The Fiduciary Duty of Directors to Give Adequate Notice of Company Meetings

Several recent cases have dealt with the issue of what constitutes adequate notice of a meeting of shareholders. These cases have not concerned the technical requirements of the Companies Code such as those found in sections 240 ff. They have addressed the wider issue of the nature and scope of a director's fiduciary duty to ensure that meeting notices are adequate, accurate and not misleading.

As one might guess, several of these cases involve merger or takeover situations. The merger and takeover arena is an obvious area where the ability to call a meeting and solicit proxies loses its "ho-hum" nature. In addition, takeovers are often the target of litigation. An adequate notice is another arrow in the bow of a corporate raider attacking the action of a target company's directors.

Whatever the factual background of the cases, the duty of adequate notice that has been enunciated is formulated in general terms. As such it is applicable to a notice for any type of meeting. Simply stated, directors are required to ensure that notices are not only accurate but also not misleading. *(Bain Company Nominees Pty. Ltd. v. Grace Brothers Holdings Ltd.)* (1983) 1 ACLC 816). When one considers that it is a duty owed to shareholders, it is also curious that it is defined as a "fiduciary duty". Thus, the water is again muddied when it comes to the question of to whom a director's duties are owed and who has standing to complain.

In the recent case of *Chequepoint Securities Ltd. v Claremont Petroleum N.L. (and others)* (1986) 4 ACLC 711, the duty was formulated as follows:

> "where directors take it upon themselves to urge or recommend or advise members to exercise their powers in General Meeting in a particular way, they are in general required to make a full and fair disclosure of all matters within their knowledge which would enable the members to make a properly informed judgement on the matters in question." (at 713.)

What is particularly interesting about recent cases such as the *Chequepoint* case is that they have focused on the application of that standard to all explanatory or other information sent with a notice of meeting. In addition, they have defined the standard in such a way as to suggest that, at least as far as special transactions are concerned (that is, matters not in the ordinary course of business), a notice vof meeting alone is not adequate.

Chequepoint involved a sale of certain company assets of Claremont (interests in gold exploration projects in Indonesia) to another company, Stellar. The consideration was to be the allotment and issue of shares in the capital of Stellar. The shares in Stellar would then be distributed (by way of a reduction of capital) to the shareholders of Claremont.

One of the conditions of the agreement between Claremont and Stellar was the passing of resolutions by Claremont's shareholders, in general meeting, approving this sale of interests to Stellar and giving effect (subject to Court approval) to the proposed reduction of capital.

Claremont dispatched to each of its members a notice of an extraordinary general meeting to be held to consider the resolutions. With the notice Claremont sent several other documents. These documents included:

1) an explanatory letter from the Chairman of the directors of Claremont;
2) a form of proxy for Claremont shareholders;
3) a copy of a notice of an extraordinary general meeting of Stellar;
4) an explanatory memorandum to the members of Stellar; and
5) a letter from a firm of consulting mining engineers to the directors of Stellar containing a valuation of the properties concerned and entitled "Independent Opinion of Indonesian gold Exploration Properties".

The explanatory letter from the Chairman of the directors of Claremont to the shareholders referred to the enclosed form of proxy but did not mention any of the other documents. The explanatory letter dealt with the opportunity which shareholders would have to deal separately with their gold interests (through their Stellar shares) and their oil interests (through their retained Claremont shares). It did not discuss the financial effect of the transaction despite the fact that directors of Claremont had carried out such a calculation. Presumably the directors of Claremont thought that the financial effect of the transaction was important. However, they failed even to allude to it in their explanatory letter.

The plaintiff was a shareholder of Claremont and sought an interlocutory injuction to restrain the holding of the Claremont meeting. Initially the plaintiff presented three arguments:

1) That the proposed transaction involved undisclosed benefits to the directors of Claremont, (a

breach of fiduciary duty and a breach of statutory duty under s229 (2) of the Companies Code);

2) That the notice did not comply with the requirements of the Articles of Association of Claremont; and

3) That the explanatory letter did not deal adequately with the effect of the transaction in financial terms, that is the dilution of the interest in the gold fields as balanced against the acquisition of an interest in other assets of Stellar.

The first argument was abandoned when the plaintiffs could not supply particulars of the alleged undisclosed benefits. The second argument was rejected by the Court which found that no case had been made out based on the absence of compliance with formal requirements. However, the Court did hold that an arguable case had been established that a full and fair disclosure of matters which would enable the members to make a properly informed judgement had not been made. The injunction was granted.

In the view of McLelland J. the material sent to the Claremont shareholders, considered as a whole, did have "a tendency to mislead Claremont shareholders on a matter of substantial importance to the making of a properly informed judgement on matters intended to be submitted to the meeting". *(Chequepoint Securities Ltd.* at 714). He particularly singled out the failure to explain the financial impact of the transaction and the inclusion of the independent expert opinion without any further explanation.

No case was made that the directors of Claremont deliberately set out to keep shareholders in the dark or intentionally mislead them. The Court noted that fact and confirmed the rule that a breach of fiduciary duty does not have to be dishonest to justify equitable relief.

It is interesting to note that the directors of Claremont in some respects erred, on the side of too much disclosure rather than too little. Fault was found not so much with the quantity of information provided as with the quality. The deficiency in disclosure was the fact that the explanatory letter did not describe the financial impact of the transaction and did not refer to or exlain the Stellar documents sent with the notice of the company meeting. The Court found that the inclusion of material addressed to the members of Stellar made a bad situation worse. Thus, Claremont would have been far better off not to have sent any of the Stellar documents. This was so because the Court found that the materials sent out had a tendency to mislead the Claremont readers into believing that an independent expert believed that the financial gains to be received by Claremont and its shareholders were fair and reasonable consideration.

The Court stated that the "Independent Opinion" was particularly troublesome both because it was called an "independent opinion" and because it ended by concluding that a valuation of $U.S. 25.6 million should be placed on the direct and indirect interests to be acquired by "your company" and that, on that basis, the consideration was believed to be fair and reasonable. The court felt that the report could easily be construed by Claremont shareholders as a reference to what they and their company would be receiving by way of consideration.

The problem of too much information being sent to shareholders also came up in *Killan v. Marra Developments Ltd.* (unreported) where Kearney J. stated:

> I don't think that the shareholders would be assisted in their consideration of their business to be brought forward at the proposed meetings by being subjected to what would amount to an intolerable burden of information, most of which, if not all, would be unlikely to assist their judgement and would be more likely to confuse than assist the recipient of such information. (1979) ACLD 608

This statement was cited with approval in the recent case of *Devereaux Holdings Pty. Ltd. v. Pelsart Resources NL & Anor.* (1986) 4 ACLC 12 at 15.

Another important fact in the *Chequepoint* case is that a careful reading of the documents addressed to the Stellar members would have made it obvious that the documents were not addressed to Claremont shareholders. However, a careful and thorough reading cannot be relied upon by directors when sending documents to shareholders. It cannot be assumed that a shareholder is a person well versed in commercial affairs or that such a person will read a document carefully from beginning to end. *(Red Mara Developments Ltd.* (1976) 1 ACLR 470). A notice must be capable of being read by a person "on the run" (*Red Marra Developments Ltd.* at 479 citing *Alexander v. Simpson* (1889) 43 Ch.D. 139 at 149). This rule was recently expanded and applied in the *Killan* and *Devereaux* cases:

> A further obligation requires the information to be propounded for the consideration of the shareholders in terms enabling the man in the street 'on the run' to absorb and understand the substance of what it is that the shareholders are being called upon to determine at the meeting. (1986) 4 ACLC 12 at 15.

Not only must a notice and accompanying documentation be capable of being read and understood by the "man in the street and on the run" but a higher standard may be applied in situations where a fundamental right of shareholders would be affected.

Barncorp Investments Ltd. v. Primac Holdings Ltd. (1985) 3 ACLC 69 is another recent case which involved a explanatory memorandum accompanying a notice of meeting. That case described the standard in a way that suggests that the standard of disclosure may be higher in cases where important rights of shareholders will be affected.

> The general principle is clear, that a notice, and particularly one that invites the shareholders to alter existing rights and provisions of the articles of

> association, should be couched in clear terms and that any comments that are given in the form of a circular or memorandum from the board of directors should fully and fairly inform and instruct the shareholders upon what is proposed to be done. (at 72)

The general standard applied in the *Bancorp* case seems to impose a greater burden on directors to clearly and fully inform shareholders than one can find in older cases such as *Peters' American Delicacy Co. v. Heath* (1938-1939) 6 CLR 457, where the High Court approved of the rule in *Bullin v Bebarfold Ltd.,* that a circular sent with a notice of meeting could be attacked on the grounds of inaccuracies and omissions. In the *Peters' American Delicacy Co.* case the directors made statement in the circular concerning the possible means of achieving a capitalization of profits. The statements were incorrect. In addition, the statements were very one-sided and argumentative. The Court (per Latham CJ) found that an expression of an honest opinion did not amount to misinterpretation or even to inaccuracy if the opinion, even if wrong, is accurately stated as an opinion. (at 488). The possibility that the statements were misleading was not considered. The argumentative nature of the circular, however, was discussed and found unobjectionable.

> the directors were putting their views forward for the consideration of shareholders. Even if their views were wrong there was no dishonesty or trickery. The shareholders could get their own advice and use their own minds. The circular was almost necessarily argumentative. (at 487)

The attack on the circular in *Peters' American Delicacy* was unsuccessful. Unlike the *Peters' American Delicacy* case the statements made in the *Bancorp* case were not incorrect. However, they were found to be incomplete and the injunction was granted. In the *Bancorp* case the defendant, Primac, was a public company with some 22,000 shareholders. The directors gave notice of a special resolution to be proposed for adoption at the annual general meeting. The resolution would alter the articles of association. The notice was accompanied by an explanatory memorandum from the chairman of Primac. The memorandum commented on the proposed alterations and invited shareholders to inspect a copy of the proposed articles at the registered office.

There were two major complaints with respect to the adequacy of the notice. The first concerned a change from an article that gave directors complete discretion not to register any transfer of shares to a new article which provided that no shareholder could be beneficially interested in more than ten percent of the issued share capital of the company and that directors could refuse to register transfers which were of less than 100 shares or which would result in anyone holding ten per cent of the issued shared capital. The commentary in the explanatory memorandum suggested that this change was merely a change to remove the absolute discretion in the previous articles by limiting the ability of the directors to refuse to register a transfer without reason. The plaintiff charged that such a description of the change ignored entirely that one of the effects of the new proposal was to prevent a shareholder from having a beneficial interest in more than ten per cent of the issued share capital of the company. McPhearson, J. agreed that the chairman's comment could not be said to fully and fairly appraise the members of the topic with which they were concerned. (at 72).

The second major complaint in the *Bancorp* case concerned a change to an article which would have the effect of reducing voting rights when read in conjunction with the recently expanded definition of "substantial shareholder" found in the Companies Code (s.136). The explanatory memorandum in describing the change in the definition of "substantial shareholding" did not disclose that the change had anything to do with voting. The court thought that this omission might not have been fatal if the provisions of the articles had been set out in full in the notice. Such was the case in *Peters' American Delicacy* and, in that case, the High Court seems to infer that the incorrect statements of the directors would have been rectified by a careful reading of the pertinent article. But that is a theory in conflict with the 'man on the run' principle. In *Bancorp* however, an invitation to inspect at the registered office was not sufficient to "fully and fairly inform and instruct" (at 72). It should be noted that in *Peters' American Delicacy* the Court also relied on the fact that certain legal opinions were available to shareholders for inspection at the meeting (at 489), a fact which really has little to do with the quality of a notice.

In conclusion, cases such as the *Chequepoint* case and the *Bancorp* case illustrate that a director's duty to give full and fair disclosure as to the purpose of a meeting continues to expand. Attention has shifted from the actual notice itself to the explanatory information sent with a notice. Such information must not be too brief or it will fall afoul of the full and fair disclosure standard. At the same time it cannot be too extensive. Too much information may be found to be "confusing" as in *Killan* and *Chequepoint,* or it may offend the "capable of being read by the ordinary person on the run" rule. In addition, Courts seem less reluctant to enjoin meetings than they were in the past. The standard applies in *Peters' American Delicacy* would probably not be accepted today. This may be due to a recognition of the importance of proxies obtained before a meeting is held. The burden is on directors to draft careful and clear communications.

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