

Chapter 2

Appointment, Removal and Restrictions on Appointment of Directors

The appointment of directors

Section 219(2)¹ says that only natural persons may be directors; a company can no longer be appointed as a director. The Jenkins Committee,² which came out against corporations being directors, agreed with the Patton Committee on Company Law Amendment in Northern Ireland, which said:

. . . the responsibility of directors for wrongful acts contemplated by the Companies Acts has been the responsibility of natural persons and this has been lost sight of It is important that it should be known who is responsible for the conduct of a company.³

Australian public companies must have at least three directors; proprietary companies at least two.⁴ At least two of the public company's directors and one of the proprietary company's directors must 'ordinarily reside' in Australia.⁵

If the articles vest in one director what amounts to absolute control of the company, is s 219, which requires two directors, fulfilled? *Welch v Welch*⁶ considered this problem. The proprietary company's articles provided for a 'governing director'. Under those articles, virtually the whole of the power of management resided in that person; he was to 'enjoy the right to the whole management, government and control of the company'. It had been suggested in *Levin v Clark*⁷ that the appointment of a governing director with complete power in the company may be inconsistent with s 219,⁸ which calls for at least two persons in management. But in *Welch*, Holland J disagreed. There would have to be some specific provision in the legislation to preclude the members of a company from vesting overriding powers of management of the

1. Cf s 114 of the UCA.

2. Cmnd 1749 (1962) para 84.

3. Paragraph 17. The New Zealand Macarthur Committee expressed similar views in para 35 of its 1973 Report on the provisions and working of the *Companies Act 1955*.

4. Section 219(1).

5. Section 219(3).

6. [1973] ACLC 27,510.

7. [1962] NSW 686 at 701, by Jacobs J (obiter).

8. Formerly s 114 of the UCA.

company's affairs in one person.⁹ The practice of appointing governing directors had been commonplace, the court stressed, and the legislature must have been aware of this. The articles conferring powers on the governing director were held to be valid and effective.

Table A of the Third Schedule to the Code no longer provides for the appointment of a governing director. Although the articles of many existing companies do make this provision, governing directors are rare today. While the articles may pass over or permit the handing over of management power to one person — usually a managing director — it will usually be in the company's best interests to have an active board with the power to make decisions, offer advice and, if necessary, interfere.

The articles set out the number and method of appointment of directors. The first directors are normally appointed by the subscribers to the memorandum.¹⁰ The first directors are named in the articles or memorandum. Section 220(1) stipulates that no one may be named there (or in a prospectus) as a director, unless he has consented in writing to act as a director and has lodged his consent with the Commission. Usually the articles say (as reg 57(2) of Table A says) that the company, by resolution at a general meeting, may increase or reduce the number of directors. Such articles are interpreted to mean that the general meeting must authorise any alteration to the maximum and minimum number of directors allowed. They also mean that the general meeting must authorise any extra appointments of persons to act as directors at any time, within the minimum and maximum limits.¹¹ However, reg 61(1) of Table A allows the directors to appoint further directors 'as an addition to the existing directors', so long as the permitted maximum is not exceeded.

Normally, articles provide that the first set of directors retires at the first annual general meeting.¹² Thereafter, a proportion — for example, one-third — of the directors retires from office every year at the annual general meeting. The retiring members are eligible for re-election. The retiring directors each year shall normally be those who have served longest since their last appointment.¹³ Their replacements are usually appointed by resolution at the same meeting.¹⁴ However, as noted above, reg 61 of Table A allows the directors 'at any time' to appoint any person to be a director (providing the total number does not exceed the maximum set out in the articles), the appointee's office to last until the next annual general meeting. To avoid any inadvertent vacancies in the directorate, reg 60(2) provides that if the vacated office is not filled at the

9. Above n 6 at 27,514–27,515.

10. See reg 57(1) of Table A.

11. *Grant v John Grant & Sons Pty Ltd* (1950) 82 CLR 1; *Woodroffe Ltd v McLeod Ltd* (1986) 10 ACLR 129.

12. For example, see reg 58(1) of Table A.

13. See reg 59 of Table A. Such an article is discussed by Hudson J in *Kraus v JG Lloyd Pty Ltd* [1965] VR 232 at 233–234.

14. See reg 60 of Table A.

annual general meeting, the retiring director shall be deemed to be re-elected unless the meeting resolves expressly or impliedly to the contrary. Regulation 60(2) says that the retiring director must offer himself for re-election before he can be deemed re-elected. *Petsch v Kennedy* rules that it is enough if the retiring director 'by his words or by his conduct at or prior to the meeting in question shows that he is prepared to continue in the office of director'.¹⁵

There appears to be no authority directly on the point, but it seems that, when voting to appoint directors, shareholders may pursue personal interests even though they may conflict with the interests of the company.¹⁶

Directors for *public* companies must be voted on individually, unless a resolution allowing more than one director to be voted for per motion has been passed without any dissenting vote, or unless the election is held by poll or ballot.¹⁷ This stops the shareholders being pressured by a 'take-or-leave-the-lot' ticket. A resolution to appoint directors was held to be void in *Harman v Energy Research Group Aust Ltd*.¹⁸ In contravention of s 223(1), the resolution purported to appoint as directors, en bloc, all those present.

Where casual vacancies arise on the board, the articles usually empower the board to fill them itself.¹⁹

'Straight' voting versus 'cumulative' voting

In Australia, New Zealand, Canada and the United Kingdom, members can invariably cast one vote per share in each motion for the appointment of a director. This method of voting is called *straight* or *unit voting*. Someone who controls over 50% of the votes can therefore elect *all* of the directors.

In the United States, many States allow or even require, in elections to the board, what is called *cumulative voting*. This practice allows a shareholder to cast in an election for any one position as many votes as are produced by multiplying his or her number of shares by the number of vacant positions on the board.²⁰ A shareholder with 1,000 shares, when voting at a meeting to fill five places, can cast 5,000 votes, and can cast these *all* on one candidate if so minded. Cumulative voting is intended to protect minority shareholders by 'affording to a minority of the voting stock an opportunity to elect one or more directors'.²¹ If a shareholder votes cumulatively, his or her voting power is 'increased' or accumulated and may be sufficient to get one or more directors onto the board. For

15. [1971] 1 NSWLR 494 at 496.

16. See dictum of Rath J in *Santos Ltd v Pettingell* [1979] ACLC 32,156 at 32,165, drawing on *North-West Transportation Co v Beatty* (1887) 12 App Cas 589 at 593.

17. See s 223.

18. (1985) 3 ACLC 536.

19. See reg 61 of Table A.

20. See, for example, *California Corporations Code*, s 708.

21. *Maddock v Vorclone Corp* (1929) 17 Del Ch 39, 147 A 255 at 256.

example, if there are three vacancies on the board and a shareholder owns 11 out of 30 voting shares in the company, he or she can be assured of an appointee on the board if all 33 votes are devoted to one candidate when the motion for election is put to the meeting.²² Cumulative voting is not prohibited under Australian company law.²³

The removal of directors

Retirement by rotation is the most common way to leave the directorate.²⁴ There are additional methods under the Code, and usually the company's articles, by which the office of director becomes vacant. These include those set out in s 222, often echoed and expanded on by articles such as reg 65 of Table A:

- Under s 226 no person of 72 years of age or over can act as director unless the company resolves otherwise (discussed below).

Furthermore, the office is vacated if the appointee:

- is removed from office by the general meeting (s 225, reg 62; discussed below);
- does not hold the required number of shares in the company (if a share 'qualification' is required by the articles) (s 221; discussed below);
- is convicted of an offence referred to in s 227(2) (discussed below);
- becomes an insolvent under administration (s 227(1));
- is absent from board meetings for six months without the consent of the other directors (reg 65(e));
- becomes of unsound mind (reg 65(c));
- holds an office of profit in the company (other than that of managing director or principal executive officer) without general meeting approval (reg 65(f));
- is directly or indirectly interested in any contract or proposed contract with the company and fails to declare the nature of the interest as required in the Act (s 228, reg 65(g));²⁵
- resigns by notice in writing to the company (reg 65(d)).

The age limit for directors

Except where s 226 has been complied with, no person of or over 72 years of age shall be appointed or act as director of a *public* company or its subsidiaries. A director can continue in office until the end of the next annual general meeting immediately after turning 72, but the office of director then automatically 'becomes vacant'.²⁶ Where such a vacancy

22. See discussion of cumulative voting by Ontario Lawrence Committee in its 1967 *Interim Report*, Ch 8.

23. The *Canada Business Corporations Act* 1979, s 102 regulates cumulative voting for directors for companies with articles providing for that system of voting.

24. See reg 58 of Table A.

25. Discussed in Ch 6.

26. See s 226(1) and (2).

arises, the director so 'retired' cannot be reappointed in default of another appointment.²⁷

Notwithstanding the prohibition in s 226(1), persons over 72 can be elected as directors of public companies until the next annual general meeting, providing that certain notice and voting requirements are met.²⁸ Fourteen days' notice, stating the candidate's age, must be given to members who are entitled to vote, and the resolution of appointment must be passed by at least three-quarters of such members voting in person or by proxy at a general meeting. Further conditions apply when the over-age person is appointed to a subsidiary company of a public company.²⁹

Section 226(12), a new provision, renders minors (that is, persons under 18 years of age) ineligible to be directors of any company.

Section 225 and the removal of directors

Shareholders may become dissatisfied with a director's performance, or new controlling shareholders may want their appointees on the board. The shareholders can wait for the directors to retire or to end their terms under the articles or executive contracts. If they are not prepared to wait, however, or if the unwanted directors will not resign, a public company may by *ordinary* resolution, under s 225, remove a director before the expiration of his term of office.³⁰ This applies notwithstanding anything in the company's articles or any agreement between the company and the director. The articles usually contain provisions similar to s 225, for example, reg 62 of Table A (which is not restricted to public companies). Although such provisions empower the company to break contracts with directors, the company may still be liable to the dismissed director for compensation or damages.³¹ If the director so removed has been appointed to represent the interests of some particular class of shareholders or debenture holders, the resolution to remove him does not take effect until a successor has been appointed.

Although only an ordinary resolution is required to remove the director, s 225(2) requires *special notice* to the company of the removal resolution. Section 249 requires 28 days' notice to the company of intention to move the removal resolution (and usually not less than 14 days' notice from the company to persons who are entitled to be given notice

27. See s 226(4).

28. See s 226(6).

29. See s 226(7). The age limit imposed under the UK *Companies Act 1985*, s 293(2) is 70. See a brief discussion of this in the *Jenkins Committee Report*, above n 2 at paras 79 and 85(a).

30. The UK *Companies Act 1985*, s 303 gives both private and public company shareholders this statutory power. The word 'director' in s 225(1) can be read as including the plural 'directors,' so that one resolution can remove all of the directors simultaneously: *Claremont Petroleum NL v Indosuez Nominees Pty Ltd* (1986) 4 ACLC 315; *Taylor v McNamara* [1974] 1 NSWLR 164.

31. See s 225(7) and the common law cases discussed in Ch 10.

of a meeting of the company). If the notice of intention to move such a resolution has been given to the company, and a meeting is then called for a date less than 28 days after the notice was given, the notice is deemed to be properly given even though the 28 days' notice requirement will not be met at the time of the meeting.

The director is entitled under s 225(3) to make his case known to the shareholders through the company apparatus. He can circulate his point of view to members so long as it is of reasonable length and does not contain defamatory material.³²

Although the Code gives the director the opportunity to debate his dismissal before the shareholders, it does not require legally sufficient cause for dismissal, or any similar test. United States' courts and the articles (called by-laws) of many United States' companies require cause for removal, for example, fraud, criminal conviction, breach of trust.³³ Yet if the shareholders own or 'are' the company, should they not have the power to remove directors at will? In small, proprietary companies there may well be a better case for such 'cause' clauses in the articles.³⁴ Cause for dismissal becomes important when the company wishes to defend a dismissed director's contractual action for damages, which may follow dismissal from office.³⁵

Section 225 is significant in the balance of power within public companies. Shareholders, who normally have no power to intervene in the management of the affairs of the company, do have this ultimate sanction. The directors wield enormous influence in the company's affairs. But final control in a sense remains with the shareholders.³⁶

Section 225(8) prohibits directors of public companies from being removed by or at the request of the other directors, notwithstanding anything in the articles or any agreement.³⁷ Such a rule is sensible: directors should be removed only by those to whom they owe their duties. In proprietary companies, the directors may remove one of their number, providing that the power to do so is in the articles.

32. See s 225(3) and (4).

33. See Travers, 'Removal of the Corporate Director During his Term of Office' (1967) 53 Iowa LR 389 at 408ff.

34. As stressed above, s 225(1) applies only to public companies. Cf reg 62(1) of Table A and the US 1983 *Revised Model Business Corporation Act* exposure draft §8.08(a) which apply to all types of companies.

35. See later discussion in Ch 10.

36. See Fletcher Moulton L J in *Gramophone and Typewriter Ltd v Stanley* [1908] 2 KB 89 at 98 and later discussion of the powers of directors in Ch 3.

37. In *Re EPHS Ltd; Stavrou v EPHS Ltd* (1984) 2 ACLC 101, contravention of s 225(8) led to declarations that the resolution by the management committee which had the effect of removing fellow members from the committee was void, and the appointment of replacements was also held to be void. Cf *Maloney v NSW National Coursing Assn Ltd* [1978] 1 NSWLR 161 at 175. Cf position in Hong Kong: *Lee v Chou Wen Hsien* [1984] 1 WLR 1202 (PC), where a director of a listed public company was expelled effectively by his fellow directors under a power in the articles. The Judicial Committee noted that such a power must be used in the best interests of the company and not for ulterior reasons.

*Bushell v Faith*³⁸ is often cited as an example of how weighted voting can upset the democratic intent behind provisions such as s 225. In that case, one of the private company's articles gave a director weighted voting rights (three votes per share) in any resolution for the removal from office of any director. He was thereby able to defeat the motion to remove him. Only in small, proprietary companies would weighted voting usually have real influence; in companies with large shareholdings and many members, a *Bushell v Faith* situation would be rare. However, the first 1980 Companies Bill did propose an amendment to s 225 to the effect that where a company had share capital and there was a motion for the removal of a director, each voting share would carry only one vote. This amendment did not appear in the Code.

As already noted, s 225(2) requires special notice of any resolution to remove a director 'under this section'. What is the situation if a director is removed not under the power in s 225, but under a provision in the articles which does not require the special notice called for under s 225(2)? (Section 225(7) specifically reserves the company's right to have a removal provision apart from s 225.) In *Holmes v Life Funds of Australia Ltd*,³⁹ Street J held a chairman to be in error in ruling that a motion removing directors was out of order for failure to give special notice. The articles provided for removal by ordinary resolution, but did not mention any notice requirement. Street J concluded that the special notice requirement of s 225(2) 'has no relevance whatever to the exercise of that power [under the articles]'.⁴⁰ If the legislature wants special notice to precede *all* such motions for removal of directors, appropriate drafting changes are required to s 225(2) and (7).

Directors' share qualification

Section 221 rules that a director, if required by the articles to hold 'a specified share qualification' (that is, number of shares in the company), must obtain those shares 'within 2 months after his appointment or such shorter period as is fixed by the articles'. The share qualification requirement, if there is one, will appear in the articles. Unless the articles rule to the contrary, the director does not need to be beneficial owner of the qualification shares.

Holding in a representative character will not do. Holding as a trustee without beneficial ownership will do, but the holder must so hold as that the company can safely deal with him as owner.⁴¹

Regulation 64 of Table A empowers the company in general meeting to fix the directors' share qualification. The regulation adds that if the quali-

38. [1970] AC 1099. But note AASE Listing Requirements, s 3 K (1) and (2).

39. [1971] ACLC 27,177.

40. *Ibid* at 27,179.

41. Per Buckley J in *Sutton v English and Colonial Produce Co* [1902] 2 Ch 502 at 506. See recent discussion by Cohen J in *Venture Acceptance Corporation Ltd v Kirton* (1985) 3 ACLC 3 at 14-15; (on appeal) 4 ACLC 158 at 163.

fication is not so fixed it is to be one share. Section 222 penalises the failure by a director to obtain in time or maintain his qualifying shares when:

- his office as director is vacated (s 222(1)(a));
- he is incapable of being reappointed until he has gained the qualification (s 222(2)); and
- he is subject to a penalty of \$1,000 or three months' imprisonment or both if he purports to act as a director when he has not been validly reappointed (s 222(5)).

Section 535 does not allow the courts to relieve a director from this liability, it being criminal liability under the Code. That section applies only to 'any civil proceeding'.⁴² All types of companies are covered by these provisions.

Today, there may not be the same necessity for requiring directors to have a personal stake in the shares of the company. A director's financial well-being is usually linked in other ways to that of the company. However, it comforts members and creditors to know that all directors (including non-executive directors) also risk their money in the company. A direct financial interest in the company's profits and dividend levels should not be underestimated as an incentive to management.

A time limit for acquiring qualification shares was at issue in *Isaacs'* case.⁴³ The articles (but not the relevant Act) required the director to acquire the qualification shares within one month of appointment and, further, said that if he did not acquire them within that time the shares would be simply allotted to him. Although the director never did apply for the allotment, it was held that his signing of the memorandum and articles meant that he had agreed to take from the company his required qualification. Accordingly, he was liable in respect of the stated number of shares.⁴⁴

Restrictions on certain persons managing companies

The 'wrongdoing' or misadventure that causes loss to companies, and which results in convictions and even prison sentences, may disqualify wrongdoers from corporate management. The Code offers the public some protection against misuse of corporate power by defaulting directors.

Section 227 excludes from management persons thought temporarily unsuitable to run corporations.⁴⁵ Section 227(1) prohibits persons who are insolvent under administration from corporate management, except with the leave of the court. Section 227(2) adds:

42. Cf s 365 of the UCA.

43. *Re Anglo-Austrian Printing and Publishing Union* [1892] 2 Ch 158.

44. Cf effect of s 220(1) and (2) of the Code where they apply.

45. Replaced ss 117 and 112 of the UCA.

- A person who has . . . been convicted, within or outside the State —
- (a) on indictment of any offence in connection with the promotion, formation or management of a corporation;
 - (b) of any offence involving fraud or dishonesty punishable on conviction by imprisonment for a period of not less than 3 months;
 - (c) of any offence under section 108, 229, 554, 555, 556, 559 or 560, under section 44 of the Companies (Acquisition of Shares) Code, under section 129 of the Securities Industry Code or under any provision of a law of a State or of another Territory that corresponds with any of those provisions; . . .

shall not, within a period of 5 years after his conviction or, if he was sentenced to imprisonment, after his release from prison, without the leave of the Court, be a director or promoter of, or be in any way (whether directly or indirectly) concerned in or take part in the management of, a corporation. Penalty: \$5,000 or imprisonment for one year, or both.

Unlike s 122 of the *UCA*, s 227(2) of the Code is a vacating provision.⁴⁶ It does not therefore require a director who falls into one of the disqualifying categories to resign from the board before his office is vacated. Automatic vacation makes unnecessary an injunctive remedy discussed in *Theseus Exploration NL v Mining and Associated Industries Ltd.*⁴⁷

Disqualification for repeated breaches and negligence

In 1983, s 227A was added to the Code. It enables the Commission and certain other prescribed persons⁴⁸ to seek court orders prohibiting 'relevant persons'⁴⁹ from taking part in company management. The 1982 Exposure Draft commentary said that the provision was 'to provide protection to creditors from persons who continually set up businesses which fail'. Regrettably, little attempt is made to tie this new provision to s 562, which avowedly has the same aim. Section 238A requires the NCSC to keep a 'Register of Disqualified Company Directors and Other Officers'. This register is open to public scrutiny and photocopying.

Under s 227A, a court order, for a period to be specified in that order, can be gained if the applicant satisfies the court that one of the following has occurred:

1. that while the person was a director, secretary, or executive officer of a corporation, the corporation 'repeatedly breached relevant legislation'; and the person 'failed to take reasonable steps to prevent the corporation so breaching that relevant legislation' (subss (1)(a) and (b));

46. See s 222(1)(d).

47. [1973] Qd R 81 at 88. There, Hoare J suggested that a shareholder would get an injunction to stop the election of persons who were ineligible for appointment under the equivalent of s 227.

48. See s 227A(7).

49. See s 227A(1).

2. that, while a director, secretary, or executive officer of a corporation, the person 'repeatedly breached relevant legislation' (subs (1)(c));
3. that while a director, secretary, or executive officer of a corporation, the person 'acted dishonestly, or failed to exercise a reasonable degree of care and diligence, in the performance of his duties as an officer of the corporation' (subs (1)(d)).

Section 227A(1)(d) does not require a conviction for dishonesty or lack of care and diligence. The provision enacts in part the recommendation of the 1962 Jenkins Committee, which thought that the law should be extended to cover persons who have shown themselves, when acting in management, 'to have acted in an improper, reckless or incompetent manner in relation to the companies' affairs'.⁵⁰ That Committee acknowledged the difficulty of deciding in any particular case whether someone had been sufficiently reckless or incompetent to warrant the bar. 'But in serious cases where, for example, a man has succeeded in steering a series of companies into insolvency, we think that the Court should be able to put a stop to his activities.'⁵¹ Difficulties will arise in the application of s 227A(1)(d), but its intent is laudable and clear.

Section 562 of the Australian Code also helps answer the Jenkins Committee's concerns. The section provides for the disqualification of persons who, at least twice within seven years, have been involved in the management of failed companies.⁵²

Section 227A(6)(b) stipulates that a 'repeated' breach of companies legislation occurs if the corporation or other person has:

- on two or more occasions, contravened or failed to comply with a particular provision of a relevant Act;
- contravened or failed to comply with two or more provisions of a relevant Act; or
- contravened or failed to comply with provisions of two or more relevant Acts.⁵³

Members and creditors of the company are included in the list of those who can seek such orders.⁵⁴ By contrast, a s 562 order can only be applied for by the Commission.

Section 28 of the UK *Companies Act 1976* enabled the courts to disqualify a person, who was persistently in default in delivering documents such as accounts and annual returns to the registrar, from acting in manage-

50. Cmnd 1749, paras 79–81, 85(b).

51. *Ibid* at para 80.

52. Section 9 of the UK *Insolvency Act 1976* provided for disqualification if there were two liquidations within five years. Now s 300 of the UK *Companies Act 1985* deals with disqualification orders for directors by reference to association with at least two insolvent companies within five years. See also s 189(1)(c)(iii) of the 1955 NZ Act (as amended in 1980), which has similarities to s 227A. See also s 562A of the Code.

53. The relevant statutes, which include the *Companies Code*, the *Securities Industry Code* and the *Companies (Acquisition of Shares) Code*, are listed in subs (7).

54. In drafting s 227A, the legislature drew on s 189 of the NZ *Companies Act 1955*.

ment for up to five years.⁵⁵ This provision was used regularly.⁵⁶ In *Re Civica Investments Ltd*,⁵⁷ Nourse J offered guidelines for determination of the period of disqualification for non-compliance with companies legislation. The court found similarities with the passing of sentence in criminal cases and thought that similar principles should apply. Longer periods of disqualification would normally apply where the failure to observe the statutory requirements was serious, the five-year maximum being reserved for the most serious cases.

Convictions for fraud and dishonesty

Concern over the possibility that persons who have been convicted of serious offences involving fraud or dishonesty are running companies and controlling creditors' and shareholders' funds is reflected overseas.⁵⁸ Although litigation on these sorts of provisions was scarce until recently, Australia has produced a spate of reported discussions. Any exercise of discretion by the court is a matter of judgment in each case, with the onus on the applicant.⁵⁹ Attempts to formulate satisfactory principles for s 227 have been haphazard. Guiding criteria are applied unevenly in this area of law, where protection of the public should be, and avowedly is, of utmost importance.

Protection of the public is paramount

The clear policy of the legislature was to protect the public generally, and shareholders and creditors in particular. Bowen CJ concluded in *Re Magna Alloys & Research Pty Ltd*:

The section is not punitive. It is designed to protect the public and to prevent the corporate structure from being used to the financial detriment of investors, shareholders, creditors and persons dealing with the company.⁶⁰

Cook J, in *Re Minimix Industries Ltd*, listed those members of the public who can properly demand protection:

55. Section 28 was superseded in 1981 when s 93 of the *Companies Act 1981* recast s 188 of the 1948 Act. The relevant portions of s 188 were identical to the former provision. Section 188 of the 1948 UK Act was criticised for its limitations: see Leigh, *The Control of Commercial Fraud* (Heinemann, 1982) at 274–275; *Jenkins Committee Report*, Cmnd 1749 (1962) paras 79–85. The 1985 consolidation of the UK companies legislation has collected these provisions together in ss 295ff of the *Companies Act 1985*.

56. See (1981) 2 Co Law 129 and 174; (1982) 3 Co Law 220–221, 263–264.

57. (1982) *The Times LR*, 9 June 1982.

58. For example, in ss 295ff of the UK *Companies Act 1985* and ss 188A and 189 of the NZ *Companies Act 1955* (as amended in 1980). There is brief discussion of the NZ provisions in Russell, 'The Companies Amendment Act 1980: Protecting the Company Against its Directors' [1981] NZLJ 131–132. The NZ s 188A was considered in *Re Minimix Industries Ltd* (1982) 1 ACLC 511.

59. *Re Magna Alloys and Research Pty Ltd* (1975) 1 ACLR 203 at 205, per Bowen CJ; *Re Ferrari Furniture Co Pty Ltd* [1972] 2 NSWLR 790 at 792, per Street J.

60. *Ibid* at 205. See also Street J in *Re Altim Pty Ltd* [1968] 2 NSWLR 762 at 764. In the latter case, a bankrupt sought leave to take part in the management of a company. See also *Alford v Commissioner for Corporate Affairs* (1985) 1 Qd R 147; 2 ACLC 815.

. . . those who have dealings with the company and are entitled to find they are dealing with persons of integrity; those who become creditors and are entitled to expect that the funds of the company are not dissipated by dishonest action; no doubt shareholders also, who have delegated the management of the company to the directors and those in the company's employment.⁶¹

Olney J, in *Chew v NCSC (No 2)*,⁶² and Zelling J, in *Re Van Reesema*,⁶³ spoke in a similar vein. In the latter case, his Honour pointed out that the hardship which denial of relief would cause to the applicant and others closely associated with the company was self-created. Whilst such hardship was envisaged by the statute, the section was not primarily punitive in nature. '[T]he whole purpose of these sections is to see that people are not put in a position where their money is at risk.'⁶⁴

The imprisoned officer

The Jenkins Committee suggested that 'the disqualification should continue for not more than five years after the end of his term of imprisonment'.⁶⁵ In the now superseded s 188 of the UK *Companies Act 1948*, however, time ran from the date of conviction. It could not be ordered to run from any subsequent date, even where imprisonment for more than five years had been imposed.⁶⁶ In s 188A of the NZ Act, also, the five-year period runs from conviction.

Before the 1983 Australian amendments, a person in prison was outside the ambit of the section and able to act in management — the five-year bar only applied from the time of 'release'.⁶⁷ To remedy this situation, s 222(1)(d) now says that the office of director is automatically 'vacated' if a director 'is convicted of an offence referred to in sub-section 227(2)'. Section 222(4) adds that a person who loses office because of such a conviction 'is incapable without the leave of the Court, of being re-appointed as a director until the expiration of the period of 5 years referred to in sub-section 227(2)'.

Examples of the exercise of the section 227 discretion

In *Re Van Reesema*,⁶⁸ the director and manager of several land agency and real estate managing and investment companies was convicted in 1972 of an offence involving fraud and dishonesty.⁶⁹ Van Reesema (on

61. Above n 58 at 512.

62. (1985) 3 ACLC 212 at 214–215.

63. (1975) 11 SASR 322 at 331–332; also reported as *Re Maelor Jones Pty Ltd* (1975) 1 ACLR 4.

64. *Ibid* at 332.

65. Cmnd 1749 (1962) para 85(c).

66. See *R v Bradley* [1961] 1 WLR 398. See, now, ss 295–302 of the UK *Companies Act 1985*.

67. See discussion of this and other matters by Corkery, 'Convicted Offenders and Section 227 of the National Companies Code: Restrictions on Certain Persons Managing Companies' (1983) 1 C & SLJ 153 at 155–156.

68. Above n 63.

69. Contrary to s 7 of the South Australian *Secret Commissions Prohibition Act 1920*.

behalf of his company) had, with intent to deceive, written to persons for whom it held money on trust, falsely telling them that their money had been secured over a certain property. Zelling J commented that 'the offence shows a degree of planning and premeditation and . . . involved a breach of confidence imposed on the applicant in relation to members of the public'.⁷⁰

The applicant had been convicted of an earlier offence involving the issuing of documents which resembled court documents with the intent to mislead persons and thereby extract payment of overdue debts. He had also been convicted in 1975 of breaches of s 122 of the *UCA* itself, for continuing as director of two companies after his 1972 conviction. The applicant argued that the companies and his livelihood would be threatened unless he was able to reinvolve himself in management. Considerable unemployment could follow and shareholders would suffer financially. But Zelling J refused leave. The applicant's 1972 offence was not at all 'a minor or unimportant one'.

Such a man . . . falls squarely within the prohibition of s 122 [now s 227] and he is not a proper subject for the exercise of the powers conferred on the Court to exempt him from the disqualification which Parliament has enacted for the protection of the public.⁷¹

In *Zuker v Commissioner for Corporate Affairs*,⁷² the applicant came within s 227 after pleading guilty of conspiring to utter forged US\$20 banknotes with the intent to defraud. He had been caught with forged US banknotes with a face value of nearly \$1.5 million. He was sentenced to five-years' imprisonment. After his release, he applied successfully for leave to be a director of and concerned in the management of a family tannery. Its business operations were 'modest'. The following year, in a reorganisation of the corporate group, the tannery was sold. The applicant then sought leave to take part in the management of the purchaser, a proprietary company from within the same group but with a substantial turnover and considerable liabilities. The Full Court of the Supreme Court of Victoria granted the leave, impressed by the applicant's recent good behaviour in management. At least the applicant's forgery appeared to have nothing to do with the conduct of the affairs of a company.

In *Re Marsden*,⁷³ the applicant, holding the offices of director, secretary and principal accounting officer of a listed public company, was convicted of two offences under s 124 of the *UCA* (s 225 of the Code) for failing to act honestly and to use reasonable diligence in the discharge of his office. The applicant appropriated \$6,774 of company money without the knowledge and authority of the board. '[T]he appellant had committed a series of dishonest actions in the payment of the amounts and of withholding

70. *Ibid* at 329.

71. *Ibid* at 332.

72. [1980] ACLC 34,334; [1981] VR 72.

73. [1981] ACLC 33,210.

relevant information from fellow directors and finally the Auditor.⁷⁴ The Magistrate had described the offences as 'grave': a fiduciary had abused his position.

Nevertheless, he was granted leave to act as a director, even though falsification of company accounts is often held up as an act that seriously threatens the welfare of shareholders, creditors and those dealing with the company,⁷⁵ and despite the fact that the applicant wished to be involved with two listed public companies, and not with small proprietary companies as is common in such applications. In his favour, the applicant had a good pre-offence reputation and had acted already for 12 months without complaint in management of the two listed public companies.

In general, the courts have been cautious in granting exemptions. They are not lightly given and the interests of shareholders, creditors and employees are placed well above those of the applicant.

The splitting of roles: director-management

In *Re Magna Alloys & Research Pty Ltd*,⁷⁶ the applicant, along with two other directors, had been convicted under the *Crimes Act* of conspiring corruptly to give or to offer agents a secret commission. He had given or offered prizes to customers to induce them to buy products from companies of which he was director. Bowen C J did not give leave to the applicant to be a director of any of the five companies in question, but he was given leave to take part in the management of three of them, although conditions were also imposed. Bowen C J thus drew a distinction between acting as a director and acting in the management of the company. His reasoning in part was that an employee in management, being subject to the directions of the board, would be less dangerous to the public.

One may wonder at the efficacy of this distinction between management and board activities. Management is the board's function, although of course by delegation non-directors are also involved in this activity. Influential managers, other officers and even major shareholders can exert considerable influence over the affairs of the company.⁷⁷ A dominant, non-board figure could even come within the new s 5 definition of 'director': 'any person occupying a position of director . . . by whatever name called and whether or not validly appointed to occupy the position.' Does the court's leave, allowing participation only in management, impliedly prohibit de facto director activity? After all, such persons are 'directors' within s 5 and they carry the statutory and general law

74. Ibid at 33,213.

75. See McInerney J in *Re Zim Metal Products Pty Ltd* [1977] ACLC 29,556 at 29,559.

76. Above n 59.

77. Bowen C J recognised such possibilities when he spoke of the 'pervading influences' and the potential sway over the applicant of the major shareholder, who resided overseas: above n 59 at 207.

duties of de jure directors.⁷⁸ If it does, then a person whose managerial activity amounts to de facto director activity would be in breach of s 227 if the court had given leave to act only in management.⁷⁹

The court's discretion when granting leave is wide. Still, the legislature probably anticipated no such 'division' of roles as Bowen C J applied in *Re Magna Alloys*, although the split is semantically possible on the wording of s 227(2).⁸⁰ Regulation 66(1) of Table A says that 'the business of the company shall be *managed* by the directors' (emphasis added). Such articles give the directors complete power of management. Accordingly, one must question the assertion that 'the functions of "management" and "directors" are separate and distinct in law and in fact'.⁸¹ In law and in fact the term 'management' encompasses the role and functions of anyone — de jure and de facto directors, officers, executive officers, principal executive officers and especially directors — who is concerned in the activities of managing.

Nevertheless, in *Re Zim Metal Products Pty Ltd*,⁸² McInerney J was attracted to the same splitting of roles. His Honour also granted leave to the applicants in that case to take part in the management of the company but not to act as directors. Once again, one can question whether deprivation of a directorship is enough to protect properly the public.

*Factors considered by the court in exercising its section 227 discretion*⁸³

- *The nature of the offences of which the applicant was convicted.* Offences involving financial dishonesty invite little sympathy from the courts. The uttering of forged banknotes conspiracy in *Zuker* did not, however, deter the Supreme Court of Victoria from granting the leave sought. Also, the serious and company-related nature of the offences in *Re Marsden* was not decisive. Zelling J, on the other hand, stressed the seriousness of the

78. See *Re Canadian Land Reclaiming and Colonizing Company (Coventry and Dixon's Case)* (1880) 14 Ch D 660 at 670ff; *Shepherd v Companies Auditors' Board* [1981] ACLC 33,105 at 33,108; *CAC v Drysdale* [1979] ACLC 32,016 at 32,023, per Mason J, at 32,026–32,027, per Murphy J.

79. Perhaps McInerney J had this in mind when in *Re Zim Metal Products*, above n 75 at 29,559, he denied each applicant leave 'to act as or to be a director of the company' (emphasis added).

80. The heading to s 227 — 'Certain persons not to manage corporations' — supports an argument that Parliament intended that the role of the director be embraced by and separated from the term 'management'. Unlike marginal notes, section headings can be of vital importance in the interpretation of provisions. See Gifford, *How to Understand an Act of Parliament* (5th ed, 1982) at 49–50; *Napier v Sholl* [1904] SALR 73 at 95–98; *DPP v Schildkamp* [1971] AC 11 (HL); Cross, *Statutory Interpretation* (1976) at 112–113. However, s 7(3) of the *Companies and Securities (Interpretation and Miscellaneous Provisions) Act 1980* states that 'No marginal note or footnote to a relevant Act [which includes the Code], and no heading to a section of a relevant Act, shall be taken to be part of the relevant Act'.

81. Legoe J in *Re Marsden*, above n 73 at 33,216.

82. Above n 75.

83. One of the most comprehensive attempts to list the factors which the court will consider was offered by Bowen C J in *Re Magna Alloys and Research Pty Ltd* (1975) 1 ACLR 203 at 205. That list is used here as a basis for discussion.

dishonesty involved in *Re Van Reese*, and both Bowen C J, in *Magna Alloys*,⁸⁴ and McInerney J, in *Zim Metal*, emphasised the threat to shareholders and creditors of 'offences [involving] falsification of company accounts or the like'.⁸⁵ Rowland J, in *Re Carey*,⁸⁶ frowned on 'a method of conducting business that is quite improper', when refusing an application. No doubt offences involving misuse of 'public' money, especially when the misuse is for the private purposes of the officer, would normally render the court most reluctant to relax the five-year ban. This would be doubly so when, as Bowen C J put it, the dishonesty leaves 'investors, shareholders and creditors lamenting'.⁸⁷

- *The nature of the applicant's involvement in that offence.* The court mentioned the greater culpability of one of the *Zim Metal* applicants in the offence of receiving stolen goods. The 'premeditation and planning' involved in the larceny offences at issue in *Re Ferrari Furniture* counted against the applicant.⁸⁸

- *The applicant's general character up to and after the offence.* This factor was of considerable importance in *Re Van Reese*, where the applicant failed. In *Re Marsden and Chew v NCSC*, the very good reputations of the applicants were probably vital to their success. So too, in *Re Marsden*, was the fact that the applicant had already acted in the management of two companies for 12 months without complaint.⁸⁹ In *Zuker*, the fact that the appellant was said to have 'borne a good reputation' before his forgery-related activities was important. Since his release from gaol he had already acted (with leave) as a director in another company for over 12 months, also without any complaint.

Good pre-offence reputation and apparent reliability after the offence are clearly significant.

- *The structure of the companies in which the applicant wishes to become involved, and*

- *The nature of the business run by those companies.* These two categories relate to concern about the degree of control exerted by the applicant and his or her associates, the size of the business undertaking, and the type of company (proprietary, public, listed, etc). In *Re Carey*,⁹⁰ the trading trustee and chain-of-trusts structure of the business troubled the court

84. *Ibid* at 206.

85. Above n 75 at 29,559.

86. [1984] 2 ACLC 470 at 473.

87. *Magna Alloys*, above n 59 at 206.

88. [1972] 2 NSWLR 790 at 792, per Street J. But compare *Re Minimix Industries Ltd* (1982) 1 ACLC 511, where the applicant gained leave to act in management even though the offences 'comprised a carefully planned and deliberately carried out scheme of deception whereby goods were procured by the use of a false name, a false address and valueless cheques' (at 512).

89. Although his Honour cryptically notes that 'The time lapse since conviction is not to my mind a relevant consideration; cf *Re Maelor Jones Pty Ltd*' (above n 73 at 33,219).

90. (1984) 2 ACLC 470.

and led to the refusal of the s 227 application. Whilst the structure was not unusual, the Court noted that it would 'clearly make it extremely difficult if not impossible for anyone dealing with the corporate trustee . . . to find a beneficiary, who can in fact indemnify the trustee for any debts incurred by the trustee'.⁹¹ The size of the expanding tannery's operation deterred Gray J in *Zuker* from exercising his discretion in favour of the applicant. But the Full Supreme Court on appeal found that other considerations outweighed the size of operations risk factor: 'the size of the annual turnover will seldom we think on its own afford a reason for refusing leave under the section.'⁹² In general, however, the larger the company, the greater its dependence on 'outside' or public investment and credit, the larger its turnover and the greater the control the applicant can wield in the company, then the more the public, investors, creditors and shareholders are at risk.

In *Re Magna Alloys*, Bowen C J ordered the regulation of board membership to keep majority control away from undesirable family influence. It had also been submitted to Bowen C J that disqualification under the equivalent of s 227(2) disentitled a shareholder from using his votes in general meeting on management matters. His Honour suggested that generally this would not amount to taking part in management within the s 227 meaning.

However, it is possible that in a particular case a majority shareholder can so use his voting power, or the threat of the exercise of his voting power, on questions of management that he would be in breach of [s 227].⁹³

This view acknowledges that management embraces more than just those directly involved in management. Depending on the structure of the company, even 'outside' influence can be dangerous.

- *The degree of risk involved for shareholders, creditors, employees and the public at large.* Protection of the public is touted as the main consideration.

The policy of the section is rather to protect the public against the further activities in the field of companies of persons who have been convicted of particular offences.⁹⁴

This guideline has not always dominated. In *Re Marsden*, for example, the companies did not seem to be troubled by the applicant's absence from their directorates. Although the applicant had been convicted of two very serious crimes so far as company shareholders and creditors were concerned, the Court granted the application, commenting that:

Creditors and persons dealing with the companies concerned here were not directly and in practice would not really be affected by the appli-

91. *Ibid* at 473.

92. Above n 72 at 34,340.

93. Above n 59 at 207.

94. *Zuker*, above n 72 at 34,338. See also Bowen C J's clear statement in *Re Magna Alloys* (cited above); Legoe J in *Re Marsden*, above n 73 at 33,215.

can't's conduct as set out above. It would be shareholders if anyone who would be most likely to suffer.⁹⁵

In effect, this says that although the offences are serious, the matter affects mainly the members and, as they should know what is good for them, they should be able to decide. This presupposes that the shareholders know the relevant facts. Conditions or orders — sanctioned under s 227(4) — would be used to ensure that shareholders are fully informed. Given the realities of control in even large public companies, a determined board and well-organised larger shareholders can often wield great influence indeed in board elections.⁹⁶

The five-year ban has a clear purpose. The statement by the Master in *Re Marsden*, when combined with the overriding public protection principle, smacks of common sense:

I think the five-year period is merely a period thought by the legislature to be long enough to restore the public confidence in the character of an offender against the Section before again permitting him to take part in the management of the company or to again take his seat on the Board unless there are exceptional circumstances justifying a reduction of that period.⁹⁷

Likewise, McInerney J, in *Zim Metal Products*, adverted to the need for vindication of 'public morality'.⁹⁸

Section 227(2) (unlike s 227A of the Code and s 189 of the NZ Act) automatically 'punishes' those it affects. That is, it imposes the full five-year bar. Under the provision, the court cannot 'punish the applicant further'.⁹⁹ Its discretionary function can only be to lift part or all of the five-year bar.¹ Under s 295 and Sch 12 of the UK *Companies Act 1985*, on the application of certain persons (including past and present members and creditors), 'the court may' make an order restricting certain persons from management for up to fifteen years. The automatic disqualification feature of the Australian s 227 ensures that those who, by their convictions, have shown their lack of fitness for management do not, inadvertently as it were, remain in managerial positions from which they can continue to threaten the business community.

• *Hardship to shareholders, creditors and employees (even directors) caused by the applicant's absence.* In *Magna Alloys, Re Minimix Industries and Re Wallace*,² hardship was a significant factor in the applicant's favour. It was

95. Above n 73 at 33,218.

96. De facto control is often possible with less than a majority of voting shares: see *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1980] 2 All ER 841 at 869ff, per Vinelott J; Wedderburn, (1981) 44 MLR 202 at 205.

97. Cited in *Re Marsden*, above n 73 at 33,219.

98. Above n 75 at 29,559.

99. Cf Legoe J in *Marsden*, above n 73 at 33,216.

1. Cf s 227A and s 562 of the Code where, unlike s 227, a disqualification does not operate automatically: the Commission or prescribed persons must apply for an order. The former UK s 188 is discussed in *R v Bradley*, above n 66.

2. (1983) 1 ACLC 1204.

unsuccessfully pleaded in *Re Van Reesema*,³ where the companies in question appeared to be running satisfactorily without the applicant. The risk to the company's existence and, it seems, the strain on the remaining directors (who included wives of the applicants) in running the company's affairs without the applicants, were significant factors in the limited success of the applicants in *Zim Metal Products*. Generally, however, the 'private' interests of the applicant and his family carry little weight.⁴ The interests of 'independent' persons will attract more judicial sympathy than will the plight of the applicant or his dependants.

- *The applicant's credibility in court.* Misleading or attempting to mislead the court hearing the s 227 application will usually destroy an applicant's chances. It did not help in *Re Van Reesema* that the applicant's affidavit was 'less than frank'.⁵ And McInerney J in *Zim Metal Products* cautioned:

Had I been satisfied that [one of the applicants, who in his affidavit had not fully admitted his culpability in the offence at issue] had sought to mislead the court, it is difficult to conceive of circumstances which would warrant the court granting him the leave he now seeks.⁶

The applicant must subject himself to scrutiny at the hearing itself:

. . . it is almost inconceivable that a person would be given leave of the Court under s.122 . . . if he were not prepared to give evidence and be cross-examined in support of his case.⁷

Demeanour and plausibility in the courtroom are obviously material. In *Re Macquarie Investments Pty Ltd*, Wootten J was most unimpressed by the applicant's witness box propensity to 'fabricate stories as he went along'. Later he noted: 'On this, as on many other matters, [the applicant] was evasive, implausible and unconvincing.'⁸ In *Re Miller*,⁹ it was significant that the unsuccessful applicant was not contrite over the events leading to his conviction and imprisonment.

- *The Commission's attitude to the application.* Under s 227(5), an applicant must give the Commission 21 days' notice of intention to apply. Section 227(6) permits the Commission to apply at any time to revoke leave granted. Further, s 540(1) allows the Commission to intervene in any legal proceedings relating to a matter arising under the Code. Although it is difficult for the Commission itself to raise this factor, the Commission's opposition to an application of itself should carry some weight; with its

3. (1975) 11 SASR 322.

4. Olney J said as much in *Chew v NCSC (No 2)* (1985) 3 ACLC 212 at 216. See also *Re Ferrari Furniture*, above n 88; *Re Van Reesema*, above n 63 at 331.

5. Above n 3 at 326.

6. Above n 75 at 29,558. See also *Re Macquarie Investments Pty Ltd* (1975) 1 ACLR 40 at 43.

7. *Re Macquarie Investments Pty Ltd*, *ibid* at 43. In *Re Marsden* the applicant did not give evidence on oath in his appeal. The Master's decision was reviewed *de novo* on the Master's findings of fact.

8. Above n 6 at 46.

9. Unreported judgment of the Supreme Court of NSW (No Eq 1140) 27 Feb 1986, Rogers J.

expertise, experience and information it is usually in a sound position to assess the potential risk to the public. Nonetheless, such opposition was insufficiently persuasive in *Re Marsden*, *Zuker* and *Re Minimix Industries* to prevent grants of leave. The Commissioner's opposition no doubt helped weigh the scales against the applicants in *Re Van Reesema* and *Re Macquarie Investments*. However, it probably favoured the partially successful applicant in *Zim Metal Products* that the Commissioner for Corporate Affairs, although represented, did not oppose the application.

The costs of a section 227 application

The court has an absolute and unfettered discretion as to the award of costs. In general, costs will not be awarded against a successful party. However, an applicant under s 227(2) may have to pay his own costs, even if successful.¹⁰ As Williams J noted in *Alford v Commissioner for Corporate Affairs*, these costs may well be 'part of the price the convicted person has to pay for obtaining the leave of the Court'.¹¹ There is force in the argument that the applicant should pay the Commissioner's costs, even if the application succeeds. In opposing s 227 applications, the NCSC or its delegates are in the public watchdog role. Its intervention is both expected and proper. However, if that intervention fails, there is some authority for the view that the public purse should pay both parties' costs.¹² In general, the cases on s 227 show no consistent pattern, some being silent on the question and many deciding there should be no order as to costs, thereby leaving them to each party.¹³

Conclusion

Investors, creditors and the public at large no doubt endorse the stated preoccupation of the courts with the protection of the public. The cautious line taken in *Re Ferrari Furniture*, *Re Van Reesema*, *Re Macquarie Investments* and *Re Carey* almost certainly accords with the wishes of the legislature. It also reassures the public and especially the business community.

In light of the apparent increase in corporate crime and misuse of the corporate form, and even with the increased scope offered by s 227A, the public and the legislature may consider that the present legislation is too narrow in its effect, and too broad in the latitude it gives for judicial generosity. A Parliament seeking to tighten up provisions like s 227 of the *Companies Code* may consider extending the bar beyond five years and including, as specific grounds for disqualification, evidence of (but not necessarily convictions for) serious managerial neglect of health and safety standards or of fair trading practices, or reckless or negligent

10. See *Re Leomund Properties Pty Ltd* (1983) 1 ACLC 1370 at 1373.

11. (1985) 1 Qd R 147 at 158.

12. *Alford v Commissioner for Corporate Affairs*, *ibid*. There, the costs of the successful appeal on the question of costs were ordered to be paid by the Commissioner.

13. See a breakdown of precedents and orders as to costs in *Alford*, *ibid* at 157.

production of defective products. Legislatures may now question whether the five years stipulated in s 227 and s 562 (but not in s 227A) of the Code is a long enough ban for some offenders, especially for those embroiled in serious corporate fraud through abuse of their positions in senior management.

The role of director and positions in top corporate management may be too freely granted and retained, especially in societies where corporations dominate business and wield far-reaching power. After all, one can still take part in business without incorporation and the protection of limited liability. As Street J said in *Re Ferrari Furniture Co Pty Ltd*:

A prohibition against taking part in the management of a company does not import any prohibition against taking part in business activities. But it denies to a person thus prohibited that statutory advantage that flows from participating in the market place under the shield of statutory limited liability. It is easy to take for granted the right of every citizen by the simple procedure of incorporating a company to avail himself of this shield of limited liability.¹⁴

14. Above n 88 at 792.