

## bar speak



with Andrew Lyons

# the deadlocked board

A NSW firm of solicitors has been ordered to pay hundreds of thousands of dollars of legal costs as a result of a misunderstanding about how deadlocks between directors may be addressed.

In the recent NSW Court of Appeal (CA) case of **Massey - v - Wales**, the two directors of a private company had fallen out with each other to the point where decision making at board level was deadlocked. One director enjoyed majority support amongst the shareholders and the solicitors accepted, from him, instructions to commence proceedings by the company against, amongst others, the second director.

It was common ground before the CA that those instructions were not properly given on behalf of the company. Acting alone the client director did not have the power to give them.

In an attempt to remedy this problem, the client director used his majority support amongst the shareholders to obtain a general meeting resolution ratifying the solicitor's appointment. Like many who run private companies as their own creature, he perhaps thought little of the distinction between the board and the general meeting and considered the resolution as the end of the matter.

The defendants thought otherwise. They applied to have the company's proceedings dismissed and sought costs from the solicitors. Arguing that a general meeting did not have power to ratify the appointment of the solicitors to act, they referred to the standard provision in the company's Articles

that said that the business of the company was to be managed by the directors who could exercise all powers of the company that were not otherwise required by the Corporations Act or the Articles to be exercised by the company in general meeting.

In response, the solicitors accepted that ordinarily such decisions fall to the board, not a general meeting, but submitted that, where a board was deadlocked, a general meeting has a reserve power to intervene. They pointed to authorities including **Winthrop - v - Wins** and the decision of the House of Lords in **Alexander Ward - v - Samyang Navigation**.

The CA held that, under standard Articles, the general position is that the general meeting lacks the power to make management decisions or to control or direct the board in the management of the company. It also held that where the board was unable or unwilling to act then the general meeting did have some kind of reserve power.

The issue then was the width of this reserve power. The Court reviewed the texts and authorities and concluded that they were unclear as to the principles to be applied.

The CA held that the relevant principles were contractual and that it was not reasonable to imply into the memorandum and articles a term that the reserve powers of a general meeting to make managerial decisions were enlivened by a board deadlock. It was not reasonable because the general meeting did not need such

powers: it could break the deadlock by changing the board.

This contractual analysis complements the differing equitable and statutory duties cast upon directors and shareholders. Unlike shareholders, directors have a fiduciary duty to exercise their powers in the interests of the company as a whole rather than, say, some only of the shareholders. This makes it preferable to refer managerial matters to the board wherever possible.

A consequence of this analysis was that the general meeting resolution which the solicitors relied as ratification of their instructions was beyond the power of the company and ineffective. The solicitors were held liable on an indemnity basis for the substantial costs. They obtained an indemnity order against the client director but the value of that order was upon his solvency.

Alternative steps in such cases include using the client director's majority support amongst the shareholders to change the board to one that will give the instructions or sue to leave to sue in the company's name under Corporations Act s. 236. Under standard company Articles, using a general meeting to make a commercial managerial decision does not resolve the board deadlock. As the unfortunate solicitors discovered, even in a small held private company, the distinction between the board and the general meeting is important.

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