



ADLV LAW

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SOLUTION BRIEF

Corporate Governance: Members, Boards & Managers



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01

Members (owners)

The people who own the 'equity' in a company are commonly referred to as shareholders or members.

The members of a company exercise ultimate control of the company through their right to appoint and remove the directors.

A member of a company can either be a person, another corporate body or a government.

A private company limited by shares must have share capital and at least one member.¹ The number of members of a privately owned company can be no more than 50 non-employee members.² When a company is limited by share capital, each member has one vote for each share held, subject to different classes of shares with different voting rights.³

Liabilities and responsibilities

Generally, as a member you:

- Own the company, together with any other members. But the company has a separate legal existence, and the company's assets belong to the company. Put another way, you do not have any direct ownership interest in the company's underlying assets;
- Make high-level decisions, principally by providing the equity funding and appointing the people who will act as the directors. This role is generally performed in a general meeting of members; and
- Do not have any fiduciary obligations to other members or the company. This can be contrasted with directors (and other officers of the company) who owe fiduciary obligations to various parties. This means that you can openly vote in your own personal interests.

As a member of a limited liability company, you are not liable for the company's debts. A member's liability is limited to any outstanding amount that has not yet been paid up on their shares. For

¹ *Corporations Act 2001* (Cth) (the **Corporations Act**), s. 1.5.6 'Shares and Shareholders'.

² *Corporations Act*, s. 45A 'Proprietary companies'.

³ *Corporations Act*, s. 1.5.6 'Share and shareholders'.

example, if you agreed to pay \$1 for each share, and you have only paid 60c, then you are liable to pay the balance of 40c when requested by the company.

If the company is not 'limited by shares' then you may have to contribute to the cost of winding up the company if it becomes insolvent, but this is rare.

Rights and powers

A company does not need to have a Constitution. If it does not have one, then the rights and obligations of the participants in the company are governed solely by the Corporations Act. If the members adopt a Constitution, then the rules in the Constitution may override a number of provisions of the Corporations Act, and impose additional rights and obligations.

A Constitution is a statutory 'contract' as between the members, and as between each member and the company.

A Constitution may be supplemented by a 'Shareholder's Agreement' which will bind those members of the company that elect to sign the agreement.

You have the right (but not the obligation) to attend general meetings, either in person or by means of a valid proxy.⁴ It is no longer the law that private companies must hold an annual general meeting after business registration (unlike publicly listed companies).⁵

Members may collectively pass resolutions at general meetings by voting in their capacity as owners of shares. This is known colloquially as the members' 'activist power'. There is a distinction between passing a general resolution (majority vote) and a special resolution (75% must vote in favour). Special resolutions are only required if stated in the company's Constitution or by law.

Under the Corporations Act, a member will also have the following general rights:

- Right to access certain types of company information, including:
 - Company Constitution:⁶ As a member you have a right to lodge a written request for a copy of the company's Constitution. The company must provide you with such a copy within 7 days, and may charge you a fee for providing this service; and
 - The Share Register:⁷ A company's Share Register contains the name and address of each member, the number of shares held, share classes and the amount paid and

⁴ *Corporations Act*, s. 252Y 'Appointing a proxy'.

⁵ *Corporations Act*, s. 250N 'Public company must hold AGM'.

⁶ *Corporations Act*, s. 139 'Company must send copy of constitution to member'.

⁷ *Corporations Act*, s. 173 'Right to inspect and get copies'.

unpaid on the shares. As a member you have a right to lodge a written request to access a copy of a company's Share Register. The company must provide a copy of its Share Register to you within 7 days, free of charge. However, you cannot request a copy of the Share Register for an improper purpose, including:

- Soliciting a donation from a member;
- Soliciting a member of a company as a stockbroker; or
- Gathering information about the personal wealth of a member;
- A right to call a general meeting if it is requested by members holding at least 5% of the total votes in the company, or at least 100 members who are entitled to vote at the general meeting.⁸ General meetings provide an opportunity for members to resolve specific questions about the management of the company; and
- A potential right to dividends:⁹ When a company earns a profit the money can be re-invested in the business, or it can be paid to the members as a dividend (or both).

02

The Board of directors

The company's Board is comprised of directors who have been elected to oversee and govern the management of the company. Proprietary companies must have at least one director.¹⁰ If a company has more than one director, at least one of the directors must ordinarily reside in Australia. Directors can only act collectively as a Board, and the function of an individual director is to participate in the decision-making of the Board.

Key roles of Directors

Some of the key roles to be performed by directors include to:

- Protect the interests of members, and protect the interests of the company's other stakeholders;

⁸ *Corporations Act*, s. 249D 'Calling of general meeting by directors when requested by members'.

⁹ *Corporations Act*, s. 254T 'Circumstances in which a dividend may be paid'.

¹⁰ *Corporations Act*, s. 201A 'Minimum number of directors'.

- Help develop policies that help the company and its members achieve their goals;
- Provide performance feedback to senior management, especially the CEO;
- Ensure that the business remains decisive; and
- Oversee the family's involvement in the business.

The Board should advise and help senior management think about 'big picture' topics important to the company, such as its vision, strategy, growth plans, ability to compete, development of human, financial and physical resources, strategic relationships and succession.

The Board should think broadly about the company's goals and challenges. It should concentrate on the big issues facing the company and avoid getting involved in day-to-day management or operational issues.

Executive and non-executive Directors

It is important to distinguish between executive and non-executive directors.¹¹ Executive directors are company employees who have been elected to the Board. A non-executive director is not an employee of the company, and ideally is independent from the company and its members (owners).

The Corporations Act does not require non-executive directors to be included on the Board. Nonetheless, business practice guidelines recommend that the Board appoint non-executive directors to provide a breadth of professional experience and expertise.¹²

Liabilities and responsibilities

If you are a director, you bear the ultimate responsibility for supervising and controlling the company's business. Both executive and non-executive directors are subject to the same obligations under the Corporations Act.¹³

Directors owe the company a fiduciary duty of care that requires them to act honestly, in good faith and to the best of their ability in the interests of both the company and its members.

Specifically, as a director you must:

- Be honest and careful in your dealings;
- Be up-to-date and aware of the company's affairs;

¹¹ *Jacques v AIG Australia Ltd* [2014] VSC 269 (Dixon J).

¹² ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (4th edition).

¹³ *Corporations Act*, s. 5.2 'Duties and liabilities of directors'.

- Act in the joint interests of the company and its members; and
- Avoid situations in which there is a conflict of interest between personal and company interests.¹⁴

The Corporations Act imposes certain civil obligations on directors.¹⁵ These statutory duties largely reflect a director's fiduciary obligations that developed at common law. They include:

- A responsibility to discharge your duties with a degree of care and diligence that a reasonable person would exercise;¹⁶
- A duty to act in good faith in the best interests of the company and for a proper purpose;¹⁷
- A duty not to improperly use your position to:¹⁸
 - Gain an advantage for yourself or anyone else; or
 - Cause detriment to the company;
- A duty not to improperly use information obtained in the course of your role to:¹⁹
 - Gain an advantage for yourself or anyone else; or
 - Cause detriment to the company; and
- An obligation to notify other directors of material personal interest if and when a conflict arises.²⁰ A material personal interest is a matter that relates to the affairs of the company.

Responsibilities of Directors under other laws

Every company is involved in activities that are regulated by other laws (such as employment, work health and safety, taxation and environment law). Accordingly, a director may also be personally liable under a broader range of laws that are specific to the company's industry. There are over 700 laws that can potentially make a director personally responsible for the actions (or inactions) of the company.

Duties

¹⁴ *Phipps v Boardman* (1967) 2 AC 123.

¹⁵ *Corporations Act*, s. 182 'Use of position – civil obligations'.

¹⁶ *Corporations Act*, s. 180 'Care and diligence – directors and other officers'.

¹⁷ *Corporations Act*, s. 181 'Good faith – civil obligations'.

¹⁸ *Corporations Act*, s. 182, 'Use of position – civil obligations'.

¹⁹ *Corporations Act*, s. 183 'Use of information – civil obligations'.

²⁰ *Corporations Act*, s. 191 'Material personal interest – director's duty to disclose'.

If the company has adopted a Constitution, it will likely specify certain powers and duties of the directors.

Under the Corporations Act, the primary duties of directors include:

- To take an active part in Board meetings;
- To report to members;
- To determine how any proposed action will affect the company's performance, especially if an act involves a significant amount of company revenue;
- To keep a register of members' names, addresses and relevant dates (this task may be delegated to the Company Secretary);²¹
- To keep signed and up to date minute books that records:²²
 - Proceedings and resolutions of director's meetings;
 - Resolutions passed by directors without a meeting; and
 - If the private company only has one director - the making of any declarations by that director;
- To keep, for a minimum of 7 years, written financial records that:²³
 - Enable an accurate assessment of the company's financial position and performance; and
 - Be sufficient for fair and true financial statements to be prepared (e.g., by an auditor);²⁴
- To prevent the company trading while it is insolvent. This duty to prevent insolvent trading extends to the following activities:
 - Paying of dividends;
 - Buying back shares; and
 - Making a reduction of share capital;²⁵ and

²¹ *Corporations Act*, s. 169 'Register of members'.

²² *Corporations Act*, s. 251A 'Minutes'.

²³ *Corporations Act*, s. 286(1) 'Obligation to keep financial records'.

²⁴ *Corporations Act*, s. 286(2) 'Obligation to keep financial records'.

²⁵ *Corporations Act*, s. 588G 'Director's duty to prevent insolvent trading by company'.

- To prepare an Annual Financial Report and a Directors' Report,²⁶ and have the reports audited if you are a 'large proprietary company'.²⁷ A 'large proprietary company' is a company where the consolidated revenue for the financial year is \$25 million or more. If applicable, you must also ensure that the Financial Report, Director's Report (and any Auditor's Report) is sent to the company's members, and you must lodge stipulated documents with the Australian Securities & Investments Commission (ASIC).²⁸

If the company is being wound up, you must report to the liquidator on the affairs of the company (includes providing liquidator access to any relevant company records).²⁹

Rights and powers

As a director, you have the following rights:

- The right to inspect the books of the company in the event that you are being sued or have reason to believe you will be sued by the company or are proposing in good faith to bring legal proceeding against the company.³⁰ This right continues for 7 years after you have ceased to be a director of the company;
- The right to access financial records at all reasonable times in order to ensure that you can perform your duties and obligations in the company's best interests;³¹
- The right to hold shares in the company, however the law does not require this. If a director does hold shares in the company, ASX requires directors of listed companies to disclose this interest;
- The right to replace or remove a senior management officer if they are not performing to the expected standard; and
- The right to postpone a general meeting that has been convened, if authorised by the company's Constitution.³²

Liabilities

A director who breaches the statutory civil obligations may be liable for civil or criminal sanctions:

²⁶ *Corporations Act*, s. 292 'Who has to prepare annual financial reports and directors' reports'.

²⁷ *Corporations Act*, s. 301 'Audit of annual financial report'.

²⁸ *Corporations Act*, s. 319 and s. 320 'Lodgement of annual reports with ASIC'.

²⁹ *Corporations Act*, s. 475 'Report as to company's affairs to be submitted to liquidator'.

³⁰ *Corporations Act*, s. 198F 'Right to access to company books'.

³¹ *Corporations Act*, s. 290 'Director access'.

³² *Pinnacle v R B Pty Ltd* [2000] VSC 330 (Beach, J).

- Criminal consequences – may apply if a director breaches their statutory duties recklessly or intentionally dishonestly.³³ If a director is found criminally liable, they may be fined up to \$200,000 or imprisoned for up to 5 years (or both); and
- Civil consequences – a court may make a declaration that a director has breached a civil penalty provision³⁴ and impose:
 - A fine up to \$200,000;³⁵
 - A disqualification order to prohibit a director from managing companies;³⁶ and
 - A compensation order to compensate the company for any damage suffered by it because of the breach.

Additionally, a director may be held personally and/or jointly liable when the company is unable to pay its debts when they become due.³⁷ A duty to prevent insolvent trading will only arise if:

- The person is a director of the company at the time the company incurs debt;
- The company is insolvent; and
- There were reasonable grounds for suspecting the company was insolvent.

In the past, Australian courts have fined a director as much as \$97 million for failing to ensure that the Commonwealth Bank did not trade while insolvent.³⁸

It is important to note that the Corporations Act expressly provides that a company must not pay a premium for a contract insuring a company director against liability arising from wilful breach of duty.³⁹

Additionally, for company trustees, legislation precludes a director from being indemnified from liability out of a trust in circumstances where:

- The company has breached trust; or
- The company acted outside the scope of its powers as trustee.

³³ *Corporations Act*, s. 184 'Good faith, use of position and use of information – criminal offences'.

³⁴ *Corporations Act*, s. 1317E 'Declarations of contravention'.

³⁵ *Corporations Act*, s. 1317G 'Pecuniary penalty orders'.

³⁶ *Corporations Act*, s. 206C 'Court power of disqualification – contravention of civil penalty provision'.

³⁷ *Corporations Act*, s. 197 'Directors liable for debts and other obligations incurred by corporation as trustee'.

³⁸ *Commonwealth Bank of Australia v Friedrich & Ors* (1991) 9 ACLC 946.

³⁹ *Corporations Act*, s. 199B 'Insurance premiums for certain liabilities of director, secretary, other officer or auditor'.

03

Managers

Directors rely on the management team to manage the company's day-to-day operations.

Managers are answerable to the Board, and it is their role to implement the decisions, policies, strategy and business plans put forward by the directors.

High-level managers are subject to the provisions of the Corporations Act as an 'officer of the company', which is a person who participates in making decisions that substantially affect the business of the company.⁴⁰

Duties

A company's internal management may be governed by the Corporations Act's replaceable rules or by a company Constitution (or both).⁴¹

Irrespective of a particular company's management, the following duties are applicable to all high-level managers of a company:

- To act in the best interests of the company and for a proper purpose in your conduct;⁴²
- To exercise care and diligence when discharging your powers;⁴³
- To not improperly use your position to:⁴⁴
 - Gain an advantage for yourself or anyone else; or
 - Cause detriment to the company; and
- To not improperly use information obtained in the course of your role to:⁴⁵
 - Gain an advantage for yourself or anyone else; or
 - Cause detriment to the company.

⁴⁰ *Corporations Act*, s. 9 'Dictionary'.

⁴¹ *Corporations Act*, s. 134 'Internal management of companies'. Replaceable rules cover a broad range of issues including appointing directors, determining the remuneration of directors, removing members, director's meetings, transferring shares and paying dividends.

⁴² *Corporations Act*, s. 181 'Good faith – civil obligations'.

⁴³ *Corporations Act*, s. 180 'Care and diligence – civil obligation only'.

⁴⁴ *Corporations Act*, s. 182, 'Use of position – civil obligations'.

⁴⁵ *Corporations Act*, s. 183 'Use of information – civil obligations'.

Essentially, these provisions extend many of the directors' civil obligations to all office holders and senior managers of companies.

Liabilities

Similar to a director, as a high-level manager you may be guilty of a civil and/or criminal offence if you breach certain statutory duties. However, unlike a director, senior managers will not be personally responsible for their acts in the event of company insolvency.

The responsibilities of specific key members of the senior management team are listed below.

Chief Executive Officer (CEO)/Managing Director (MD)

The CEO is the most senior management officer of the company. There is little direct law clarifying the role of a CEO, but as a senior manager the rules set out above in relation to directors and company officers apply.

The CEO must:

- Act as a direct link between management and the Board of directors. They are responsible for ensuring the implementation of the decisions of the Board by the management team;⁴⁶
- Promote ongoing accountability to the Board and bring relevant matters to the attention of the Board (which may require cooperation with the Company Secretary);
- Build and lead the management team;
- Be responsible for the company's success and reputation as the public face of the company;
- Consider the interests of members; and
- Make decisions about how to apply company resources to meet company objectives.

Chief Financial Officer (CFO)

The CFO is the most senior executive officer responsible for the financial affairs of the company.

Responsibilities of the CFO include:

- Maintaining the company's present financial position and stability;
- Developing economic and tax strategies, which include aspects of economic forecasting and modelling;

⁴⁶ Carrigan, A., *Australian corporate CEOs are less powerful than they once were*, Australian Journal of Corporate Law 212 (2014).

- Managing the company's budget and deciding how to invest the company's money;
- Overseeing the financial reporting to higher management;
- Monitoring the implementation of strategic business plans; and
- Allowing the auditor to access the books of the company,⁴⁷ and giving the auditor any information, explanation or other assistance for the purpose of an audit (in the context of 'large proprietary companies').⁴⁸

Chief Information Officer (CIO)

The CIO is the most senior executive officer responsible for the company's information technology and computer systems.

Responsibilities of the CIO include:

- Managing the company's IT resources;
- Planning the information and communications technology (ICT) infrastructure, including preparing policies, planning, budgeting, resourcing and training;
- Linking technology to internal management strategies;
- Overseeing implementation of new software/hardware; and
- Generally reporting directly to the CEO on ICT issues.

Company Secretary

The Company Secretary is on the Board of the company and is often also seen as part of the company's management team.

The Company Secretary's job is to deal with the financial and legal issues of the company. The Company Secretary is responsible for ensuring the company's compliance with the Corporations Act and any requirements of ASIC, and this responsibility may continue past the winding up or deregistration of the company.⁴⁹

Specifically, the responsibilities of the Company Secretary include:

- Administration of the records of the company, including ensuring that the register of members is established and maintained;

⁴⁷ *Corporations Act*, s. 312 'Assisting auditor'.

⁴⁸ *Corporations Act*, s. 310 'Auditor's power to obtain information'.

⁴⁹ *Corporations Act*, s. 1.5.5(5.4) 'Company directors and company secretaries'.

- Organising meetings of the Board and members (e.g. general meetings);
- Informing the Board of all relevant business (acting as link between senior management team and board of directors);
- Assisting the Board with strategic planning, policy creation, management and compliance; and
- Notifying ASIC of changes in the company's records.



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What next?

If you would like to speak to someone about Corporate Governance, call us on 1300 654 590 or email us at wehelp@adlvlaw.com.au.

Further information can also be found on our website at www.adlvlaw.com.au.

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