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High court rules on mistakes in corporate governance

Introduction

Where minor irregularities and mistakes occur in corporate governance, the *Corporations Act 2001* (Cth) (**the Act**) has inherited the longstanding principle that it is not in the public interest that such honest mistakes should inflict unnecessary liability or inconvenience if they are able to be remedied without substantial injustice. Section 1322(4)(a) of the Act gives the court the power to make an order declaring that:

(a)...any act, matter or thing purporting to have been done, or any proceeding purporting to have been instituted or taken, under this Act or in relation to a corporation is not invalid by reason of any contravention of a provision of this Act or a provision of the constitution of a corporation.

The power within s 1322 has been used in the past to validate irregularities such as the lack of a quorum at a meeting,¹ an inadvertent omission in a report provided to shareholders and option holders,² and decisions made at a directors meeting convened without proper notice.³ For the court to make an order under s 1322(4)(a), one of three conditions must be satisfied:

- (i) the matter is essentially of a procedural nature;
- (ii) the persons concerned acted honestly; or
- (iii) it is just and equitable that the order be made.

The court also needs to form the view that in making such an order, no substantial injustice has been or is likely to be caused to any person.

The recent High Court decision of *Weinstock v Beck* [2013] HCA 14 has provided useful guidance on the scope of the application of the above section. The decision focused on the interpretation of the requirement for a "contravention" under s 1322(4)(a), and reaffirmed that the section, in accordance with its evident purpose, is to be construed broadly and applied pragmatically by references to considerations of substance rather than form.⁴

Background

L W Furniture Consolidated (Aust) Pty Ltd (**LWC**) was incorporated by its founding directors Mr and Mrs Weinstock. In 1973, a resolution was passed by the existing directors appointing Mr and Mrs Weinstock's children, Amiram and Tamar as additional directors. Article 66 of LWC's articles of association provided that at every annual general meeting each director shall retire from office, and then be eligible for re-election. This Article was the mechanism by which the two founding directors were re-elected each year. Unbeknown to the Weinstock siblings, Article 66 did not apply to them as their appointment came to an end at the commencement of the next annual general meeting

and as a result they were not re-elected as directors retiring at that general meeting. Both siblings continued to act as de facto directors until eventually, at different points in time, Tamar and her parents retired, leaving Amiram as the sole director. In 2003, Amiram purported to exercise a power under the articles which permitted a continuing director to increase the number of directors so that the minimum requirement for quorum of a board meeting could be satisfied (LWC's articles provided for a quorum of two directors), and appointed his wife, Helen, as a director of LWC. On the face of the articles, this act was ineffective as at the time Amiram was not a validly appointed director of LWC himself. It was also problematic that none of the issued shares in LWC carried any voting rights, which prevented a director being appointed by shareholders in a general meeting.

Tamar, in her capacity as a shareholder, brought an application to have LWC wound up on the grounds that it was just and equitable to do so, given that LWC was without a validly appointed board, and there were no means by which it could be restored. Amiram and his wife Helen cross-claimed and sought a declaration under s 1322(4) that Helen's appointment as a director was not invalid by reason of Amiram's lack of capacity to make such an appointment.

Lower courts

Barrett J in the Supreme Court of New South Wales held that as Amiram was not a director at the time he purported to appoint his wife, the appointment was in contravention of the company articles. His Honour held that an order made under s 1322(4) would be just and equitable, and in those circumstances the order was made validating the appointment. Amiram could then be re-appointed by his wife and return LWC to a functioning corporation, which would also dispense with the winding up application.

The majority judgment in the Court of Appeal overturned the primary judge's decision in finding that the purported appointment was not a "contravention" of the company constitution as provided in s 1322(4)(a). Young JA held that for a contravention to occur there must be an infringement or a failing to take advantage of a provision in the company constitution. Although Sackville AJA took a more liberal approach with respect to the interpretation of the requirement for a contravention, his Honour similarly found that s 1322(4)(a) could not apply to the purported act of a director who himself had never been validly appointed a director (and, in the context of the articles of association and issued shares in the company lacking voting rights, could never be validly appointed a director). As there were no provisions in the articles that Amiram could have taken advantage of in order to appoint Helen, there could be no "contravention" as required under s 1322(4)(a). Amiram and his wife appealed the decision to the High Court.

High court appeal

The High Court in ultimately allowing the appeal preferred a broad and pragmatic application of s 1322(4)(a), and rejected any contention that the meaning of "contravention" contained an implied limitation which necessitated some "failure" to do something before the court could exercise its remedial powers under s 1322(4). Their Honours unanimously held that although Amiram did not have the authority to appoint his wife, s 1322(4)(a) granted the court the power to validate such an appointment.

“Section 1322 conferred jurisdiction on and granted powers to a court. The provision is not to be read ‘by making implications or imposing limitations which are not found in the express words.’”

It was submitted by Tamar that the term "contravention" within s 1322(4)(a) should be interpreted as an "infringement", "violation" or "transgression" of some negative prohibition or positive requirement in the company constitution. Her submission followed that as the purported appointment of directors by non-directors was not dealt with in the company constitution, an order under s1322(4)(a) was not open to the court. Chief Justice French, in considering the meaning of "contravention", held that it would amount to an inexplicable limitation on the evident purpose of the section to find that its operation requires a disobedience of a prohibition or non-compliance with an obligation.⁶ With respect to the overarching purpose of the section, his Honour said:

*"Section 1322(4) and related provisions reflect a long-standing legislative recognition that mistakes will happen in corporate governance and that it is not in the public interest that the validity of decisions made in relation to corporations be unduly vulnerable to innocent errors which may be corrected without substantial injustice to third parties."*⁷

In a separate joint judgment of Hayne, Crennan and Keifel JJ, their Honours similarly found that s 1322(4)(a) had been cast in very broad terms and the remedial discretion it affords the court is not to be hedged about by an implied limitation.⁸ On this basis, their Honours' reasoning followed a two step process. Firstly, as the purported appointment of Helen by Amiram was not made by a continuing director for the purposes of increasing the number of directors fixed as the quorum for board meetings, the appointment was not made in accordance with the requirements of the company's articles. Secondly, as the appointment was not made in accordance with those requirements, it was made in contravention of the company's constitution. In their Honours' view, the fact that Amiram did not have the power, and could not have validly been given the power, to make the appointment neither added or subtracted from the conclusion that Helen's appointment was invalid by reason of a contravention of the company's articles.⁹

Gageler J, also delivering a separate judgment, agreed with the dissenting judgment of Campbell JA in the Court of Appeal, where he stated:

*"[a]ll that is required for there to be a 'contravention' of the constitution is that something have happened that is different to what the constitution of the corporation requires": "[f]or [Amiram] to appoint Helen as director, when he had no power to do so, is a contravention in this sense".*¹⁰

The High Court set aside the order of the Court of Appeal and ordered that the matter be remitted to the Supreme Court to decide whether an order under s 1322(4)(a) should to be made, and whether LWC should be wound up.

Conclusion

Modern day corporations are governed by men and women with varying experience in corporate governance. Common to all corporate entities, irrespective of size or sophistication, is the possibility that corporate governance processes may be tainted by innocent mistakes. The High Court's decision reaffirms the broad field of operation of s 1322(4) to acts rendered invalid by reason of provisions of the Act or a company's constitution. *Weinstock v Beck* will not change the established foundations of good corporate governance practice - a strong knowledge of a company's constituent documents and a familiarity with relevant legislation - but it does emphasise the breadth of the Court's discretionary power to alleviate corporations from unduly adverse implications of innocent errors.

¹ *Deputy Commissioner of Taxation v Portinex Pty Ltd (subject to dca)* (2000) 34 ACSR 391.

² *Re Sonic Healthcare Ltd* (2002) 43 ACSR 353.

³ *Mitropoulos v Greek Orthodox Church and Community of Marrickville and District Ltd* (1993) 10 ACSR 134.

⁴ *Weinstock v Beck* [2013] HCA 14 per French CJ at [39].

⁵ *Weinstock v Beck* [2013] HCA 14 at [56].

⁶ *Weinstock v Beck* [2013] HCA 14 at [42].

⁷ *Weinstock v Beck* [2013] HCA 14 at [39].

⁸ *Weinstock v Beck* [2013] HCA 14 at [53] and [55].

⁹ *Weinstock v Beck* [2013] HCA 14 at [54].

¹⁰ *Beck v LW Furniture Consolidated (Aust) Pty Ltd* (2012) 265 FLR 60 at 92.

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