SPARKE HELMORE

Director Information Series

The complete guide

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Contents

Introduction

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Corporate & Commercial

In May 2023, we launched our Director Information Series. Recognising that operating a business in Australia could be rewarding but also challenging, our Dispute Resolution & Commercial Litigation team set about sharing their expert knowledge and insights through a series of articles aimed at considering issues that might arise in the running of your business and to explore best practice outcomes and solutions.

This guide is the culmination of that series and brings together all ten episodes published over the past 12 months. It is intended to provide you with practical and informative tips in an easy-to-read format and in support of every major phase in the lifecycle of a company. We have considered each issue through a legal lens so you can ensure your business is compliant and protected, particularly given that in addition to statutory duties, the duties and responsibilities of directors and officers are governed by the common law, equity and a company's constitution.

Issues covered in this wrap-up include shareholders' agreements and shareholder disputes, best practice execution of documents, ESG considerations, protecting a business' rights and assets when contracting, and recognising and dealing with financial distress and insolvency in your business and that of your customers.

We hope you find this round-up useful. If you need assistance with an issue we have highlighted in this guide or have any questions about your business or obligations as a director or officer, please do not hesitate to contact one of our team.

SHAREHOLDERS' AGREEMENTS

Author: Nell McGill, Special Counsel

Top tips

1. A shareholders' agreement defines the terms on which business owners agree to be bound in their dealings with one another.

2. The agreement can be as simple or as complicated as shareholders choose, but the best agreements include terms about how profit redistribution decisions are made, new directors and shareholders are admitted, meetings are conducted, and deadlocks are broken.

3. Putting a shareholders' agreement in place can save significant sums of money for shareholders that later fall into dispute about management matters.

What is a shareholders' agreement?

A shareholders' agreement is a contract between the owners of a business: the shareholders. It defines the terms on which the shareholders agree to be bound in their dealings with one another. A shareholders' agreement is implemented in addition to the formal rules that govern a company, which are set out either in the company's constitution, or by adopting the replaceable rules in the *Corporations Act 2001 (Cth)* (**Act**). The replaceable rules are generic provisions dealing with the very basic operations of company management.

Typically, public companies listed on the ASX do not have shareholder agreements, managing the relationship with shareholders through a formal shareholder engagement policy.

Why do I need a shareholders' agreement?

Just like putting terms of agreement in writing with clients or customers, parties starting a new venture together should record in writing the way they want to deal with each other within the business and the best time to agree fair and equitable terms is at the beginning, when everyone is driven towards the joint success of the venture. A shareholders' agreement is an essential tool to determining how the company is to be managed, including distributions of profit, appointment of directors, and the process by which shareholders join or leave the business.

Without a shareholders' agreement, relationships between business owners are governed by the Act or by the company's constitution, both of which can be woefully inadequate to deal with some of the more complex issues that arise in running a company. The inevitable consequence of unsatisfactory policies is significant cost to stakeholders to resolve many of the common issues and disputes that might eventuate. A lack of a shareholders' agreement can also cause difficulties when friends or associates fall out, shareholders need to cash in their shares for personal reasons or where there is a death, divorce or a relationship breakdown.

What terms are included in a shareholders' agreement?

The most effective shareholders' agreements are those that have clear, certain terms that look to achieve efficient resolutions to common problems. Shareholders' agreements usually deal with the following issues, among others.

Directorships

There are several different types of directorships, and the role a person holds can significantly affect the way a company is managed. A shareholders' agreement will commonly define who does what, and how directors of different types are appointed (for example, some agreements limit which shareholders can appoint directors). It can also provide how directors are removed or terminated in the event of disputes, wrong-doing or the exit of a shareholder.

Shareholdings

Like directorships, shares can be held in different ways, such as ordinary or preference shares, with various rights attaching to the different nature of shareholding. A shareholders' agreement can distinguish between types of shares and the rights that attach to them, including voting rights, rights to share in profit distributions and the rights and obligations that arise when things go wrong (such as the company becoming insolvent).

Decision-making

Agreements will usually deal with decision-making by allowing shareholders to appoint directors to a board, and then setting requirements for majority or unanimous voting on particular matters. It is common for a company to identify a list of decisions that require all directors or shareholders to vote unanimously on a resolution, and others that require only simple (50%+1) or special majorities (75%). Examples of decisions that require unanimous voting might be the issue or creation of additional shares or classes of shares and incurring expenditure, or taking loans, over a certain amount. Decisions that change the nature of the company generally require approval by a special resolution of the shareholders. Some examples include: modifying or adopting the company constitution, changing the company's name, changing the company share structure or changing the company type.

Meetings

While a company's constitution, or the replaceable rules, often make basic provision for the process of calling a meeting, shareholders' agreements permit more specific provisions to be made about the calling, and voting at, board meetings and shareholder meetings.

Distributions

The distribution of profits is the way shareholders make money from their investment in the business. It is also where taxation implications arise and, unfortunately, where disputes are commonly founded. It is therefore imperative that shareholders reach and record their agreement on matters relating to the company's profits, such as how it is to be retained, reinvested and distributed, who has the right to receive a dividend (particularly if there are different classes of shares), and when the dividends will be distributed.

Incoming/outgoing shareholders

Stakeholders can agree the process and include terms such as requiring a selling shareholder to give existing shareholders the first right of refusal to purchase the shares, allowing a majority shareholder to 'drag' along minority shareholders in a larger share sale, or allowing a minority shareholder to 'tag' along on such a sale. Importantly, the shareholders' agreement can set out how the share price is to be determined for a sale or purchase of shares.

Deadlocks

A shareholders' agreement can define who gets a casting vote on any decision where shareholders are split down the middle. There are various methods of resolving deadlocks, and it is better to agree which one will be used well in advance of the stalemate occurring.

Disputes

Dispute resolution provisions in shareholders' agreements usually require the parties to go to mediation, arbitration, or expert determination before a party can commence litigation. Within the dispute provisions, stakeholders should identify what constitutes a breach of the agreement, and the consequences of breach, such as a forced sale, removing a shareholder or terminating the agreement.

How do I put a shareholders' agreement into place?

Whether you are just getting ready to start a new venture, or if you have been in business for a while without a shareholders' agreement, we encourage you to get in touch with one of our experts who can assist you with putting together an agreement that is tailored to suit the needs of your business, and how the owners want to interact with each other.

EXECUTION OF DOCUMENTS

Author: Nell McGill, Special Counsel

Top tips

1 A company can sign contracts and deeds by persons who have appropriate authority.

2 Execution in accordance with s 127 of the Corporations Act is best practice.

3 Companies should implement proper protocols regarding who within the company has authority to execute under s 126 of the Corporations Act.

Introduction

In the first of our Director Information Series, we considered the importance of a shareholders' agreement as an instrument that records the rights and obligations of shareholders and company executives as they embark upon a business venture.

The effective execution of documents by a company is the next important topic in the Series. While the authority to execute a document on behalf of a company is something that a shareholders' agreement might contemplate, it is prescribed in the *Corporations Act 2001* (Cth) (**Act**) and may also be provided for in the company's constitution.

How can a company execute documents?

A company is a legal entity that can enter into commercial arrangements and sign documents such as contracts and deeds, which are binding upon it. However, as a company is not a physical entity, it cannot physically execute a document. Consequently, a person or persons within the company must be given the authority to execute binding documents on behalf of the company.

The most straightforward form of valid execution by a company is in accordance with s 127 of the Act, which provides that a company may execute a document:

- by two directors, or a director and company secretary, or (if there is one director who is also the company secretary) the sole director signing it, or
- by affixing the company's common seal in the presence of, and witnessed by, the company's sole director, or two directors, or a director and company secretary.

However, a company can also validly execute a document under s126, which permits an individual acting with the company's express or implied authority to execute documents on behalf of the company. There is no requirement under the Act for the execution of the document by directors or an authorised individual to be witnessed.

If a document has been formally executed in accordance with the provisions of ss 126 or 127 of the Act, the party dealing with the company is entitled to assume that the document has been duly or properly executed by the company. That is the case even if an officer or agent lacked actual authority including by acting fraudulently. However, if the other party to the agreement is aware that the person who executed the document did not in fact have authority to bind the company that party will not be entitled to rely upon the execution as being valid and binding on the company.

Authority to act on behalf of the company

The assumption about execution by an agent under s126 can undoubtedly create significant potential risk for a company. While a very useful tool for many larger corporate entities, the section can create headaches for directors because of the risk of an individual within the organisation acting without the express authority of the Board. It can also create uncertainty for parties dealing with the agent on behalf of the company. It is not uncommon for a company to deny the authority of someone who has purported to act as agent in binding a company on execution.

Actual authority

The clearest way for a company to give an individual authority to bind it in commercial negotiations is expressly and in writing usually achieved by passing a Board resolution, which gives the agent power to act on behalf of the company. The resolution should be framed in a narrow compass to give the agent authority to bind the company in a specific context. For example, actual authority can be limited in various ways to contracts or agreements of a particular nature such as employment agreements, or for a limited value, or in certain circumstances only. A party dealing with an individual who acts in compliance with the company's actual authority can have comfort that agreements reached are binding and enforceable.

Actual authority can also be implied. This often occurs when a person is appointed in a role that conveys such authority, such as managing director or chief financial officer. If a managing director holds themselves out as having the authority to bind the company, and the company does not take steps to limit the apprehension of authority, then a party dealing with a managing director may have the right to assume that this individual has the relevant authority to act. Directors should keep a close eye on the actions of all senior executives, to ensure that these executives are not acting outside the limits of their authority.

Ostensible authority

Ostensible, or apparent, authority is an area of greatest risk to a company because of the inherent vagueness of the concept. Ostensible authority arises where an agency relationship is created by the appearance of the agent's authority, rather than agreement or inference from a position of authority. If a reasonable person would believe that a person has authority to act, they will be the ostensible agent for the company.

For ostensible authority to exist, the following circumstances must be in place:

a. the company, or someone with actual authority, must make a representation that the individual has authority, and

b. the contracting party must have relied upon the representation (not knowing that the person didn't have authority).

The question as to whether an individual had ostensible authority usually arises after the fact: when an individual who purported to have authority executes a document, and the company is trying to extricate itself by alleging the person was not authorised to enter into that agreement or arrangement. If a contracting party can show that it had reason to believe the individual had authority from the company's own representations, then the contract will be binding.

Electronic execution

This topic necessarily requires a brief consideration of how execution of documents has changed as a result of the electronic execution provisions introduced across Australia in response to the COVID pandemic. The temporary measures that enabled electronic execution while most of the country was locked down were made permanent in early 2022.

The amendments to execution under the Act enable authorised persons to execute documents by any electronic means – this can include physically signing and scanning in, adding an electronic signature, or using a program like DocuSign or Adobe Sign (the various methods have been described as "technology neutral"). The biggest amendment to the legislation is that deeds can be electronically signed by agents of a company without a witness.

While the change in law is undoubtedly intended to facilitate transactions, the ability for an agent to execute documents without a witness and electronically undoubtedly creates greater opportunity to bind a company without its knowledge. Company directors should be aware of this additional risk and increase vigilance with respect to giving or implying authority.

How can I best protect my company?

We always recommend that our corporate clients implement an internal procedure that require documents to be executed in accordance with s 127 of the Act or with clearly defined authority under s 126 in order to guard against persons unknowingly binding the company. It is also recommended that the shareholders' agreement for the company clearly delineates the power of the Board to delegate authority to the company executive/s.

Directors should be aware of the risks of appointing individuals to roles within the company that might imply authority, such as the roles of managing director and chief financial officer. The contracts under which senior executives are appointed must clearly define the scope of that officeholder's authority. Further, where an executive is enabled to bind the company, the Board must pass resolutions that precisely describe nature and limits of executive authority.

Companies should also be disciplined with who is held out as having authority to act on its behalf. This can involve implementing and maintaining strict guidelines about what persons can do and say on behalf of the company and ensuring that any misunderstandings in this regard are clarified immediately. Companies can also include in their outgoing documents statements describing the level of authority required for the document to be validly executed.

On the other side of the equation, when companies are entering into agreements with parties who execute documents other than by directors, it is prudent to seek evidence that the party executing on behalf of the other party has authority to bind the company. Evidence may include sighting a Board resolution or a direct communication with a director of the other party.

Our experts can assist with ensuring your company implements best practice regarding execution of documents, as well as assisting to resolve issues relating to agents without authority executing documents.

DUTIES OF DIRECTORS

Author: Scott McDonald, Partner
Jocelyn Sutcliffe, Senior Associate

Top tips

1 A director must exercise their powers and discharge their duties with the degree of care and diligence that a "reasonable person" would be expected to exercise. The 'business judgment rule' recognises this risk and protects directors against breaches of their duty of care and diligence.

2 A director of a company must exercise their powers and discharge their duties in good faith in the best interests of the company and for a proper purpose.

3 It is crucial to understand that directors or officers can't use their position or confidential information to gain an unfair advantage for their company or anyone else.

Introduction

The *Corporations Act 2001* (Cth) (**Act**) regulates companies in Australia. It also imposes duties and responsibilities on directors and officers of companies. The Australian Securities & Investments Commission (**ASIC**) is an independent Australian government body that regulates and enforces the Act.

In addition to statutory duties, the duties and responsibilities of directors are governed by the common law, equity and a company's constitution.

In the third episode of our Director Information Series, we outline the requirements under the Act for directors to exercise care and diligence, and act in good faith. We also consider what constitutes improper use of position or information.

Duties of directors

Care and diligence

A director must exercise their powers and discharge their duties with the degree of **care and diligence** that a "reasonable person" would be expected to exercise in the circumstances.[1] The reference to reasonable person indicates an objective standard of care. A breach of s 180 gives rise to civil liability only and not criminal liability.

Sometimes, a director's well-intentioned decision can lead to a poor outcome. The '**business judgment rule**' recognises this risk and protects directors against breaches of their duty of care and diligence.

The Act states that a director has fulfilled their responsibility of care and diligence, regardless of the outcome, if they meet the below criteria.:[2]

- make a business judgment in good faith and for a proper purpose; and
- do not have a material personal interest in the subject matter of the judgment; and

- inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- rationally believe that the judgment is in the best interests of the corporation.

The business judgment rule was introduced into the Act in 2000. Since then, it has only been successfully utilised as a defence to a breach of s 180 on a few occasions.[3]

Directors should be aware that breaching their duty of care and diligence could result in significant civil penalties from ASIC.[4] In addition, they may face claims for damages from the company or become defendants in shareholder class actions.

Good faith

A director of a company must exercise their powers and discharge their duties in **good faith** in the best interests of the company and for a proper purpose, as referenced in s 181 of the Act.[5] This includes avoiding conflicts of interest and revealing and managing conflicts if they arise.

In practice, this means that a director must act in the interests of the shareholders of the company as a whole. The duty does not extend to a wider range of stakeholders (for example, customers or creditors).[6]

This is a civil penalty provision[7] but the Act also creates a criminal offence for the same conduct.[8] The fault elements of the criminal offence are dishonesty and recklessness and must be proven beyond a reasonable doubt.

Improper use of position or information

A director must not **improperly use their position** to gain an advantage for themselves or someone else or cause detriment to the company.[9] A director may be found to have contravened this duty regardless of whether the advantage or detriment actually occurs.

A director must not **improperly use the information** obtained as a director to gain an advantage for themselves or someone else or cause detriment to the company.[10] A director may be found to have contravened this duty regardless of whether the advantage or detriment actually occurs.

Each of these duties is a civil penalty provision but the Act also creates criminal offences for the same conduct. The fault elements of these offences are intention and recklessness.[11]

It is crucial to understand that directors or officers can't use their position or confidential information to gain an unfair advantage for their company or anyone else. This is considered an offence and using such information or position to gain an advantage won't be accepted as a defence in court proceedings.[12]

Case study

ASIC v Star Entertainment Group Ltd

In December 2022, ASIC launched civil proceedings against 11 current and former directors and officers (the Defendants) of the Star Entertainment Group (**Star**) for alleged breaches of their statutory duty of care and diligence (s 180 of the Act).

The pleadings alleged that Star's directors and officers should have taken meaningful action to respond to material risks of criminal association and money laundering in the period 2017-2020. ASIC sought declarations that the Defendants breached their duty as well as for the imposition of civil penalties and disqualification orders against them.

The allegations concern the following circumstances:

- Star approved dealings involved with certain individuals with reported criminal links and did not address the money laundering risks by inquiring into whether Star should be dealing with the individuals.
- Star did not take steps to make further enquiries of management when provided with information about money laundering risks and that this was a breach of their director's duties.
- Star did not adequately address the money laundering risks that arose with certain individuals, as well as continuing to deal with the individuals despite becoming aware of reports of criminal links.
- Officers failed to escalate money laundering issues to the Board.

The case serves as a reminder for all directors and officers that ASIC expects boards to adopt an active role, especially with respect to risk management.

It is also the first time that ASIC has sought to pursue an entire board for alleged breaches of their director's duties related to non-financial risk management. Any judgment is likely to impact future corporate governance standards in this area.

1 Act, s 180(1)
2 Act, s.180(2)
3 *ASIC v. Rich* [2009] NSWSC 1229 and *ASIC v. Mariner Corporations Ltd* [2015] FCA 589
4 Act, s 1317E
5 Act, s.181
6 *Australian Securities and Investment Commission v Maxwell and Ors* [2006] NSWC 1052 at [107 - 110]
7 Act, s 1317E
8 Act, s 184(1)(c)
9 Act, s.182
10 Act, s.183
11 Act, ss.184(2) and 184(3)
12 Act, ss.184(2A) and 184(4)

THE RISE OF ESG: CONSIDERATIONS FOR DIRECTORS

Author: Scott McDonald, Partner
Jocelyn Sutcliffe, Senior Associate

Top tips

1. ESG-related regulation and enforcement activity in Australia has expanded significantly, in line with the rise in prominence of these issues.

2. Understanding ESG issues is the first step to developing a strong ESG strategy allowing directors to understand the impact of the company's operations on the environment and community, and the ESG regulatory trends and risks that may impact the company, including around shareholder activism.

3. Where environmental claims or disclosures are false or are not able to be substantiated, companies run the risk of offending under Australian Consumer Law. Directors should be aware of the potential for any false or unsubstantiated claim to also give rise to personal liability risks.

In the fourth episode of the Series, we explained how directors of companies are bound by a number of duties, both under the general law and as codified in the *Corporations Act 2001* (Cth) (**Corporations Act**).

Part of discharging those duties involves directors identifying, considering, and ensuring their company properly manages environmental, social and governance (**ESG**) issues.

The rise of ESG

ESG refers to a set of frameworks used to assess activities that may impact on or present an opportunity to a company across the three broad categories of "environmental", "social", and "governance". In other words:

how does the company treat the environment?

how does the company treat employees, consumers and the community?

how is the company being run?

ESG issues have become increasingly prominent in recent years, and we have seen a significant expansion in ESG-related regulation and enforcement activity across Australia, particularly in relation to reporting and disclosure.[1]

ESG are important issues for all companies, with the effective management of ESG concerns and opportunities now a key business objective. Apart from the risk of exposing themselves and their companies to financial and reputational risk as well as to regulatory action where ESG issues are not properly considered,[2] directors must also be mindful of stakeholder expectations. Stakeholders will be keeping a close eye on how companies respond to ESG-related concerns and also how the operations of the company potentially contribute to ESG impacts.[3]

A director's role

Companies and directors need to be across the different ESG issues, requirements and expectations that apply to each company, its activities and the industry in which it operates. Understanding ESG issues is the first step to developing a strong ESG strategy allowing directors to understand the impact of the company's operations on the environment and community, and the ESG regulatory trends and risks that may impact the company.

Understanding the risks associated with greenwashing

A particular area of ESG risk for directors is "greenwashing". Greenwashing involves misrepresenting or overstating a company's environmental credentials or positive environmental impacts.

With companies now facing pressure from investors and consumers to make net zero commitments, establish and implement energy transition strategies, companies may feel pressured to make environmental claims about their products, services, and operations. Similarly, market expectations around ESG reporting are increasing, particularly regarding disclosure of climate change-related risks and impacts.[4] Where those claims or disclosures are false or are not able to be substantiated, companies run the risk of offending under the prohibition on misleading and deceptive conduct under *Australian Consumer Law* (**ACL**). Committing an offence under this legislation can carry heavy penalties.[5]

While it is important that companies provide accurate, detailed, and transparent disclosure of the ESG risks relevant to the company and how it is responding to those risks, directors should be aware that these disclosures have the potential to give rise to personal liability risks for their involvement in the company's misleading and deceptive conduct and false or misleading statements.[6]

Overstating a company's climate credentials or understating its exposure including unrealistic representations about net zero goals or emission reduction targets are some examples of the kind of matters that may expose companies and directors to action by regulators.[7]

To safeguard against the risk of greenwashing and to avoid regulatory scrutiny, directors should ensure all ESG-related claims, commitments and disclosures to the market are clear, accurate and can be substantiated.[8]

Litigation and shareholder activism

Shareholders want assurances that a company they have invested in reflects their values, and where that is not the case, they may seek to influence corporate decision-making through shareholder activism.

ESG-related litigation and shareholder activism is increasingly common, with shareholders demanding responsible business conduct and that directors recognise the financial and operational risks to the company of not adequately responding to ESG issues. In particular, there has been a significant increase globally in climate-related litigation, mainly due to increasing urgent calls for responses to climate change and growing stakeholder awareness of ESG issues.

It is imperative that companies keep up to date with trends in shareholder activism and trends in corporate governance to reduce the risk of shareholder activism by identifying ESG risks, communicating openly with shareholders and specifically addressing their concerns.

Key takeaways

Companies and directors must recognise and understand the increasing attention being given to ESG issues, and the associated regulation and risks arising from this attention, and work to address the following priorities:[9]

- strengthen and improve standards of governance and disclosure
- take steps to avoid the practice of greenwashing
- ensure that standards remain high when it comes to ESG compliance, and
- prepare for the broader evolution of the ESG space and future regulatory enforcement.

[1] Australian Securities & Investments Commission, 'ASIC highlights focus areas for 30 June 2022 reporting' (Media Release 22-124MR, 1 June 2022).
[2] Australian Securities & Investments Commission, 'ASIC announces Enforcement Priorities for 2023 (Media Release 22-302MR, 3 November 2022) ('ASIC Enforcement Priorities for 2023').
[3] Ibid.
[4] Joe Longo, 'ASIC Chair's AFR ESG Summit speech' (Speech, AFR environmental, social, and governance (ESG) Summit, 5 June 2023) ('ASIC Chair's Summit speech').
[5] ACL, s 18.
[6] ASIC Enforcement Priorities for 2023.
[7] Ibid.
[8] Australian Securities & Investments Commission, 'How to avoid greenwashing when offering or promoting sustainability products, Information Sheet 271 (INFO 271, June 2022).
[9] ASIC Chair's Summit speech.

PROTECTING A BUSINESS' RIGHTS AND ASSETS WHEN CONTRACTING

Author: Nick Christiansen, Partner

Top tips

1 Usually all that is needed to create a valid and enforceable contract are four elements—an offer, acceptance of that offer, a contractual relationship and 'consideration'.

2 It's important to ensure that all parties that have obligations under a contract are included as a party to the contract. It is preferable to prepare a written contract to avoid the risk of a dispute later arising as to what the parties agreed. Ensuring that contracts are carefully drafted also reduces the risk of a dispute.

3 To ensure a written contract is enforceable, care must be taken to ensure the contract is executed validly and in accordance with any legislative requirements. When contracting with an Australian company, ensure that the contract has been signed by two directors of the company, by one director and one company secretary, or by the sole director who is also the company secretary.

Adequately protecting a business' rights and assets often will depend on having effective business contracts containing the right terms.

In our fifth episode, we outline the key elements of a valid, enforceable contract, explain the terms that comprise the substance of a contract and provide tips on drafting common trading terms included in commercial contracts.

Contracting basics

Elements of a contract

Usually all that is needed to create a valid and enforceable contract is:

- an offer by a party
- acceptance of that offer by the other party
- an intention by the parties to create a legally-binding, contractual relationship with one another, and
- 'consideration', meaning something given or promised in exchange for the promise of the other party – usually in the form of money.

Parties

A contract should identify all of the relevant parties with sufficient specificity to ensure that the people or entities bound to the contract are clear and that you can later enforce the contract against those parties. This includes accurately identifying each party's name and, for a company, its ABN or ACN.

Only the parties to a contract can enforce it or be subject to the obligations under it, and so it is important to ensure that all parties that have obligations under the contract are included as a party.

Form

A contract does not always need to be in writing to be enforceable. Where the elements above are established, a contract will be created whether it has been written down or not.

It is preferable to prepare a written contract—in clear and precise terms, signed and dated— to avoid the risk of a dispute later arising about what the parties agreed.

Legislation requires that some types of contracts be made in writing to be enforceable – for example, contracts about interests in land must be in writing and signed by the relevant parties.[1]

Contract terms

The substance of a contract is its terms, which establish what each party has agreed to do or not do under the contract.

To identify the terms of the contract and what they mean, an objective approach is taken. We look first at the 'express terms' – that is, the terms written into the contract – because if the parties recorded those terms, then they will be taken objectively to have intended those terms to form part of the contract.

If the express terms of the contract are incomplete, then it is possible for the courts to imply terms into the contract. Terms might be implied because the law considers them generally applicable to all contracts, because they are generally accepted to be implied into a particular type of contract, or because they are necessary to give 'business efficacy' to the contract – that is, they are necessary to achieve the result that the parties intended the contract to achieve.

Ensuring that contracts are carefully drafted to include clear and complete terms reduces the risk of a dispute about the extent or meaning of the contract terms and of the court implying terms that might not have been what the parties subjectively intended.

Important trading terms

The following trading terms are mechanisms often used in commercial contracts to protect a business' rights and assets.

Scope of the supply

Whether the contract relates to goods or services, it is important to be clear about exactly what is being acquired in exchange for payment of the agreed price. In supplies of goods, this means accurately describing the goods and any relevant qualities or quantities. In supplies of services, this means detailing precisely what work will be carried out and when.

Payment clauses

Payment clauses should include terms that clearly state the price, the dates by when payments are to be made, and the permitted method or methods of payment. Such terms should also outline the consequences of a party not complying with its payment obligations. For example, it would be common to provide that the supply of goods or services will stop and that interest may be charged on unpaid invoices.

Taking security

Particularly where payment will not be due until after goods or services have been provided, it might be appropriate for the contract to provide some form of security. This might be a personal guarantee from a director of the company or the grant of a security interest over its assets.

Historically, it was common for goods supplied in advance of payment to be supplied subject to a 'retention of title' clause, under which the supplier sought to retain ownership of the goods until payment had been received as well as the right to retrieve the goods.

The *Personal Property Securities Act 2009* (Cth) has changed the effect and enforceability of retention of title clauses, and they are now likely to be regarded as a 'security interest' subject to the Act. This means that clauses must be more carefully drafted than previously and the security interest will need to be registered on the Personal Property Securities Register. That is the subject of our next issue in this Series.

Warranties

Contracts often include warranties giving assurances about the quality or standard of the goods or services supplied, or the way in which services will be performed. These sorts of warranties can be important to the party acquiring the goods or services.

Supplies or goods or services for $100,000 or less, or of a kind ordinarily acquired for personal, domestic, or household use or consumption, will also be subject to consumer guarantees under the *Australian Consumer Law*, whether or not the contract for those supplies includes any separate warranties.

Default

Default clauses should include terms that specify what actions or events constitute a default under the contract and the rights of the aggrieved party upon default. Default provisions should also specify whether there is a period in which a default may be rectified and, if so, the effect of a default being rectified.

Common types of default events include a failure to fulfil repayment obligations under a contract, or a company being deregistered or becoming insolvent.

Exclusion or limitation of liability

Contracts often contain provisions that exclude or limit a party's liability to the other party in the event something goes wrong. It is common, for example, to exclude liability for 'consequential losses' such as loss of profits, or to specify a maximum amount for which a party will be liable.

Termination

Usually, a default clause will permit an aggrieved party to terminate the contract where a default is not remedied or is not capable of being remedied.

Where a contract has a fixed term, it will end naturally once that term expires.

It may also be appropriate to include rights for a party to terminate without needing a reason, usually be giving notice to the other party.

Execution of contracts

To ensure a written contract is enforceable, care must be taken to ensure the contract is executed validly and in accordance with any legislative requirements that may apply. For example, the *Corporations Act 2001* outlines the different ways in which an Australian company can execute documents.[2]

When contracting with an Australian company, you will usually want to ensure that the contract has been signed by two directors of the company, by one director and one company secretary, or by the sole director who is also the company secretary.

When contracting with third parties that have authorised a specific representative to execute documents on their behalf, such as through a power of attorney or trust deed, it is important to ensure that the person executing the contract is duly authorised to bind the party to the contract under the relevant, authorisation document.

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[1] For example, *Conveyancing Act 1919* (NSW) s 54A.
[2] s 127.

REGISTERING SECURITY INTERESTS ON THE PPSR

Author: Nick Christiansen, Partner

Top tips

1 When supplying goods or services, taking a security interest is a good way to ensure you receive payment in the event your customer or client becomes insolvent.

2 Registration is important to ensure that your security interest is valid and enforceable as a matter of law. It is also important in determining which secured creditor has priority. A failure to provide the necessary details in your financing statement or to lodge it within the prescribed timeframe may mean that the priority of your security interests diminishes.

3 If you fail to register your interest you have a high risk of losing your claim or interest over the secured property to others who have registered. It is also critical to monitor registrations to ensure that they are valid and to undertake renewals within the timeframe where required to avoid the losing your interest over the registered property.

When supplying goods or services, taking a security interest is a good way to ensure you receive payment in the event your customer or client becomes insolvent.

It is a common misconception that security agreements and retention of title clauses will guarantee a party's right to realise secured assets when other contracting parties are unable to meet their debts.

In our sixth episode in this series, we discuss the importance of formally registering a security interest on the Personal Property Securities Register (**PPSR**) as a critical step in protecting your right to enforce a security interest.

What is the PPSR?

Created by the *Personal Property Securities Act 2009* (Cth) (**PPSA**), the PPSR is a centralised public listing of all security interests claimed over personal property in Australia. The PPSR is, in effect, a public notice board. By registering security interests on the PPSR, other interested parties are aware of those interests.

What is personal property?

'Personal property' includes all property except land and rights, entitlements or authorities excluded by or under a law of the Commonwealth, a state or territory. Personal property includes a range of tangible property, for example, livestock or vehicles, as well as intangible property, such as copyrights and trademarks. It will include things like cash, stock, office equipment, cars, boats, furniture, and machinery.

What is a security interest?

A security interest is an interest in personal property that arises in the context of a transaction, where payment or performance of an obligation is secured. The registration of a security interest over personal property or an asset will protect your interest against other parties (for example, liquidators) who seek to also claim an interest in the same property.

Common examples of security interests may include hire purchase agreements, consignments, leases of goods, fixed and floating charges and conditional sales agreements. It is now common take security over personal property under a General Security Agreement. The person or organisation who grants a security interest in a transaction is known as a 'grantor', while the party who obtains the security interest is known as the 'secured party'.

It is important to note that not all transactions of this nature will give rise to a security interest. For instance, certain licences will not be considered to be security interests.

Why should I register my security interest?

Registration is important to ensure that your security interest is valid and enforceable as a matter of law. It is also important in determining which secured creditor has priority in enforcing against the grantor's assets.

How do I register my security interest?

The registration of security interests can be a complex process. A failure to provide the necessary details in your financing statement or to lodge it within the prescribed timeframe may mean that the priority of your security interest diminishes, preventing you from realising the secured property if enforcement becomes necessary.

It is possible to register a security interest yourself following the instructions on the PPSR website, but if you are registering complex or particularly significant security interest or will need to make a large number of registrations, we recommend consulting a lawyer to ensure that you get the registration right.

What happens if I don't register my interest?

It is critical that a security interest you are entitled to is registered over an asset on the PPSR. Failing that, any interest in personal property will remain 'unperfected' and there is a high risk of losing your claim or interest over the personal property to others who have registered. Unperfected interests carry a lower priority than those interests that have been 'perfected' through registration and allow other parties to assert a stronger claim over the relevant property.

What happens if more than one security interest is registered?

In circumstances where multiple security interests are registered in respect of the same property, the secured creditor with the highest priority will have first right to enforce over the secured assets. The perfection of a security interest by registration will affect the priority of your interest over others in the same property.

'PMSI' and 'perfected' interests

The highest priority security interest is a purchase money security interest (**PMSI**). Generally speaking, a security interest is a PMSI if the grantor used the funds provided by the secured party to acquire the relevant property. A 'retention of title' provision in an agreement for sale of goods, for example, will give rise to a PMSI and will need to be registered.

A PMSI has a 'super priority' over all other registered security interests, including those registered earlier than the PMSI itself.

To have the benefit of this super priority, a PMSI must be correctly registered and identified as a PMSI, within a certain period of time – a PMSI over tangible collateral, for example, must be registered before the grantor obtains possession, whereas a PSMI over non-inventory tangible property must be registered within 15 business days of the grantor taking possession. If it is registered correctly but not explicitly identified as a PMSI, or is registered outside of the prescribed timeframe, it loses its status as the highest-ranking security interest and merely becomes a 'perfected' interest (which is a security interest constituted by a written agreement and validly registered on the PPSR).

A security interest is otherwise generally 'perfected' upon registration.

Where multiple perfected interests are registered in respect of particular property, the security interest with the highest priority will be that registered first in time, with the most recently registered interests being of the lowest priority.

Unperfected interests

Where an interest is 'unperfected', meaning it has not been registered or is not supported by a written security agreement, it will be rank behind a perfected interest. For example, a supplier who fails to register their security interest in unpaid goods arising under a retention of title clause in a supply agreement may find that, if the purchaser of the goods becomes insolvent, they are unable to enforce that clause to recover unpaid goods and that instead the goods are recoverable by a secured party with a registered security interest in them or the goods may 'vest' in the grantor (i.e., become its property, even if they were not paid for). This is an illustration of how traditional legal concepts of 'ownership' are subordinated under the PPSA regime.

If there are multiple unperfected interests, the highest-ranking interest among the unperfected interests will be the interest that 'attached' to the property first. 'Attachment' occurs when the grantor has a right to the relevant property (or the power to transfer its rights in the property to the secured party) and the secured party provides value for the security interest (for example, a loan) or the grantor undertakes another act by which the security interest arises.

It is important to note that although these priority rules apply in most circumstances, however, there are instances where the priority status of a security interest may be influenced by other factors.

Can a PPSR registration lapse?

Most registrations on the PPSR will only be valid a period of 7 years unless a shorter duration was specified on registration. It is critical to monitor registrations to ensure that they are valid and to undertake renewals within the timeframe where required to avoid losing your interest over the registered property.

We would like to acknowledge the contribution Anthony Metcalfe.

RECOGNISING AND DEALING WITH FINANCIAL DISTRESS AND INSOLVENCY IN YOUR BUSINESS

Author: Shane Williamson, Partner and
Nell McGill, Special Counsel

Top tips

1 A company is insolvent when it cannot pay all of its debts as and when they fall due.

2 Directors are legally obliged to be aware of their company's financial position at all times, to ensure there are sufficient cash flow and assets to pay creditors. If they are not, and the company is liquidated, they may be personally liable or penalised.

3 If you suspect that your company may be at risk of insolvency, enlist professional assistance to help you assess the financial position and implement risk-minimising measures, or utilise the various insolvency appointment options available and best suited to your situation.

In our seventh episode in this series, we consider the concept of insolvency, what corporate insolvency might look like, and what steps can be taken to identify and then manage insolvency when it arises.

What is insolvency?

Section 95 of the *Corporations Act 2001* (Cth) (**Act**) states that a company is solvent if, and only if, it can pay all of its debts as and when they fall due. Therefore, insolvency is defined by the inverse – an inability to pay all debts as and when they fall due.

As with many legal concepts, it is not quite that simple. Consideration is given to questions about what constitutes a "debt", and what is 'due and payable', and cashflow and balance sheet tests are applied. There must be more than a temporary lack of liquidity, where a company may not have enough cash and other marketable financial assets to meet its short-term obligations. It is necessary to look at a company's financial position, considering commercial realities, to determine if the company's liquidity issue is temporary, or if it is genuinely insolvent, and it is not always an easy conclusion.

Nevertheless, the assessment of insolvency is important, as there is a statutory duty upon directors to prevent a company from trading when insolvent. If a director is found to have breached that duty, they can be personally liable for the debts incurred while insolvent as well as criminal and civil sanctions, including substantial fines or imprisonment. Consequently, directors should be aware of the key signs of insolvency, so they can take appropriate steps to minimise risk to the company and creditors, and limit their personal liability.

Indicators of insolvency

While ascertaining whether a company is technically insolvent can be difficult, the following are indicators which, when appearing simultaneously, tend to suggest corporate insolvency.

- Continuing trading losses.
- Experiencing cash flow difficulties.
- Overdue state and Commonwealth taxes (i.e., PAYG, GST and superannuation guarantee contributions).
- Operating outside its trading terms with creditors or loan terms with lenders and/or suppliers imposing onerous trading terms (for example COD).
- Making special payment arrangements with certain creditors.
- No access to further or alternative finance and unable to raise equity.
- Payments to creditors of round sums, which are not reconcilable to specific invoices.
- An inability to produce timely and accurate financial information to display the company's trading performance and financial position and make reliable forecasts.
- Dishonoured cheques.
- Receiving repeated demands for payment, solicitor's letters, summonses, and director penalty notices.
- Changes in key office holders such as directors and managers.

Managing potential insolvency in your company

If some of these indicators of insolvency are present, it is prudent to implement certain steps in an effort to minimise risk and losses to the company, its creditors and director/s. Such steps can include the following.

1. **Stay informed and increase monitoring** – monitor profit and cash flow budgets, review financial statements, review the company's level of lending facilities, and keep an eye on creditor payments and arrangements.
2. **Engage early with creditors and financiers** – be as open and transparent as possible. You want to avoid your key stakeholders getting nasty surprises. Seek any necessary moratorium on payments by way of manageable instalments to assist the company in overcoming any temporary lack of liquidity.
3. **Get professional advice** – experienced insolvency practitioners and lawyers can help you assess your company's financial position and viability, and understand the various insolvency appointment options available and best suited to your situation.
4. **Act quickly** – not acting as soon as you suspect insolvency can be fatal to the company and expose you to personal liability. Proactive management of financial distress can be the difference between a good and a bad outcome. A great example of this is the "safe harbour" provisions of the Act, which provide a defence to insolvent trading for directors who, when faced with insolvency, seek advice from an appropriately qualified advisor and implement a plan that would reasonably likely lead to a better outcome for the company.

Formal insolvency options and appointments

There are a number of options available if your company is insolvent. They differ in application and purpose, and what is best for your company will depend on the specific circumstances. The most common types of insolvency appointment are as follows.

1. **Voluntary administration** – a process designed to give 'breathing space' to a company facing insolvency. The company can appoint an administrator to take control of the company, investigate the financial affairs, and make a recommendation to creditors to either hand control of the company back to directors, approve a deed of company arrangement, or wind up the company and appoint a liquidator. Voluntary administration is an interim process intended to take no longer than 2-3 months.
2. **Deed of company arrangement (DOCA)** – a DOCA is a binding agreement between a company and its creditors usually to facilitate the company's recovery. It will usually provide a fund into which realised assets or income is paid, and from which creditors will receive a distribution. A proposal for a DOCA can be made during voluntary administration and the administrator will assess whether it will result in a better return to creditors, who will then vote whether to execute the deed or not.
3. **Liquidation** – if there is no prospect of recovery, the most common option is winding up the company and appointing a liquidator, whose main responsibility is to convert any remaining assets or property of the company into cash to repay as many creditors as possible and then to deregister the company. Liquidators will also investigate the affairs of the company and are empowered to pursue recovery action against creditors, debtors and directors of the company for voidable transactions and insolvent trading (among other things).
4. **Small business restructuring** – a simplified debt restructuring process specifically for small businesses, allowing directors to retain control while working with a restructuring practitioner to improve the financial position of the company. A number of eligibility criteria apply, including debts of less than $1 million and having all tax lodgements up to date.
5. **Receivership** – this is a non-voluntary process initiated by a secured creditor, who appoints a receiver to take control of, and realise, the secured assets. Receivers act only in the interest of the secured creditor by whom they are appointed and do not control the company as a whole (unlike administrators and liquidators).

Conclusion

While there are differing outcomes and avenues open when faced with the prospect of an insolvent company, the critical point is not to ignore the warning signs and trade on without obtaining professional advice on the actual financial position of the company and appropriate next steps.

In our next episode, we discuss how to identify insolvency or financial distress in your customers or creditors, the impacts that situation can have on your business, and how you can minimise your risk in those circumstances.

We would like to acknowledge the contribution of Leanne Hsieh.

RECOGNISING AND DEALING WITH INSOLVENCY IN YOUR CUSTOMERS

Author: Shane Williamson, Partner and Nell McGill, Special Counsel

Top tips

1 Identifying and managing financial difficulty in your customers or clients is essential to minimising economic risk in your own business.

2 In addition to preliminary protective measures at the commencement of a trading relationship, continued monitoring and attention to your customers' financial performance and business practices can reduce exposure and potential losses.

3 Be proactive in your account management: enforce payment terms, chase outstanding amounts, or negotiate settlements, and be prepared to escalate recovery processes in order to protect your interests.

In our seventh episode, we looked at key indicators of insolvency in your own businesses and options on how to manage that situation. In our eighth episode in this series, we discuss the warning signs of insolvency to look out for in your customers or clients, and what steps you can take to best insulate your business from the impacts of your customer's financial distress or insolvency.

Identifying financial distress in customers

Financial hardship in an entity that buys your goods or services can have significant, adverse effects on your business and could be fatal to your operations. Failure of your clients to pay your invoices will invariably have a downstream effect on your revenue. Therefore, being able to identify deteriorating financial conditions or insolvency in your customers or clients is a key business management skill.

There are numerous indicators of financial distress in your customers, some of which include:

- Payments well outside terms, particularly where there is a negative change in the payment performance (for example, a customer that used to pay on time has become delinquent with payments), or payments in round-sums or amounts that do not correlate to invoices issued.
- Seeking extensions of time to pay or reductions of invoices, or disputing invoices to avoid payment in part or altogether.
- A communication breakdown with the customer, potentially involving your contact person going "missing", or a change in key personnel.
- ASIC searches shows significant changes, including registration of judgments and increased credit checks on the client company.
- Increased reporting of insolvencies in your industry, including of parties you know to be upstream to your customer.

Practices that can minimise risk

There are certain practices that a company can implement to safeguard its interests and minimise risks against the potential consequences of customer insolvency, both at the commencement of the relationship and then as trading continues.

Preliminary protective measures:

- comprehensive initial checks on customers, particularly when extending credit
- ensuring contract terms (particularly with respect to payment) are robust and fit for purpose, and
- taking security, including registering any security interest on the PPSR (see Episode 6 of our series).

Ongoing management:

- maintaining complete records, utilising accounting software that monitors payments where possible
- invoicing regularly so that delinquency in payment is more easily identifiable
- continued monitoring of payment performance and active engagement with customers throughout the relationship, and
- regular checks on the financial health of customers (for example, by way of ASIC and PPSR searches).

Proactive management and recovery

As an informed business owner, you are best placed to diagnose the difference between a simple missed payment of an invoice here and there, and a significant and bigger financial problem in your customer. If you are concerned that it may be the latter, this should be met proactively by pursuing debt recovery measures as quickly as possible, to avoid deterioration that impacts your business, and these may include:

- **Enforcement of security** – if your terms of trade allow it, you may be able to enforce against any security your customer has given for performance of its payment obligations.
- **Letter of demand** – normally the first step in recovering a debt, often a letter foreshadowing more substantive action if the debt is not paid can result in prompt payment and avoid any further delay and cost.
- **Statutory Demand** – this is a formal demand that can be issued on a debtor company where there is no dispute about the debt being claimed. Once served, the debtor has 21 days from the date to either pay (or provide security for) the debt in full or file an application in court to have the demand set aside, failing which the company is deemed insolvent under s 95A of the *Corporations Act* and can be the subject of winding up proceedings.
- **Legal proceedings** – if there is a dispute about the debt, or the debtor isn't a corporate entity, it may be necessary to commence court proceedings with the view to obtaining and enforcing a judgment against the debtor.

What if the customer is actually insolvent?

Despite taking all proactive measures to insulate against it, customer insolvency might sometimes be simply unavoidable. In some cases, the insolvency might be the result of you taking measures to enforce your debt.

Where your corporate customer goes into external administration (most commonly, liquidation or voluntary administration), or your individual customer becomes bankrupt, any claim you have for outstanding payments becomes a claim in that administration. In those circumstances, you will be entitled to, and should, lodge a proof of debt notifying the administrator of the quantum and detail of your claim. This will give you the right to participate in meetings, to vote on what action is taken by the administrator, and to receive a dividend (share) of any assets that are recovered.

Conclusion

Recognising and dealing with insolvency in your customers can be difficult and time-consuming, but it is an essential element of protecting your interests, ensuring you are paid for the goods or services you provide, and minimising losses.

While debt recovery action can be daunting, it is wise to seek advice as soon as a customer has stopped making regular payments or once a debt becomes outstanding so your business doesn't suffer the consequences of non-payment.

In the next part of our series, we will move on to discussing breakdowns in shareholder relationships and exploring the different avenues to resolution.

We would like to acknowledge the contribution of Leanne Hsieh and Corrine Penny.

SHAREHOLDERS DISPUTES - IS THERE SUCH A THING AS AN AMICABLE BREAKUP?

Author: Shane Williamson, Partner and
Nell McGill, Special Counsel

Top tips

1 Shareholder disputes often arise over financial issues, with the irony being that the disputes themselves can cause a deterioration in the value of the company itself.

2 The best strategy for dealing with the challenging and stressful experience of a shareholder dispute is having an effective strategy to prevent them or to deal with them early and effectively. One of the key methods is implementing a solid shareholders' agreement.

3 If a shareholder dispute does arise, it is essential to consider the available options for resolution. Litigation can be expensive and time-consuming, while ADR methods, such as mediation or arbitration, can provide a cost-effective and efficient path to resolution.

In the life of a company (regardless of size), often what starts as an amicable joint endeavour can sour, with shareholders finding themselves in a dispute they never envisioned. Dealing with shareholder disputes can be a challenging and stressful experience and can have significant legal and financial implications.

Understanding how to prevent and resolve shareholder disputes quickly and effectively is key to ensuring that the underlying value in the company is impacted as little as possible. In our ninth episode, we provide a comprehensive guide to help business owners navigate the complexities of shareholder disputes.

Common causes of shareholder disputes

Some of the most common causes of shareholder disputes in Australia include:

1. Disagreements over the direction or management of the company
2. Disputes over the distribution of dividends or profits
3. Disputes over the valuation of shares
4. Breach of shareholder agreements or director duties
5. Disputes over the sale or transfer of shares
6. Allegations of fraud or misconduct

It is essential to address these issues quickly and effectively to avoid escalation and potential legal action.

Preventative measures

The best strategy for dealing with shareholder disputes is having an effective strategy to prevent them or to deal with them early and effectively.

One of the primary ways to avoid shareholder disputes is to implement a solid shareholders' agreement. This agreement should be created at the start of your company's life rather than when a dispute seems imminent. In our first Director Information Series episode, we discussed the benefits of shareholders' agreements. As a reminder, the key aspects of a shareholders' agreement are:

- Balancing minority and majority shareholders
- Valuation and disposal of shares
- Breaking deadlocks
- Transferring shares – tagalong/drag along provisions
- Non-competition
- Dispute resolution
- Director appointment
- Exit strategy

In addition to a sound shareholders' agreement, regular communication, thorough record-keeping, and implementation of effective corporate governance practices to ensure that directors act in the best interests of the company and its shareholders all play a key role in avoiding disputes.

Litigation and Alternative Dispute Resolution for shareholder disputes

In the shock and stress of a dispute with your fellow shareholder/s, it is often difficult to see a way through. There is a number of ways disputes can be resolved, from negotiating a settlement between shareholders without any external intervention all the way to years-long court proceedings. Litigation is generally the most costly and time-consuming way to deal with a shareholder dispute. Furthermore, it is almost always the most damaging to both the disputants and the business of the company, due to the expense, the stress and the distraction of being involved in court proceedings, and also due to reputational risks that can arise as a consequence.

Resolution without court intervention

Conversely, alternative dispute resolution (**ADR**) methods, such as mediation or arbitration, can be a cost-effective and efficient way to resolve shareholder disputes. ADR allows parties to reach an agreement without going to court, and the process is private and confidential. When properly conducted, with appropriate advice, early ADR can save significant time and expense. Where litigation usually ends with only one party's success, a mediated settlement can result in both parties receiving more satisfaction from the process.

A mediated resolution might involve one or more of the following:

Share sale/buy out

The simplest solution is usually that one of the disputing parties sell their shares and exits the company. Shares may be sold to an existing shareholder, or to a new, incoming shareholder.

Where the parties have a shareholders' agreement, that document will often require that the remaining shareholders approve an incoming shareholder, which can create hurdles to sale. Consequently, selling the shares to an existing shareholder is usually more straightforward.

If that share sale can be agreed, the only residual issue is to determine the share value. Again, this process is best agreed and included in a shareholders' agreement, but where that mechanism isn't in place, there are methods, and professionals, that can be utilised to facilitate the process and avoid creating a new issue of dispute between the parties.

Share buyback

A share buyback agreement is when a company agrees to buy shares back from its shareholders. This is an increasingly popular solution to resolve shareholder disputes, particularly where there is no obvious purchaser for the shares and/or the remaining shareholders do not have the funds to buy out the exiting shareholder.

Share buyback arrangements also benefit the remaining shareholders by reducing the number of shares in the company and increasing the 'per share' value of the asset held by the remaining shareholders.

Court intervention

If all else fails and court intervention is required, what are the options and what remedies are available to quarrelling shareholders?

Depending on the nature of the dispute, it may be open to a shareholder to apply to the court for a range of orders, the most common include:

1. Appointment of an auditor.
2. An order compelling the company to provide the shareholder with audited accounts.
3. Winding up on just and equitable grounds s 461(k) *Corporations Act 2001* (Cth) (**Corporations Act**).
4. Orders resulting from a finding of oppression pursuant to s 232 of the Corporations Act (which can include anything from a forced share sale to a winding up).

We examine below the most common relief sought by disputing shareholders in court.

Winding up on just and equitable grounds – s 461(k) of the Corporations Act

In cases where the relationship between the parties has completely broken down, it is open to a party to apply to court pursuant to s 461(k) of the Corporations Act to wind the company up on just and equitable grounds. Section 461(1)(k) provides that:

> *'The Court may order the winding up of a company if:*
>
> ….
>
> *(k) The Court is of the opinion that it is just and equitable that the company be wound up.'*

Determining when it is 'just and equitable' to wind up a company is complex. In short, the court will need to be satisfied that, in all the circumstances, the relationship has broken down irretrievably such that the dispute is simply not capable of being resolved in any way other than by bringing the company's existence to an end. Usually, this requires a finding that there has been a loss or failure of substratum or objects (for example, a company was formed for a particular purpose, which had been abandoned or has come to an end). Just and equitable winding up is often ordered in small private companies where, notwithstanding that a corporate structure is in place, the relationship between the shareholders is one of mutual trust and confidence akin to being partners.

A winding up means the end of the company in its existing form, with a liquidator appointed, assets sold, liabilities paid, and the sale proceeds (after payment of liquidator's fees) distributed to the parties. It is a significant step and courts are often reticent to grant this relief. However, a successful application results in the parties being separated and an independent person taking control of the assets and selling them at arms' length, which can sometimes be the only way a shareholders' dispute is finalised.

Shareholder oppression – s 232 of the Corporations Act

An alternative basis for application to court for relief in the context of a shareholder's dispute arises out of s 232 of the Corporations Act. That section provides, relevantly, that the court may make orders in relation to the affairs of company (as it sees fit) if the conduct of the company's affairs, an actual or proposed act or omission by or on behalf of a company or a resolution or proposed resolution is either:

> *'contrary to the interests of the members as a whole; or*
>
> *oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members.'*

Not all unfair or undesirable conduct will amount to oppression. Whether conduct is oppressive or unfairly prejudicial is assessed objectively against the judgment of an objective commercial bystander. Some examples of conduct that has previously been considered by the court as oppressive include:

1. improperly excluding a shareholder from participation in management decisions where the company's constitution gave rise to a reasonable expectation of participation in management decisions
2. denying the shareholder access to books and records
3. acting oppressively at board meetings, and
4. failing to take steps to facilitate the exit of a shareholder.

Often, it is not any one act or omission that is oppressive but rather the cumulative effect of the parties' conduct, meaning that a number of moderately prejudicial acts can add up, over time, to shareholder oppression.

Pursuant to s 233 of the Corporations Act, the court can make any order it considers appropriate to remedy the oppression, including:

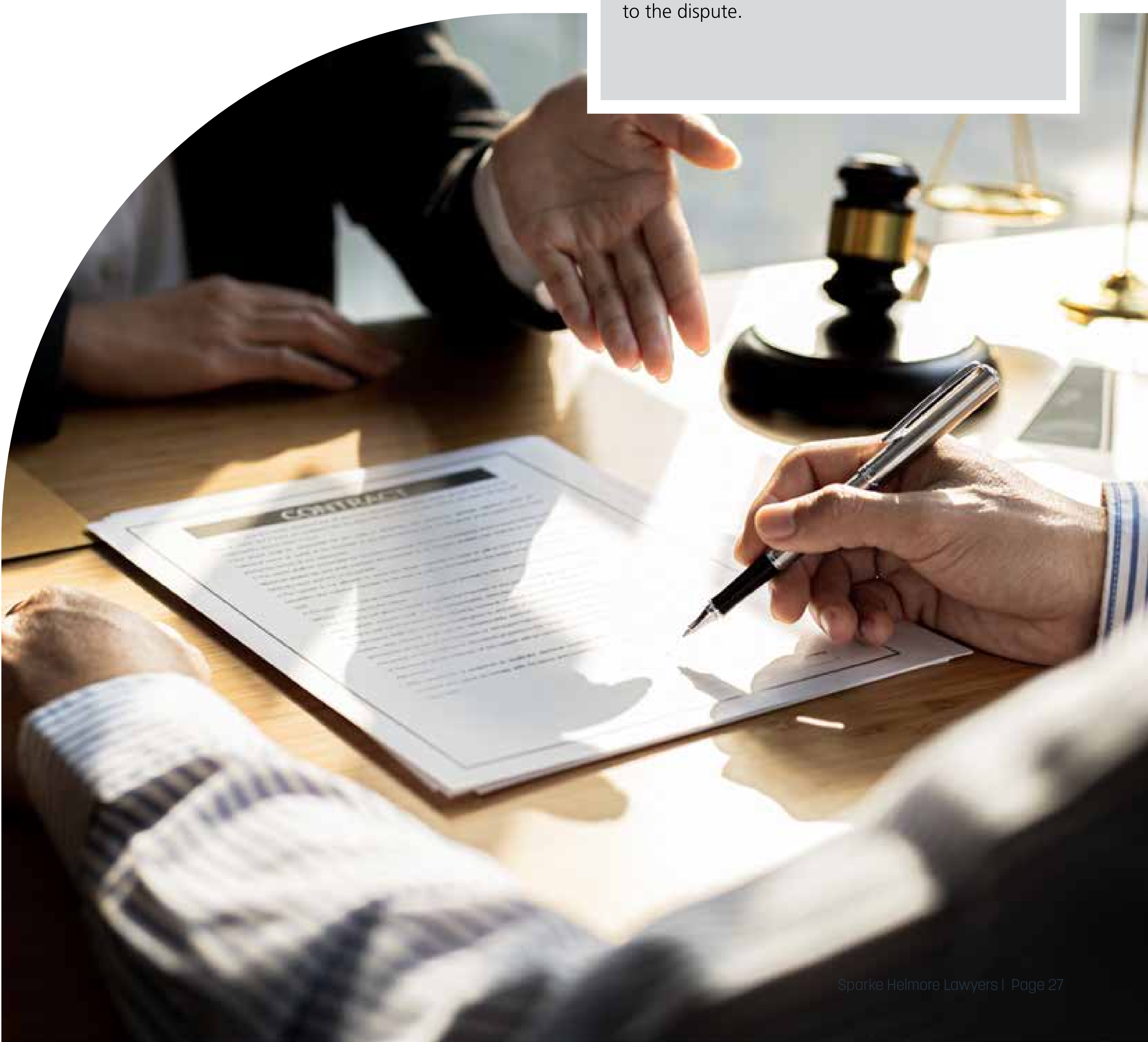
1. winding up a company
2. requiring that a company's constitution be modified or repealed
3. directing that a company purchase a shareholder's shares through a reduction in share capital, and/or
4. requiring a person do a specified act.

Summary

Recognising an ever-deteriorating shareholder dispute and seeking to manage and resolve it as soon as possible will result in the least disruption to the current and future successes of the company and the wellbeing of the parties involved.

Seeking advice, open communication and negotiation between the disputants, coupled with ADR methods, can often achieve a timely and cost-effective outcome that allows the parties to control their future and the end result.

If ADR fails, and there is no other achievable resolution, parties are able to seek relief from the court to bring a formal end to the relationship and to the dispute.



DIRECTOR LIABILITY FOR CONTRAVENTIONS OF THE COMPETITION AND CONSUMER LAWS

Author: Shane Williamson, Partner and Nell McGill, Special Counsel

Top tips

1. Directors will not be protected from personal liability for contraventions of the competition and consumer laws merely because they are acting in their capacity as directors or otherwise on behalf of the company.

2. Directors should ensure that they are aware of the competition and consumer laws affecting their business and consider whether their own conduct, as well as that of the business, risks contravening those laws.

3. Directors should not expect to rely on indemnities from their company to protect them from liability, which will be prohibited and void if the director is found liable for a pecuniary penalty or guilty of a criminal offence.

Although the *Competition and Consumer Act 2010* and its consumer protection component, the *Australian Consumer Law*, are primarily targeted at preventing conduct by corporations and businesses detrimental to consumers and the economy as a whole, directors are at risk of personal liability for contravening those laws as discussed in our tenth and final episode.

Matters covered by the competition and consumer laws include:

- restrictive trade practices such as cartel conduct, and contracts, arrangements or understandings restricting or affecting competition
- the consumer protections against misleading and deceptive conduct, unconscionable conduct, and unfair contract terms
- the consumer guarantees, and
- the goods and services safety protections.

A director may be primarily liable

A director may engage in conduct on their own behalf or on behalf of the corporation that is, in itself, a contravention of the competition and consumer laws, in which case the director will be primarily liable for that conduct.

Example – director primarily liable for misleading and deceptive conduct

The *Australian Consumer Law* prohibits a "person" from engaging in conduct that is misleading or deceptive or is likely to mislead or deceive. Particularly in smaller companies, or where they are otherwise closely involved in the operations of the business, a director is at risk of being found liable personally for misleading or deceptive conduct where they themselves engage in that conduct, even where they do so while acting on behalf of the company.

In April 2019, the Federal Court of Australia found that the director of Flightdeck Geelong Pty Ltd had engaged in misleading and deceptive conduct by inflating the past sales figures and profitability of the business and making representations about future sales figures and profitability without reasonable grounds, which induced the Plaintiff to purchase the business.

The Court found the director primarily liable for the contraventions of s 18 of the *Australian Consumer Law*, referring to him as the "voice" of the company and its "alter ego", and finding that he did not merely act as a "corporate organ" for the company but was vitally interested in the outcome of the sale. The Court found that the Plaintiff was entitled to damages in the sum of $1,362,500.

A director may be liable for their involvement in a contravention

Even where they are not primarily liable for a contravention of the competition and consumer laws, a director is at risk of liability for being "involved" in such a contravention by their company or a third party. A director might be indirectly personally liable for involvement in a contravention where they:

- aided, abetted, or procured the contravention, meaning that the director has intentionally done something to bring about the contravention or to make it more likely
- induced the contravention, meaning that the director has done something to cause another person or entity to commit a contravention
- in any way, directly or indirectly, knowingly concerned in or party to the contravention, meaning that the director was involved in the contravention ranging from knowing the essential facts of the contravention through to being an active participant in the contravention, or
- conspired with others to affect the contravention.

Example – director deemed liable for cartel conduct by involvement

The cases where corporations are pursued for contraventions of the cartel conduct provisions will almost always reveal the involvement of the company's directors or other officers in doing something to cause the company to engage in that conduct.

A person – including a director of the corporation – who "aids, abets, counsels or procures" the corporation to contravene a cartel conduct provision, or who "induces, or attempts to induce" that contravention, or who is "in any way, directly or indirectly, knowingly concerns in, or party to" that contravention, is taken to have contravened that cartel conduct provision themselves. They are liable for conviction with a term of imprisonment of up to 10 years and/or a fine of up to 2,000 penalty units (being $313 per unit, totalling $626,000).

In February 2024, the former Managing Director and Chief Executive Officer of Bingo Industries Pty Limited was convicted of aiding, abetting, counselling or procuring Bingo Industries to contravene the cartel offence provisions by making and giving effect to an agreement containing a cartel. The Managing Director engaged in a series of communications with the Chief Executive Officer of a competitor company concerning the prices at which their respective companies would provide collections and processing services, in which they agreed to maintain and increase prices. The director cooperated with the ACCC and pleaded guilty. He was sentenced to two terms of imprisonment of 18 months each, fined $100,000, and banned from managing corporations for five years.

Example – director knowingly concerned in company's conduct

It is common in other cases for directors to be found liable alongside their company for conduct in contravention of the competition and consumer laws due to their "involvement" frequently on the basis that they were "knowingly concerned" in the conduct. The risks to directors are obvious in circumstances where the director – as the person through which the company conducts its operations or who is the "directing mind and will" of the corporation – performs the contravening acts for which the company is found liable.

In November 2018, the Federal Court of Australia declared that We Buy Houses Pty Ltd had contravened the prohibition on misleading and deceptive conduct at s 18 of the Australian Consumer Law by making various false or misleading representations to consumers that, by following or implementing certain techniques it promoted, they (amongst other things) would be able to buy a house for $1.

The Court declared also that the company's director had been knowingly concerned and a party to the company's contraventions and had himself contravened s 18. The Court referred to the director being the "human face" of the corporation, the named author of publications and main presenter of seminars where the representations were made, such that his personal conduct was integral to the corporation's contraventions. The Court imposed a $6 million penalty on the director, disqualified him from managing corporations for 10 years, and permanently restrained him from being involved in providing services or advice about real property transactions or investments.

Possible penalties and remedies

Directors who contravene the competition and consumer laws risk a range of penalties and remedies.

Possible civil sanctions include pecuniary penalties, orders to pay damages, injunctions, and disqualification from managing companies. For most types of prohibited anti-competitive conduct, the maximum pecuniary penalty for an individual for each contravention is currently $2.5 million.

For criminal offences, the penalties include a term of imprisonment of up to 10 years, a fine of up to 2,000 penalty units (or up to $626,000 at the current rate), or both.

Prohibited indemnities

The competition and consumer laws prohibit companies indemnifying an officer of the company against:

- liability to a pecuniary penalty, and
- legal costs incurred in defending or resisting proceedings in which the director is found liable for a pecuniary penalty or guilty of a criminal offence,

whether by agreement or by making a payment, either directly or through another entity.

A company that contravenes this prohibition risks criminal conviction and a fine. Anything that purports to indemnify an officer against such liabilities is void to the extent it contravenes this prohibition.

Directors should also be aware that, under the common law, the courts will not enforce indemnities for company officers against liability for pecuniary penalties or criminal fines. This may prevent directors from being able to rely on directors' and officers' insurance policies that purport to cover such liabilities.

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