SQUIRE PATTON BOGGS

Directors' Duties

Procedural and Substantive Irregularities in Shareholder Dispute Contexts

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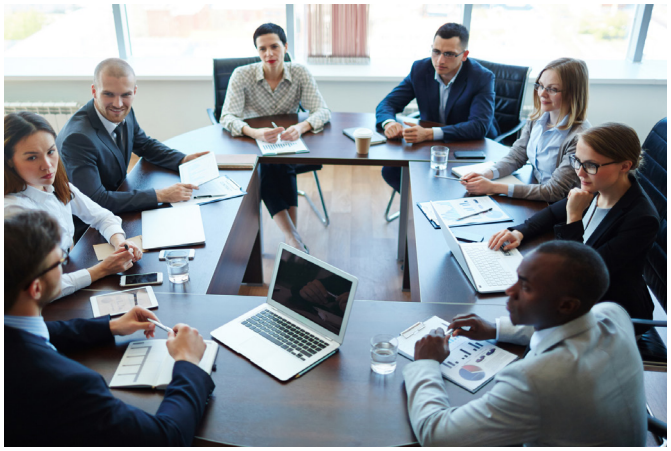
Disputes between shareholders, and their representative directors, are common. The likelihood that such disputes end up in court processes increases when the security interests tied to shareholders are being, or are threatened to be, enforced.

The prevalence of such disputes also increases in the zone of insolvency and certainly following the appointment of external administrators. In all of these scenarios, shareholders (and their representative directors) sometimes lose sight of commerciality and instead focus on the broadest possible scope of dispute by including grievances on procedural irregularities. The immediate difficulty with such an approach is that even if an irregularity can be established – which cannot just be assumed – it must be shown to be substantive, or of such significance as to cause real prejudice to the aggrieved party's interests.

Irregularities

Claims are often brought under s 1322 of the Corporations Act (Act) on the basis that an irregularity in respect of a meeting has resulted in an unfair outcome. Seeking relief under s 1322 is not straightforward. A claim cannot be made out simply on the basis of a procedural irregularity. Instead, the court must be satisfied that the irregularity – once actually established – has caused, or may cause, substantial injustice that cannot be remedied by any court order. Procedural irregularities – particularly in relation to the convening of, and resolutions passed at, meetings – are common. They occur most commonly in privately owned small to medium-sized companies, but also in joint venture scenarios and with public or listed entities.



In contentious scenarios, where sometimes significant interests are at stake and other times only egos are hurt, focusing on procedural irregularities can be fraught. Disputes often arise in relation to the issuance of new shares, the conversion of debt into equity and capital raising terms. In those contexts, meetings are usually held, and resolutions or motions are passed. In other words, those scenarios would meet the requirement of "a proceeding under the Act" set by s 1322. If a deficiency is alleged in respect of such "a proceeding" and relief is sought under s 1322, the court will consider whether the deficiency (if established) is a procedural or substantive irregularity. In doing so, it will determine what the "the thing to be done"[1] was and whether the final outcome miscarried. In most instances, "the thing to be done" would likely be the discussion of, and the taking a vote on, a particular resolution. Assuming the basis for that discussion and the end outcome could be properly established, any procedural irregularities leading up to that point would not be sufficient to overturn or disturb the outcome on an application under s 1322.

The exclusion of a director from a meeting – either by insufficient or no notice, or alternatively by actual exclusion – when the meeting was considering a motion on which that director had a right to vote is a substantive irregularity. However, on an application under s 1322, the director would have to firstly establish the procedural irregularity and the fact that they had a right to vote on the relevant matter. The restrictions imposed by s 195 of the Act – which deals with limitations on voting rights where a director has personal interests – often come into play in applications under s 1322 when it concerns the passing of contested resolutions at meetings. Where material personal interests exist,[2] a director would ordinarily be prohibited from taking part in deliberations and voting on resolutions. Unfortunately, sometimes directors lose sight of their lack of standing and if they are aggrieved by the outcome of a meeting, they can bring applications under s 1322 on a misapprehended basis.

1 Per Palmer J, in *Cordiant Communications (Australia) Pty Ltd v. Communications Group Holdings Pty Ltd* [2005] NSWSC 1005; (2005) 194 FLR 322 at 346 [103].

2 There are exceptions to s 195 (1) set out in s 195 (1A).

Notice

The sufficiency of notice is also often a flashpoint in shareholder and director disputes whereby plaintiffs submit that a notice is not only insufficient due to timing and delivery considerations, but also because it failed to particularise the items of business intended to be covered at the meeting. Contentions as to particularisation are misplaced in the face of a long line of authorities that establish that there is no obligation, absent an express requirement in a constitution, for the business proposed to be transacted at a meeting to form part of the notice convening the meeting.[3] Justice Barrett neatly summarised the position in *Dhami v. Martin* [2010] NSWSC 770:[4]

> No provision of the constitution requires the notice by which a meeting of directors is convened to state the business proposed to be transacted. Nor is there any general law requirement to that effect, so far as meetings of directors are concerned: *La Compagnie de Mayville v Whitley* [1896] 1 Ch 788; *Eastern Resources of Australia Ltd v Glass Reinforced Products (GRP) Pty Ltd* [1987] 2 QdR 31. The general principle is that directors should come together whenever called on notice of reasonable length and without any expectation of being told why they are being summoned to a meeting.

Contentions as to timing are often compromised by a failure to consider the facts relevant to the company and the reasonableness of the course taken by those calling the meeting. The question of reasonableness is one of fact. It is to be determined by reference to the ideals of fairness to all parties. It requires a context-specific inquiry that considers the nature and urgency of the business to be done. It must also assess the practicability of providing longer notice, the board's previous practice and whether, by reason of the alleged insufficient notice, directors were actually precluded from attending.

Reflection

The Act (and its associated regulations) sets extensive requirements for the management and conduct of a company's affairs. It also includes protections to safeguard the interests of different stakeholders – particularly those who might be oppressed or in the minority. Shareholders and directors can often be genuinely aggrieved by outcomes at the company level. However, they sometimes lose sight of the fact that their grievances lie in matters of procedure and not substance, and that seeking court relief is not a straightforward process.

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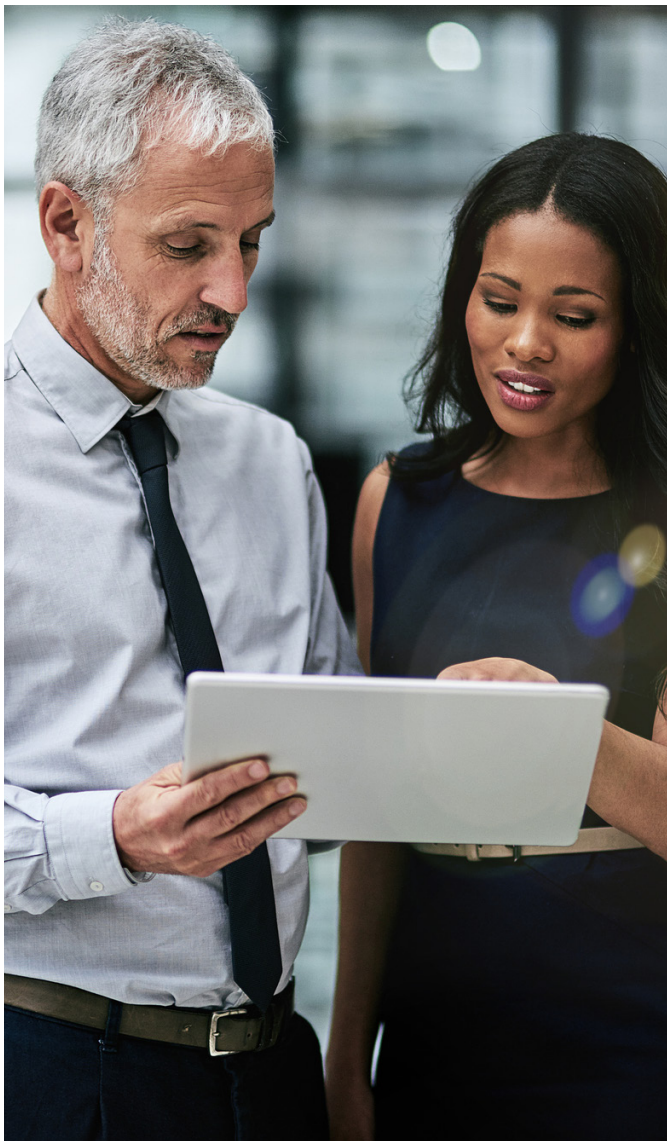

3 See, for example, *La Compagnie de Mayville v. Whitley* [1896] 1 Ch 788 at 797 to 799.

4 *Dhami v. Martin* [2010] NSWSC 770 at 174.