USE OF COMPANY FUNDS IN A PROXY FIGHT DEFENCE

Upon lodging a meeting requisition with the target company, generally the requisitionist's solicitors will write to the incumbent directors pointing out to them (gratuitously) their legal obligations in the period up until the conclusion of the shareholders' meeting.

Such correspondence generally goes to matters including what's known as the "Caretaker" principle, limitations on the ability to issue shares and, of relevance to the ensuing discussion, the suggestion that the use of company funds for the purposes of campaigning and soliciting votes is prohibited, based on the leading Australian authority, *Advance Bank Australia Ltd v FAI Insurances Ltd* (1987) 9 NSWLR 464.

So, what is this case all about?

Five of the nine directors of the board of Advance Bank were obliged to retire at its first AGM. The remaining directors favored the election of the retiring directors but a substantial shareholder, FAI, nominated four of its own persons for election.

In response, the Advance Bank directors mounted a campaign that involved expenditure of the company's funds on a letter to shareholders from the Chairman, the engagement of a proxy solicitation firm (at a cost of around $130,000 in present day terms) and the engagement of bank employees in a manner favourable to the re-election of the retiring directors.

FAI then sought injunctions to restrain various aspects of the campaign.

The trial judge held in favour of FAI, granting the injunctions sought and refusing the relief sought by Advance Bank. The appeal by Advance Bank was subsequently dismissed.

Key to the Court's decision was the fact that the materials disseminated by the Advance Bank directors were deemed misleading.

Most notably, the Chairman's letter expressed concern that election of four FAI nominees "could lead to FAI subsequently gaining effective control of the board and thus the Bank without having to pay shareholders the substantial premium for control normally payable in company take-overs".

Having regard to the provision of the Bank's articles limiting control of ordinary share capital, the relevant legislation limiting such control and the provisions governing company take-overs, it was deemed by the Court that the information provided was simply wrong and certainly misleading.

Indeed, in an article entitled "Aspects of the law relating to contested elections of directors", Mr Rodd Levy, a Senior Partner of Herbert Smith Freehills, states:

> "If the Advance Bank board had simply advised shareholders to vote against the election of Mr Adler (Chairman of FAI Insurances) and his associates and outlined the concerns they had about the impact their election may have on the Bank as they had discussed in the board meeting (and possibly canvassed advantages as well), rather than focusing on FAI acquiring "control" of the Bank, the campaign would have been acceptable based on earlier cases."

Of relevance to the current discussion is that nowhere in the lengthy judgment is the quantum of company moneys spent on the campaign by the directors even

considered, let alone a view arrived as to whether or not such expenditure was reasonable or otherwise.

Subsequently, the New South Wales Court of Appeal summarized the applicable principles as follows:

> "Whilst there is no special rule governing the authority of directors in connection with elections or proxy solicitation, the heightened risk of a confusion between private interest and the best interests of the corporation (or corporate purposes) requires scrupulous conduct on the part of the directors. It necessitates particular care where that conduct has the effect of influencing the outcome of an election in favour of themselves or their colleagues … In election and proxy solicitations cases, such an excess or abuse of powers [breach of fiduciary duty] may occur where the directors:
>
> a) expend an unreasonable sum of the company's moneys;
>
> b) expend moneys of the corporation on material relevant only to a question of personality and not relevant to corporate policy; or
>
> c) otherwise act in a manner which is excessive or unfair in the circumstances, having regard to the corporate purpose to be attained."

The following points are noted:

- The decision in Advance Bank v FAI and the position of the New South Wales Court of Appeal would seem to expressly sanction the expenditure of a "reasonable" quantum where such expenditure is considered to be in the interests of informing shareholders and the contest involves a policy issue, not merely a personal power contest, and the directors have acted in good faith

- There is no direction from Advance Bank v FAI, nor, apparently, from any case since, as to what might be considered as "reasonable" expenditure

- Even though the Advance Bank v FAI case was considered some thirty years ago, Metropolis is not aware of any situation since where directors of a company have been required by a Court to reimburse funds spent on a proxy fight defense

As such, any suggestion by the requisitionist's solicitors that, based on legal precedent, a prohibition exists on the use of company funds for campaigning and the soliciting of votes would seem entirely without basis.

It is noted that proxy fights are largely akin to hostile takeover offers, expenditure on which by the target company attracts no such scrutiny.

Metropolis considers that the apportionment of any expenditure incurred between the company and the directors themselves, supported by Minutes recording the fact that the matter was appropriately considered, would be a further beneficial defence to any claim that moneys were inappropriately spent.