



## Précis Paper

### Resolutions of Company Directors: Validity & Effect

A discussion of the recent decision in *Hawcroft v Jamieson* [2017] NSWSC 1478

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# Précis Paper

## Amending the Constitution of a Company

1. In this edition of BenchTV, Louise Coleman (Barrister, Sixth Floor Selborne Wentworth Chambers, Sydney) and Shanaka Jayasuriya (Barrister, Seventh Floor Wentworth Selborne Chambers, Sydney) discuss the recent decision in *Hawcroft v Jamieson* [2017] NSWSC 1478, and the interaction between the constitution of a company and subsequent contractual arrangements.

### Overview

2. The case ran for two days in April 2017, and judgment was delivered in October 2017.
3. The plaintiff ultimately succeeded in obtaining a declaration that the "chairperson resolution" that had been carried by a majority of directors was invalid and of no effect.

### Key facts

4. The case concerned the corporate governance of a company called Hawcroft General Trading Co Pty Ltd, which operates a hotel business in Newcastle. The plaintiff and each of the two defendants were directors of the company, with the plaintiff being appointed after the death of her husband Martin Hawcroft.
5. Martin and each of the two defendants were siblings, all of whom had been directors and equal shareholders of the company prior to his death in 2012.
6. The plaintiff sought to challenge the validity of a resolution that had been passed and carried by majority in 2016.
7. The resolution was referred to as the 'chairperson resolution'.
8. In broad terms, it appointed the first defendant as chairperson of the company, and provided her with certain additional authority over and above that of the other directors.

### On what basis did the plaintiff challenge the validity of the chairperson resolution?

9. The plaintiff challenged its validity on two bases:
  - first, she contended that the resolution breached the terms of a written agreement that had been executed by the then directors and shareholders of the company in August 2011. This agreement was referred to as the 'protocol' in the proceedings.
  - second, she contended that the chairperson resolution was beyond the power of the directors under the company's constitution, because it provided for one of the

directors - namely, the first defendant - to be paid more remuneration than that which the other directors were being paid.

### Key issues

10. The key issues of the case were:
  - whether the protocol was in fact a legally binding and enforceable agreement
  - whether the chairperson resolution was beyond the power of the directors under the company's constitution
11. In the course of determining these two issues, the Court was required to consider a number of other issues, including:
  - whether the protocol was operative after the death of Martin Hawcroft (assuming that it was legally binding)
  - whether the plaintiff had standing to enforce the protocol as a non-signatory to the agreement, but in her capacity as legal personal representative of the estate of her husband
  - whether the company was the proper plaintiff, or should otherwise have been joined to the proceedings in relation to the contractual claim to enforce the protocol
  - whether the protocol operated as a resolution of the directors to amend the company's constitution to the extent that any inconsistency existed between the two instruments
  - whether the plaintiff's contractual claim was precluded by an Anshun estoppel
12. Anshun estoppel was raised by the defendants on the basis of earlier proceedings that had been brought by the plaintiff against the company, in which the plaintiff claimed an entitlement to the proceeds of a life insurance policy on behalf of the estate. The insurance policy had been taken out by the company in respect of Martin's life.
13. In those proceedings, the protocol was relied on essentially to corroborate what was said to have been an equitable assignment of the policy to Martin. It was this aspect of the proceedings that caused the defendants to claim that an Anshun estoppel arose. This argument was ultimately rejected by the court.

### Breach of the terms of the protocol

14. The plaintiff's submission in relation to the breach was founded on clause 10 of the agreement. Clause 10 of the protocol provided that any decision to vary the way the company was managed or operated would require a vote representing at least 70% of the issued shares in the company.

15. Clause 10 in effect meant that decisions of this type had to be unanimous (because the company had three directors who were all equal shareholders). The contention was therefore that the chairperson resolution breached clause 10 of the protocol, because it was carried by a 2/3 majority, with the plaintiff dissenting.

#### The chairperson resolution

16. The chairperson resolution created a designated role of chairperson of the company, and appointed the first defendant to that role. The Court described it as essentially a delegation of certain powers of the other directors to the first defendant.
17. It authorised the first defendant to, for example:
- act as the primary representative of the company in dealing with external parties
  - approve non-budgeted company expenditure up to a given amount
  - act as the link between the board and the general manager of the company
18. It also provided, as consideration for the extra time involved in performing the chairperson's role, that the director's fee would be increased by \$20,000 a year, which proved to be critical to the outcome of the case.

#### The protocol

19. The protocol was a document that had been prepared by the company's then accountant and consultant Hugh McKenney following the exit from the company of Peter Hawcroft (another sibling) who had been a shareholder and director until about August 2011.
20. The protocol document was provided to Martin and to the two defendants at a meeting that had been called on short notice in August 2011, and it was signed by each at this meeting.
21. It basically created a set of rules for the management of the company. Among other things, it dealt with:
- who could be directors of the company
  - the frequency of directors meetings
  - the appointment of Martin to the position of managing director of the company
  - a procedure for handling any disputes that might arise between the parties

#### Was the protocol a legally binding agreement, and did the plaintiff have standing to enforce it?

22. The Court found that the protocol was not a legally binding and enforceable agreement. This finding was informed by the fact that prior to signing the protocol, each of the two defendants had expressly qualified their assent to it by indicating that they were signing the agreement as a draft.

23. It followed from this finding that the defendants did not intend to be immediately bound by the agreement upon signing it.
24. The Court also found that the directors had continued to discuss various provisions of the agreement after it had been signed, without suggesting that they were already bound by those terms, and that they ultimately abandoned these discussions and engaged the company solicitor to draft a formal shareholders agreement.
25. This conduct was held by the Court to be inconsistent with the existence of a binding contract before that date.
26. Because of the Court's finding that the protocol was not binding, the Court did not ultimately have to determine whether the plaintiff had standing to enforce that agreement.
27. It did, however, indicate its view on the issue. The Court suggested that the passage of the chairperson resolution directly affected the rights of the individual shareholders, which included Martin's estate, as represented by the plaintiff, to have the company and its directors act in accordance with the articles of association as amended by clause 10 of the protocol.
28. This view as expressed by the court assumed a number of things, including:
  - that the protocol was a binding agreement even after the death of Martin Hawcroft
  - that the protocol was effective in amending the company's constitution to the extent of any inconsistency between the two instruments

Both assumptions were not ultimately favoured by the court.

29. In any event, the Court indicated that even if the plaintiff had succeeded in establishing that the agreement was binding, it would have deferred final orders until the company had been joined as a defendant to the proceedings.

Why did the court have to consider whether the protocol amended the company's articles?

30. The court had to consider this issue because of the tension between article 80 of the company's constitution and clause 10 of the protocol.
31. Article 80 provided that decisions of directors required a simple majority, whereas clause 10 provided that such decisions would require a 70% majority, which meant in practical terms that decisions had to be unanimous by reason of there only being three directors. So the court had to consider how to reconcile these two seemingly inconsistent provisions.

32. The plaintiff relied on the Duomatic principle (*Re Duomatic Ltd* (1969) 2 Ch 365) to argue that the protocol reflected the unanimous assent of the directors and shareholders to amend the constitution, so that in effect clause 10 trumped article 80.
33. On the Duomatic analysis, the protocol was then as effective as a special resolution to amend the company's constitution. But the Court ultimately found (without needing to decide the issue) that the Duomatic principle did not apply in this case, because the Duomatic principle only applies to allow shareholders to waive formalities or procedural rights, rather than substantial rights.
34. Under the *Corporations Act 2001* (Cth), the defendants had a right to receive notice setting out an intention to pass a special resolution. This right was described by the Court as a substantial right, and notice of this kind had not been given to the defendants in this case.
35. The Court also found that the Duomatic principle required the informed assent of the members before it could be said that an informal agreement had been reached to amend the constitution.
36. The Court was not satisfied that the defendants were aware of their right to receive notice of the special resolution, and absent this knowledge, they could not have been said to have waived their right to rely on that statutory notice.

#### Outcome of the case

37. The Court held that the chairperson resolution was invalid and granted declaratory relief to that effect. The basis for this finding was that the chairperson resolution provided for the first defendant as chairperson to receive additional remuneration.
38. Under Article 70 of the company's constitution, the authorisation of additional remuneration for directors rested with the members of the company in general meeting. So it was beyond the power of the directors to authorise the remuneration.

#### Costs

39. In the primary judgment, the court had indicated its preliminary view that the defendants should pay 60% of the plaintiff's costs, having regard to her success in obtaining a declaration that the chairperson resolution was invalid, but also her failure to establish that the protocol was a binding agreement. The defendants meanwhile had failed in their defence of Anshun estoppel.
40. In a separate judgment, the court confirmed this preliminary view, observing, of course, that costs follow the event. The event in this case was properly characterised as the plaintiff's success in obtaining a declaration that the resolution was invalid.

41. The plaintiff's costs were then discounted to reflect her lack of success in relation to the protocol, and the amount of time that had been spent on this issue.

#### Takeaways for practitioners

42. The *Hawcroft* decision canvassed quite a number of issues, probably the most interesting of which was the discussion surrounding the Duomatic principle, and the question of whether shareholders can informally agree to amend the constitution without passing a special resolution to that effect.
43. It is not uncommon for members to enter into contractual arrangements (e.g. shareholders agreements). Usually these agreements will contain a provision that specifically deals with how the agreement is intended to interact with the constitution. But not all do - as was the case in this instance.
44. The decision points to the limits of the Duomatic principle when substantial rights are in play, or perhaps to the difficulty in drawing a clear line between substantial and procedural rights. It also suggests that a reasonable level of knowledge will be required on the part of members before it can be said that the Duomatic doctrine has been engaged.
45. The decision highlights the need for practitioners to be alive to the possible interplay between the constitution of a company and subsequent contractual arrangements between shareholders, and also the prospect that the company might be an interested party to any proceedings that raise these questions.

## **BIOGRAPHY**

### Louise Coleman

Barrister, Sixth Floor Selborne Wentworth Chambers, Sydney

Louise was called to the Bar in 2016. Before coming to the Bar, Louise practised as a solicitor in the Disputes group at Herbert Smith Freehills. She was a tipstaff and research assistant to the Hon. Justice Robert Macfarlan in the NSW Court of Appeal, and has been an examiner and tutor in Federal Constitutional Law at the University of Sydney since 2014. Louise has a diverse practice in public and commercial law and has appeared in a range of courts and tribunals, including the High Court of Australia, the Federal Court of Australia, the NSW Court of Criminal Appeal, the NSW Supreme Court and the NSW Civil and Administrative Tribunal. Louise accepts briefs in all areas of law. Louise holds a Bachelor of Laws and Bachelor of Arts (History) from the University of Sydney. She graduated with First Class Honours in Law, and was awarded the Sir Dudley Williams Prize for graduating in second place.

### Shanaka Jayasuriya

Barrister, Seventh Floor Wentworth Selborne Chambers, Sydney

Shanaka works in both civil and criminal law. Since being called to the Bar, he has worked alongside highly regarded Senior Counsel and barristers in complex litigation. Shanaka has acquired considerable international experience, both academically and as a solicitor in Sydney and London. Shanaka was Tipstaff to the Honourable Justice McColl AO of the New South Wales Court of Appeal and to the Honourable Justice Robb of the Supreme Court of New South Wales. He later joined the commercial disputes group at Henry Davis York, where he practised as a solicitor, advising and acting in a broad range of commercial matters. Shanaka holds a Bachelor of Civil Law (with Distinction) and a Bachelor of Law (with First Class Honours) from the University of Oxford, where he was a Broughton-Forrest Exhibitioner. He was School Captain and Dux at The King's School.

## **BIBLIOGRAPHY**

### Focus Case

*Hawcroft v Jamieson* [2017] NSWSC 1478

*Companies Act 1961* (NSW)

### Benchmark Link

[\*Hawcroft v Jamieson\* \[2017\] NSWSC 1478](#)

### Judgment Link

[\*Hawcroft v Jamieson\* \[2017\] NSWSC 1478](#)

### Legislation

*Corporations Act 2001* (Cth)