> recommended that the UK relevant provision (virtually identical to those in the New Zealand and Australian statutes) should be tightened up to demand that the general meeting approval required by the section should (a) be by special not ordinary resolution, and (b) be extended to retirement payments to directors of subsidiary companies. The *Taupo Totara* 'loophole' was not anticipated by these suggestions. The first version of s 233 (in the 1981 Code) tried to close that gap. It applied to a 'payment or other valuable consideration or any other benefit' by way of compensation for loss of office. Section 129 of the UCA had applied only to 'any payment'. One obvious loophole, whereby directors could be 'paid off' in benefits other than payments by way of compensation (for example, cars or accommodation), without the approval of the shareholders, was closed. It also applied to payments for the loss of any management position held by directors in the company or related corporation(s), as well as to the loss of the office of director. The *Taupo Totara* situation was thus covered. Payments to former office holders and spouses and relatives of, and persons (and their spouses) associated with, present and former office holders, were also subject to shareholder approval under the 1981 section. But the Jenkins Committee recommendation that a special resolution of approval be required was not adopted. Nevertheless, the new drafting was more likely to protect company funds from covert distributions to working directors for the loss of office, even though it allowed gratuitous lump

67. [1964] VR 193.

68. For example, see Shapira, 'Golden Handshake to an Executive Director' [1977] NZLJ 437 at 439.

69. Cmnd 1749, para 93.

sum payments to outgoing directors of up to the total amount of their last three years' emoluments, and seven years for principal executive officers, without disclosure and approval.

## **A comparison with the United Kingdom provisions**

Section 319 of the 1985 UK Act purports to protect companies from unexpected and hefty compensation payments paid out on the removal of directors employed under service contracts (for example, removal by general meeting under s 303 of the 1985 UK Act — the equivalent of s 225 of the Australian Code). Section 303(5) — like s 225(7) of the Code — says that removal under the section is not to affect compensation rights. Such provisions were enacted to control directors who entrenched themselves in office under long-term service agreements with the company, often in the face of imminent takeover (and probability of removal) or dismissal. On takeover, these directors were dismissed as expected and their long-term contracts were breached accordingly. Such directors could reap substantial compensation payments from the company. This problem is addressed in Australia by s 50 of the *Takeovers Code*, discussed earlier. Under the UK ss 319(3) and (5), when a director seeks a service contract for more than five years, a written memorandum setting out the proposed agreement must be available to members at, and for at least 15 days before, a general meeting to which the agreement must be presented for approval.<sup>70</sup> Approval need only be by ordinary resolution.

The agreement is void insofar as it infringes s 319. The infringing term is statutorily replaced by a term 'entitling the company to terminate it [the agreement] at any time by the giving to reasonable notice'. The section applies to 'agreements' and not just to contracts (to catch not just regular contracts of employment but also looser types of service and consultancy arrangements). One commentator surmises that s 47 of the 1980 UK Act (the predecessor of s 319) 'seems to balance well the problems posed by entrenchment against the need for continuity in management, and places the final decision on this matter in the hands of shareholders'.<sup>71</sup> Section 318 of the UK 1985 Act<sup>72</sup> requires the company to keep for inspection a register of directors' service contracts with both the company and its subsidiaries.

## **Section 233 of the Code today**

Section 233, as amended in 1985, still takes the view that generally companies should be prohibited from making payments to directors or principal executive officers (or their spouses, relatives or associates) in connection with loss of office or retirement without disclosure and

70. Formerly s 47(1) and (4) of the 1980 UK Act.

71. Hare, 'Companies Act 1980-VII' (1980) 124 Sol's J 602 at 603-604.

72. Cf s 235 of the Code.

approval of the general meeting if the payment does exceed a certain quantum. 'The rationale for this provision is that shareholder approval should be obtained for those payments which could conceivably be regarded as exceeding normal and reasonable payments in the circumstances.'<sup>73</sup>

Principal executive officers could formerly receive termination benefits of up to seven years' emoluments without shareholder approval; directors could get up to three years' emoluments. The new s 233 distinguishes between executive and non-executive directors. Executive directors have been bracketed with PEOs and they also can receive up to seven years' emoluments without approval.<sup>74</sup> Non-executive directors can still receive up to three years' emoluments without approval.<sup>75</sup> Seven years' 'emoluments' (defined in s 233(7)) can be a large sum to leave the company without shareholder approval. To extend the class of persons entitled to it runs contrary to the principles of accountability to members.

The exceptions and exemptions listed in s 233(2A) and (7) threaten, by their generosity of expression, almost to undo the section, presuming that its aim is to protect the company's funds from stealthy diminution. For example, para (d) exempts any '*bona fide* payment by way of damages for breach of contract'. Have the words '*bona fide*' enough force to deter manipulated '*settlements*' of disputes over breaches of executive director's service contracts? Paragraph (e) of s 233(7) exempts prescribed benefits given pursuant to agreements made before the person became a holder of the prescribed office as consideration for agreeing to hold that office. Does this allow an executive, as a precondition of accepting office, to secure an agreement before his appointment that, say, on the occasion of any future unfriendly takeover, or on his resignation for any reasons for that matter, he is to get a lump sum at the time of resignation of such amount as shall be agreed between the parties? Could such promised '*golden handshakes*' not completely undermine the force, such as it is, of s 233? Or could a managing director resign and then graciously accept a short-term appointment to another executive position with the company after negotiating a large retirement payout as part of the consideration for agreeing to accept the lesser executive position? These exemptions date back to s 129 of the *UCA*, and as ever they offer solace to those who would rather avoid making disclosure to and seeking approval from the shareholders. Why, though, should the shareholders' approval not be needed for these potentially very large payments? There is no question of prohibiting these payments, just of informing and getting the approval of shareholders whose funds are being spent.

73. Explanatory Memorandum to Companies and Securities Legislation (Miscellaneous Amendments) Bill 1985, para 309, discussing cl 69 of the Bill. Under the 1986 amendments to Sch 7 of the Companies Regulations, all companies (except exempt proprietary companies) must disclose in the company accounts the particulars and amounts of any retirement or superannuation payments: see cl 25.

74. Section 233(2A)(b) of the Code.

75. Section 233(2A)(b)(ii).

Section 233(1)(a) and (b) ensure that the giving of a prescribed benefit to any person, not just to an officer, is caught. They refer to benefits given to 'a person'. 'Prescribed benefit' is widely defined, along with other key terms, in s 233(7). It means a payment or other valuable consideration or any other benefit, and includes an interest in property. Section 233 formerly stopped only the company from giving the payments without approval. Now, s 233(1)(a) and (b) also stop superannuation funds and 'associates' of the company from giving such payments. An 'associate' is defined in s 233(7) to mean 'a person who is associated with the company', which in turn is defined in s 9 of the Code. The legislation thus tries to prohibit indirect payments to directors, PEOs (or their spouses, relatives or associates) via some entity or other person. As a final note on the 1985 amendments to s 233, the Explanatory Memorandum comments that it is intended that the lump sum payments described in s 233(2A)(b) will include group tax payments.

Section 233 has become long and its drafting is complex. There may be concern that it now allows too much to be paid out by the board to officers without general meeting approval. There may also be concern that its drafting is too wide.<sup>76</sup>

## **Prohibition of loans to directors by the company under section 230**

Companies attract and retain top executives with benefits other than healthy salaries. The promise of a generous 'golden handshake' is one such inducement. The provision of housing and other loans at low interest rates may be others.

Loans to directors, like the voting of remuneration by the board itself, raise the spectre of self-interest. Loans on favourable terms to insiders may threaten the interests of creditors and others. Indeed, such loans may constitute breaches of the fiduciary duty to act in the company's best interests and the directors will be liable to account accordingly.<sup>77</sup> The legislature broadly accepts that loans to directors of one's own company are needless. The company's assets can be better used elsewhere. As the UK Cohen Committee reasoned:

If the director can offer good security, it is no hardship to him to borrow from other sources. If he cannot offer good security, it is undesirable that he should obtain from the company credit which he would not be able to obtain elsewhere.<sup>78</sup>

76. See Austin, below n 86 at 38–39.

77. See, for example, *Paul A Davies (Aust) Pty Ltd v Davies* (1982) 1 ACLC 66, affirmed on appeal (1983) 1 ACLC 1091; see also *O'Brien v Walker* (1982) 1 ACLC 59; *Ring v Sutton* (1980) 5 ACLR 546 at 550, per Hope J A.

78. Cohen Committee, Cmnd 6659 (1945) para 94. See also the Dept of Trade's White Paper, *The Conduct of Company Directors* Cmnd 7039 (1977) at paras 8–15.

The policy of the law is that the use of company funds for non-company purposes is improper. How well does the legislation give effect to this? Section 230(1) of the Code says:

A company shall not, whether directly or indirectly —

(a) make a loan to —

- (i) a director of the company, a spouse of such a director, or a relative of such a director or spouse;
- (ii) a director of a corporation that is related to the company [defined in s 7(5)], a spouse of such a director, or a relative of such a director or spouse;
- (iii) a trustee of a trust under which a person referred to in sub-paragraph (i) or (ii) has a beneficial interest being a loan made to the trustee in his capacity as trustee;
- (iiia) a trustee of a trust under which a corporation has a beneficial interest, where a person referred to in sub-paragraph (i) or (ii) has, or 2 or more such persons together have, a relevant interest or relevant interests in shares in the corporation the nominal value of which is not less than 10% of the nominal value of the issued share capital of the corporation, being a loan made to the trustee in his capacity as trustee; or
- (iv) a corporation, where a person referred to in sub-paragraph (i) or (ii) has, or 2 or more such persons together have, a relevant interest or relevant interests in shares in the corporation the nominal value of which is not less than 10% of the nominal value of the issued share capital of the corporation; or

(b) give a guarantee or provide security in connection with a loan made or to be made by another person to a natural person or corporation referred to in paragraph (a).

Section 230 is a long and detailed provision.<sup>79</sup> Yet it prohibits only loans, guarantees and the provision of guarantees by the company.<sup>80</sup> It does not, as its UK counterpart does,<sup>81</sup> extend to 'credit transactions', 'quasi-loans' and guarantees and securities provided by 'relevant companies' in connection with those quasi-loans.<sup>82</sup> Further, does s 230 catch back-to-back arrangements where one company agrees to offer loans to directors of another unrelated company in return for loans to its own directors? Does it cover the payment by the company of a director's private credit card purchases on the company account, or the purchase by the company of an asset from a director which is then resold to him on indefinite and

79. Harper, 'The Regulation of Directors' Benefits' unpublished LLB (Hons) dissertation (University of Adelaide, 1984) at 49–77 analyses s 230 and related provisions of the *Companies Code*. Section 230 was at issue in *Re Myer Retail Investments Pty Ltd* (1983) 8 ACLR 102 at 106–107.

80. Cf s 233 of the Code which prohibits 'a payment or other valuable consideration or any other benefit'.

81. See ss 49 and 65 of the UK *Companies Act 1980*, now ss 330 and 331 of the 1985 Act.

82. As defined in s 331 of the UK *Companies Act 1985*.

low repayments? Does it prohibit the payment of the director's liability for children's school fees? Although the force of the word 'indirectly' in the opening words of s 230(1) is untested, it is likely that these transactions, which would be caught by the UK provision, would not be caught by s 230.<sup>83</sup>

Regrettably, s 230, like several other important provisions of the Code, appears vulnerable to 'loopholes and sophisticated devices'.<sup>84</sup> The word 'indirectly' in the preamble to s 230(1) is not interpreted widely. If it were, then loans and 'quasi-loans' to directors, spouses, relatives and other persons (including companies) related to the director, indirect loans using trusts and similar devices, could be caught as indirect benefits to the director.<sup>85</sup> Much of subs (1) and the rest of s 230, including the newly-created 'relevant interest' definition in subs (2), could then be thrown away. But the legislature has little confidence that the word carries such force.<sup>86</sup> The very attempt to list exhaustively the ways of getting an indirect benefit encourages efforts to devise an indirect route not caught specifically. The section's particularity helps to breed loopholes.

### *Exceptions to the section 230(1) prohibition*

Whilst the general policy is that such loans are to be discouraged as inherently subject to abuse, the legislation says that some loans and some other benefits to directors are proper and acceptable.<sup>87</sup> For example, exempt proprietary companies can do 'anything' and still not infringe s 230(1). Loans, guarantees and security can be provided to related corporations, providing that the benefits are authorised by a board resolution, to a person to meet expenditure incurred for the purposes of the company or to perform his duties as an officer (subject to getting general meeting approval pursuant to subs (4)), and to assist a full-time employee of the company or a related corporation to acquire premises to be used by him as his principal place of residence (again subject to

83. Some of them would, though, be subject to tax under the Australian *Fringe Benefits Tax Assessment Act 1986*.

84. See Report by Wade (Victorian Commissioner for Corporate Affairs), 'Roles and Objectives of the Victorian Corporate Affairs Office' MTIA, 8 December 1982 at 5; see also Munn, 'The National Companies Legislation in Perspective' (September–October 1982), Business Law Education Centre at 114; Warren, *Company Law Seminars' Transcript*, 1982, CCH Australia.

85. Lord Denning M R went even further in *Wallersteiner v Moir* [1974] 1 WLR 991 by saying that a loan to another company that was a 'puppet' of a director of the lender was really a loan to the director.

86. 'Indirectly' does not appear in s 233(1) although it does in s 228(1). The lack of uniformity in the drafting of analogous provisions goes on. See Austin's criticisms in his paper entitled 'Directors' Benefits' delivered to the Companies and Securities Workshop Australian Confederation of Industry in 1982 and in 'A Survey of the Exposure Draft [1984] — Part II', *Current Legal Developments* series, Monash University, August 1984 at 37–38. See also Harper, above n 79.

87. See s 230(3) (a)–(f) of the Code for these exceptions.

subs (4) general meeting approval). Further, a loan may be made to a full-time employee of the company, or a related corporation, where the company in general meeting has 'approved a scheme for the making of such loans' and the loan is made pursuant to the scheme. If the company is a subsidiary of a listed corporation, the approvals of both subsidiary and parent are needed. If the company is not a subsidiary of a listed corporation, but is a subsidiary whose ultimate holding company is incorporated in Australia or an external Territory, both the company and the ultimate holding company must have the appropriate general meetings and approve the scheme. Finally, if the loan, guarantee or security is made 'in the ordinary course of [the company's] ordinary business', which includes lending money, the giving of guarantees or the provision of security, and is made on 'ordinary commercial terms', it is not prohibited.

Austin has pointed out that, although a transaction is expressly exempt by s 230(3), it may still constitute a breach of fiduciary duty.<sup>88</sup> In *Davies*,<sup>89</sup> for example, the directors caused the company to advance them money to help finance their purchase of property. The directors were held to hold the purchased property on trust for the company. They were also liable to pay the liquidator all of the profits made on resale of the property.

If directors do not comply with s 230, they are liable to a fine of \$5000, or, if the offence was 'committed with intent to deceive or defraud', \$20,000 or five years' imprisonment, or both.<sup>90</sup> Directors may also be jointly and severally liable to indemnify the company against any loss arising from the making of the benefit.<sup>91</sup> Under s 230(6), the absence of knowledge of the making of the benefit is a defence.

Whilst these provisions may help to stop this form of undesirable self-dealing by directors, regrettably, their terms are complex for both those affected and those protected. One overseas solution has been to ban outright all loans by any company to its directors or, alternatively, ban them unless the disinterested shareholders approve. The US *Model Business Corporation Act* at various times has suggested both solutions.<sup>92</sup> A complete ban has much to commend it: 'Such a clause would protect adequately the interests of creditors, prevent the impairment of corporate resources, and preclude the use by management of corporate assets for private use.'<sup>93</sup>

88. Austin, above n 86 at 8, citing *O'Brien v Walker* (1982) 1 ACLC 59 and *Paul A Davies (Aust) Pty Ltd v Davies* (1982) 1 ACLC 66; (1983) 1 ACLC 1091.

89. *Ibid.*

90. See s 230(5).

91. *Ibid.*

92. See s 42 of the *Model Bus Corp Act Ann 2d*, (Vol 1) (American Bar Foundation, 1971).

93. Palmer, above n 10 at 384.

## Indemnification of officers for legal costs and other liabilities

The articles usually say that directors may be paid all expenses incurred in connection with the company's business affairs.<sup>94</sup> But can the company pay a director's legal costs and expenses incurred in defending civil or criminal proceedings arising out of his capacity or conduct as a director? Articles such as reg 98 of Table A<sup>95</sup> say that it can, providing that he wins or obtains relief (including under s 535) or an acquittal. Section 237(2) of the Code also specifically allows the company to do this. Its wording does not limit its ambit to proceedings to which the director is made a party by reason of being an officer of the company, but this limitation is surely implied. The board, in voting such indemnification, will be guided by what is fair and reasonable and in accordance with the best interests of the company.

Further, a company may insure its officers against liabilities incurred as officers. But it must heed s 237(1) which says:

Any provision, whether contained in the articles or in a contract with a company or otherwise, for exempting any officer or auditor of the company from, or indemnifying him against, any liability that by law should otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company is void.

Section 237(3) specifically confirms that companies and related companies may not themselves insure officers against the consequences of negligence, default, breach of duty or breach of trust.

Section 237, drawn from s 205 of the UK *Companies Act 1948* (now s 310 of the 1985 Act), attacks the sorts of articles that would have exempted the directors from liability in *Re Brazilian Rubber Plantations & Estates Ltd.*<sup>96</sup> There an article said that no director should be liable for any loss or damage whatsoever, unless it arose through his own dishonesty. Neville J noted that, even if gross negligence had been found, this article would have protected the directors. This would not have been possible if a provision like s 237 had existed then.<sup>97</sup>

What, though, of articles such as articles 78 and 84 of the pre-1 July 1985 UK Table A, which purported to relax the directors' duties and to let them act in a way that would otherwise be a breach of duty. Article 84(3) said:

94. See, for example, reg 63(3) of Table A.

95. Kaye J in *Bendix Consolidated Industries Ltd v FCT* (1982) 82 ATC 4582 at 4595 discusses and interprets such a provision.

96. [1911] 1 Ch 425.

97. See also *Re City Equitable Fire Assurance Co Ltd* [1925] Ch 407, where an article exempted officers from all liabilities 'unless the same should happen by or through their own wilful neglect or default respectively'.

A director may hold any other office or place of profit under the company (other than the office of auditor) in conjunction with his office of director for such period and on such terms (as to remuneration and otherwise) as the directors may determine and no director or intending director shall be disqualified by his office from contracting with the company either with regard to his tenure of any such other office or place of profit or as vendor, purchaser or otherwise, nor shall any such contract, or any contract or arrangement entered into by or on behalf of the company in which any director is in any way interested, be liable to be avoided, nor shall any director so contracting or being so interested be liable to account to the company for any profit realised by any such contract or arrangements by reason of such director holding that office or of the fiduciary relation thereby established.

Are such articles void by virtue of s 237(1) of the Code or its equivalent? Do they purport to exempt from or indemnify against liability for a breach of duty or trust? Or, more fundamentally, do they exclude the underlying duty altogether? Is an article that excludes the duty altogether valid, and the article that only relieves from liability not? There has been a lively debate in the United Kingdom, where, unlike Australia, there were specific articles in their Table A at issue. One line of argument concluded that the former s 205 of the *Companies Act 1948* (UK) (s 310 of the 1985 Act) rendered void both the article that excluded the duty and that which exempted directors from liability for breach of duty.<sup>98</sup> Another line said that s 205 of the UK Act allowed articles that reduced or abrogated the relevant duty, but knocked out those that sought to exempt directors from liability.<sup>99</sup> This matter has yet to be finally resolved by the courts.

Section 237 of the Code does not prevent members in general meeting from forgiving officers in breach of duty, or resolving to relieve an officer from liability for negligence already committed by resolving not to institute proceedings. In *Winthrop Investments Ltd v Winns*,<sup>1</sup> despite the existence of the predecessor of s 237, it was held that the general meeting can waive a breach of fiduciary duty, even in advance.

98. Baker, 'Disclosure of Directors' Interests in Contracts' [1975] JBL 181 at 194.

99. *Gore-Browne on Companies* (44th ed, 1986) at para 27.21.3. See also Parkinson, 'The Modification of Directors' Duties' [1981] JBL 335 at 344:

These articles, and similar articles which a company might adopt to release the no-conflict duty as it applies in other circumstances, are valid because section 205 [UK] only invalidates articles which exempt directors from liability for breach of duty. Whilst the no-conflict duty may be released in this way, the duty to act in good faith and the duty of care may not, because where release is equivalent to permission to injure the company that release will be repugnant to the fiduciary relationship between director and company . . . . It is not open to the company, therefore, to circumvent section 205 by including a provision in its articles releasing the whole range of directors' duties.

See also Gregory, 'The Scope of the Companies Act 1948, Section 205' (1982) 98 LQR 413; Gregory, 'Section 205 of the Companies Act 1948 — A Reply' (1983) 99 LQR 194; Instone, (1982) 98 LQR 548; Instone [1982] JBL 171.

1. [1975] 2 NSWLR 666. See also *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134.

The NSW Supreme Court has decided that the composite expression 'negligence, default, breach of duty or breach of trust' in s 237(1) is not restricted in its ambit to the interpretation given to the expression 'misfeasance' used in the UCA.<sup>2</sup> Instead, it should be construed 'as meaning what it appears to say'.<sup>3</sup>

2. *Re Price Mitchell Pty Ltd* (1984) 2 ACLC 524. 'Misfeasance' appeared in s 367B of the UCA and was replaced in 1973 by the words 'negligence, default, breach of duty'.
3. *Ibid* at 529. McLelland J refused to order any meeting under s 315(1) of the Code in relation to a proposed scheme of arrangement because some provisions in the proposed scheme could disadvantage some creditors, and the courts' practice was not to allow officers to limit their liability in the manner proposed. Two provisions in the proposed scheme were inconsistent with the tenor of s 237. See generally on s 237; Paterson, Ednie and Ford, *Australian Company Law* (3rd ed, Butterworths) Vol 3; CCH, *Australian Company Law and Practice*, Vol 1, at para 26–350.