

**CASE COMMENTARY****MORRIS V PNG ASSOCIATED INDUSTRIES LTD N260(L) OF 1980**

Management of Companies - Directors' and General Meetings - Breach of Articles of Association and Provisions of Companies Act - disparity between Company Law and company practice.

The belated appearance of this case commentary may seem surprising. What is even more surprising is that the case itself is not reported in the Papua New Guinea Law Reports, the only official Law Reports in the country. Yet the case deals with important aspects of company law and raises unsettling questions concerning the disparity between company law as found in statutes, cases and other sources on the one hand and company practice, that is, the way companies are operated and managed in practice, on the other. The omission of the case from the official Law Reports is even more startling in view of the dearth of local cases on company law. One of the possible explanations for the omission is the length of the case. It is one hundred and twenty three (123) pages long.

**THE FACTS**

In this case, the plaintiff, who was a director and the managing/executive director of the defendant public company (the company) sought, inter alia, to recover damages for wrongful dismissal and monies allegedly due under a retirement deed entered into between himself and the company. The company had on two separate dates, first, on March 2 1979 at a meeting of directors and secondly, on November 13 1979 at another meeting of directors and also at two separate general meetings of the company, purported to dismiss the plaintiff as managing/executive director and to remove him as a director of the company. The actions on the November 13 1979 were taken in case the directors had acted invalidly on the March 2 1979. Under the service agreement, as varied by a variation agreement, the plaintiff's employment as managing/executive director of the company could only be terminated by the company if at any time during his appointment, the plaintiff had been guilty of any grave misconduct which was prejudicial to the interests of the company and under the articles of association, the plaintiff could only be removed as a director by ordinary resolution of the general meeting. The plaintiff was entitled, under the retirement deed, to receive K15,000 for each year of service or part thereof on retirement. The retirement deed was part of a re-arrangement scheme of the company under which the plaintiff guaranteed a

K300,000 loan to Keas Pty Ltd, the majority shareholder in the defendant company, and provided A\$225,000 as security. It was also in appreciation of the plaintiff's long and outstanding service to the company.

The company alleged that the plaintiff was guilty of grave misconduct which was prejudicial to its interests while the plaintiff contended that he had not been guilty of any such misconduct and insisted that his dismissal was wrongful and in breach of the service agreement and constituted a repudiation thereof by the company. The company also sought to impeach the retirement deed alleging, inter alia, breach of fiduciary duty on the part of the plaintiff.

#### THE ISSUES

The principal issues for determination were:

- (i) Whether the company had validly and rightfully dismissed the plaintiff as managing/executive director and removed him as a director of the company; and
- (ii) Whether a valid and binding retirement deed had been entered into between the company and the plaintiff.

#### DETERMINATION OF THE ISSUES

##### Dismissal as Managing/Executive Director

There is no doubt that the board of of directors had power under the articles of association to dismiss the plaintiff as managing/executive director (see art.99 of the company's articles of association). However, the legal position is that unless otherwise specified in the company's documents, when powers are conferred on directors, they are conferred on them collectively as a board, to be exercised at a board meeting of which due notice has been given and at which a quorum is present (Gower, LCB, The Principles of Modern Company Law 3rd edn 1969 Stevenson & Sons p138).

What happened on March 2 1979 was that four of the directors of the company simply walked into the board-room which formed part of the plaintiff's office and purported to hold a board of directors' meeting. No notice of the meeting had been given to any of the directors and accordingly not all the directors were present at the meeting. Neither a director nor the secretary upon the request of a director, as required by the articles of association, convened the meeting

and no chairman was appointed for the meeting. In these circumstances the court held that the alleged meeting of directors of March 2 1979 was merely a casual or an informal gathering of directors and not a valid board meeting. Although a board meeting can be held under informal circumstances, it has long been established that a casual meeting of directors even at the company's office cannot be treated as a board meeting at the option of one or some of the directors against the will and intention of the other or others who has/have not received notice of the meeting (Barron v Potter [1914] 1 ch 895).

Regarding the irregularities and deficiencies alluded to above with respect to the alleged directors' meeting, counsel for the company contended that s398(1) of the Companies Act (the Act) c146, automatically validated that meeting and that the court should under s398(2) declare the meeting valid notwithstanding any defect, irregularity or deficiency. He also urged the court to exercise its powers under s398(3) and make an order validating the meeting. Section 398 provides as follows:

"398. Irregularities in proceedings

(1) Proceedings under this Act are not invalidated by reason of any defect, irregularity or deficiency of notice or time unless the Court is of opinion that substantial injustice has been or may be caused by it that cannot be remedied by any order of the Court.

(2) If it thinks fit, the Court may make an order declaring that any such proceedings are valid notwithstanding any such defect, irregularity or deficiency.

(3) Without affecting the generality of Subsection (1) or (2) or of any other provision of this Act, where an omission, defect, error or irregularity (including the absence of a quorum at a meeting of a company or of the directors of the company, or of the creditors of the company, or at a joint meeting of the creditors and members of the company) has occurred in the management or administration of a company by which -

- (a) a breach of this Act has occurred;  
or
- (b) there has been default in the observance of the memorandum or articles of a company; or

- (c) any proceedings at or in connexion with a meeting of a company or of the directors, or an assemblage purporting to be such a meeting, have been made ineffective, including the failure to make or lodge a declaration of solvency under Section 276,

the Court -

- (d) may, of its own motion or on the application of an interested person, make such order as it thinks proper
- (i) to rectify, or cause to be rectified, or to negative or modify, or cause to be modified, the consequences in law of any such omission, defect, error or irregularity; or
  - (ii) to validate an act, matter or thing rendered or alleged to have been made invalid by or as a result of any such omission, defect, error or irregularity; and
- (e) shall, before making any such order, satisfy itself that such an order would not do injustice to the company or to any member or creditor of it; and
- (f) where any such order is made, may give such ancillary or consequential directions as it thinks proper; and
- (g) may determine what notice or summons is to be given to other persons of the intention to make such an application, or of the intention to make such an order, and whether and how it should be given or served and whether it should be advertised in a newspaper."

The court held that s398(1) only related to proceedings under the Act and as the court was not in this case concerned with proceeding under the Act, s398(1) had no application. The judge seems to have interpreted "proceedings under this Act" to mean "court or legal proceedings under this Act". This was clearly an error on the part of the judge since a

closer look at s398(3) leaves one in no doubt that a meeting of the board of directors is covered by s398(1) & (2). In fact Bowen CJ in *Re Compaction Systems Pty Ltd* (1976) 2 ACLR 135 in interpreting s366(1) of the Companies Act 1961 (NSW) which is in almost similar terms as s398(1) expressly stated that "proceeding under this Act" was not limited to legal proceedings but extended to both curial and non-curial proceedings. The only limitation to s398(1) is that the defect, irregularity or deficiency must be one "of notice or time". Thus the judge could have excluded the application of s398(1) & (2) on the ground that the defects, irregularities and deficiencies with respect to the meeting of directors went beyond "notice or time".

The power conferred on the court by s398(3) is very wide and discretionary (*Mansfield v NSW Leagues' Club Bowling Club Ltd* (1963) 80 WN (NSW) 1407). It is not limited to circumstances where there has been an omission, defect or error or irregularity of a merely procedural character; it also enables proceedings, which would be a nullity at law, to be given full legal effect even though that course might have incidental consequences on other persons (*Omega Estates Pty Ltd v Ganke* (1963) NSWLR 1416). However, before the court exercises its discretion a very strong case must be made out to satisfy the court that no injustice would be done to the company or to a member or creditor of the company (*Ryan v Kings Cross RSL Club Ltd* [1972] 2 NSWLR 79).

In declining to exercise the discretionary power given to him under s398(3) Wilson J held first, that s398 is not to be resorted to "simply as a matter of convenience or, when those concerned with the management of a company have, by disregard of the articles and the normal practices, produced a legal position which is difficult of resolution". Secondly, relying on Else Mitchell J in *Omega Estates Pty Ltd v Ganke* [1963] NSWLR 1416 he held that the section did not authorise the court to override the articles of association. In view of the fact that s398(3) expressly empowers the court to make an order validating an act, matter or thing where there has been "default in the observance of the memorandum or articles of a company", there is certainly power in the court to override or disregard the articles. With due respect to the judge, it must be pointed out that this interpretation of the section is evidently wrong (see also *Re Compaction Systems Pty Ltd* [1976] 2 ACLR 135 at p149). Thirdly, the judge held that no strong case had been made out to satisfy him that the order sought under s398(3)(d) would not do injustice to the plaintiff as a creditor of the company. The judge considered the plaintiff a creditor "for at least his outstanding salary entitlements". This appears to be a very stretched interpretation of s398(3)(e). No injustice would have been caused to the plaintiff as such a creditor by

the validation of the invalid directors' meeting since in any event the plaintiff would have been paid his outstanding salary entitlements. The more convincing proposition would have been for the judge to hold that validating the invalid directors' meeting and consequently giving effect to the purported dismissal would have done injustice to the company by depriving it of the services of a man who had been very instrumental in the very existence and success of the company.

The judge concluded that the directors at the alleged meeting of directors held on March 2 1979 did not validly dismiss the plaintiff as managing/executive director and that at the end of the day the plaintiff was still managing/executive director. He also concluded that no effective ratification by the company in general meeting of the directors' action ever took place.

The judge then went on to consider whether the company validly dismissed the plaintiff as its managing/executive director on the November 13 1979. On that day a 'meeting' of directors and two 'general meetings' of the company were purportedly held at each of which the plaintiff was dismissed as managing/executive director of the defendant company.

In relation to the 'meeting' of directors the judge made the following factual findings: (a) the request to the secretary to convene the meeting was made by a person who had ceased to be a director of the company, contrary to the company's articles of association (b) the chairman of the 'meeting' was not a director of the company (c) persons who were not directors attended the 'meeting' and (d) the motion to dismiss the plaintiff as managing/executive director was moved by a person who was not, at the time, a director of the company. The judge had no hesitation in holding the so-called meeting of directors invalid. He also observed that it was a serious matter for a person who is not a director to engineer the dismissal of a company's managing director.

As regards the first 'general meeting' of the company, held at 10.10 am, notice of the meeting had not been given to all the members of the company contrary to the articles of association and s145(4) of the Act. Even such notice as was given was shorter than required by the articles and consent to such shorter notice was given by persons who were not at the time members of the company contrary to s145(3)(b) of the Act. Further, persons who were not members of the company attended and voted at the meeting. The judge held that the meeting was invalid.

The second 'general meeting' of the company held at 10.18 am was bedevilled by the same problems of failure to give notice to all the members of the company, shorter notice and lack of consent thereto by all the members. Additionally, contrary to the articles of association, the meeting was convened by a Mr. Hay, who at the time, was not a director of the defendant company. He had not been re-elected at the annual general meeting of the company held on August 25 1979. The judge considered whether this flaw was cured by Art 109 of the company's articles of association or s138 of the Act.

Art 109 provided as follows:-

"109 All acts done ..... by any person as a Director shall notwithstanding that it shall be afterwards discovered that there was some defect in the appointment of such ..... person acting as aforesaid ..... be as valid as if every such person had been duly appointed ....."

Section 138 provides as follows:

"138 Validation of acts.  
The acts of a director ..... are valid notwithstanding any defect afterwards discovered in his appointment or qualification."

Relying on Grant v John Grant & Sons Pty Ltd (1950) 82 CLR 1, Morris v Kanssen [1946] AC 459 and Omega Estates Pty Ltd v Ganke [1963] NSWLR 1416, the judge drew a distinction between (a) an appointment in which there is a defect or, in other words, a defective appointment, and (b) no appointment at all. The former is covered by Art 109 and s138 while the latter situation is outside the scope of Art 109 and s138. The judge came to the conclusion that the failure or omission to re-elect Mr. Hay as a director was not a "defect in the appointment" of Mr. Hay within the meaning of Art 109 and s138. It was a case of no appointment at all and, therefore, not curable under Art 109 or s138. It is thus clear that s138 does not validate an act of a person who without any shadow of title purports to act as a director.

On the question of notice, the judge held that failure to give notice of a general meeting to all the members entitled thereto and in the manner prescribed by the articles invalidates the meeting (see also, Smith v Darleys (1849) 2 HLC 789). However, s145(5) of the Act and in most cases the articles, relax this rule as regards accidental omission to give, or non-receipt of, notice. In this case there was no occasion for relaxing the rule.

Aside from the question of the invalidity of the 'general meetings' of November 13 1979, the general meetings did not have power to dismiss the plaintiff as managing/executive director. That power was vested in the board of directors and it is trite law that, short of inability or unwillingness on the part of the board of directors to act, the general meeting cannot by ordinary resolution override or usurp the powers and authority of the board of directors (Automatic Self-cleansing Filter Syndicate Co, Ltd v Cunningham [1906] 2 Ch 34; Gramophone & Typewriter Ltd v Stanley [1908] 2 KB 89; Shaw & Sons (Salford), Ltd v Shaw [1935] 2 KB 113; Quin & Axtens, Ltd v Salomon [1909] AC 442; Bamford v Bamford [1968] 3 WLR 317). There was no question of inability or unwillingness on the part of the board of directors to exercise powers vested in it.

This fundamental issue of lack of capacity on the part of the general meetings to dismiss the plaintiff as managing/executive director does not seem to have been thoroughly considered by the judge. He only alludes to it when considering whether the general meeting held at 10.10 am, by ratification, validated the plaintiff's dismissal by the meeting of directors on March 2 1979. He concluded that that general meeting did not validate the plaintiff's dismissal because it purported to ratify the plaintiff's dismissal by the directors "pursuant to Article 96" when in actual fact the power to dismiss the plaintiff as managing/executive director was conferred on the directors by art99 and not art96. Thus there was no power in the general meeting to ratify and confirm a resolution referring to art96 which the directors had no power to make.

Having come to the conclusion that the purported dismissals were invalid as outlined above, the judge did not consider it necessary to decide whether "grave misconduct" on the part of the plaintiff had been proved. However, he went on to indicate his views with reference to the allegations of "grave misconduct" that were made against the plaintiff, in case his decision was upset on appeal. He concluded that the allegations of "grave misconduct" were not proved.

#### Removal as a Director

The power to remove a director was by art96 and s127 of the Act vested in the company in general meeting. Accordingly, any purported removal of the plaintiff as director of the company by the directors was a nullity as the directors cannot usurp powers vested in the general meeting (John Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113). In any

event s127(8) of the Act expressly provides that a director of a public company cannot be removed by any resolution of the directors or any of them.

Although the general meetings of November 13 1979 had power to remove the plaintiff as director of the defendant company, they did not validly remove him since the meetings were themselves invalid on account of the reasons indicated above. In addition to those reasons there was a failure to comply with s127 of the Act which requires in case of a public company special notice to be given to the company of an intended resolution to remove a director at least 28 days before the meeting at which the resolution is intended to be passed. Section 127 further requires the company on receipt of the notice to immediately send a copy thereof to the director concerned for the purpose of enabling him to make representations in his defence if he so wishes and if so requested in good time, the company is bound to notify the members of the fact that written submissions have been made and to send copies of the representations to every member to whom notice of the meeting is given. If copies of the representations are not sent to members, the director concerned may require that the representations be read at the meeting.

#### Conclusion on the first issue

The general conclusion drawn by the judge was that the defendant company through its respective organs did not validly and rightfully dismiss the plaintiff as its managing/executive director or remove him as a director either on March 2 1979 or on the November 13 1979. The plaintiff's dismissal was thus in breach of the service agreement and constituted a repudiation thereof. As the plaintiff had accepted the company's repudiation of that agreement the judge awarded K163,598 damages for wrongful dismissal.

#### VALIDITY OF RETIREMENT DEED

The retirement deed was attacked on the ground, inter alia, that the plaintiff was in breach of his fiduciary duty to the defendant company with respect to the deed. The plaintiff had travelled to Sydney, Australia, to have the retirement deed prepared.

As a fiduciary, a director must not allow a conflict to arise between his duties to the company and his personal interests. As a consequence, a contract entered into between a company and one of its directors is voidable at the

instance of the company (*Aberdeen Ry v Blaikie Brothers* (1854) 1 Macq (HL) 461) and any profits made by the director personally will be recoverable by the company. However, most modern articles of association relax this common law rule by allowing a director to contract, or be interested in a contract, with his company provided that the director declares his interest in the contract to the board of directors and refrains from voting on the contract.

In fact art91 of the company's articles of association permitted a director to contract with the company provided he declared his interest in the contract at the meeting of directors at which the contract was first considered (see also s129(1) of the Act).

The judge made the following factual findings with respect to the retirement deed:

- (a) the deed was initiated by a Mr Lussick, one of the directors and not by the plaintiff;
- (b) the plaintiff travelled to Sydney to have the deed prepared in his capacity as chief executive of the company;
- (c) it was within the scope of the board of directors to enter into the retirement deed; and
- (d) when the matter of the retirement deed was first raised at a meeting of the board of directors the plaintiff, as chairman of the board, declared his interest in the matter and left the board-room. Another director was then appointed chairman of the meeting. The uninterested directors then proceeded to pass resolutions approving the retirement deed and providing for the execution of the deed by all the voting directors of the company.

In these circumstances the judge held that the retirement deed was entered into with the fully-informed consent of a free and independent board of directors and that the plaintiff discharged such fiduciary duty as he owed to the company when he declared his interest to board of directors and refrained from participating in the board's deliberations. The deed was therefore a valid and binding contract between the plaintiff and the company. The plaintiff was awarded K270,000 as the amount due under the deed.

Breach of s126 of the Act

Section 126 of the Act provides that at a general meeting of a public company, resolutions for the appointment of directors must be put to the vote separately for each director unless the meeting has previously unanimously agreed to a procedural resolution permitting the appointment of two or more directors by one resolution. A resolution passed in breach of this requirement is void, notwithstanding that no member objected to its being passed.

At the company's annual general meeting held on August 15 1979 motions "that Messer T, W and S be elected to Office" and "that Mr R.D. and Mr A.O.K. be appointed directors" were carried without the previous procedural resolution referred to in s126(1). The judge held that the appointments of T, W, S, R.D. and A.O.K. were invalid, with the consequence that several of the people who attend the 'direct)rs' meeting' of November 13 1979 were in law not directors of the company.

The functioning of companies without properly and validly appointed directors is not a new phenomenon in Papua New Guinea. Goldring, JL in 1971 in a commentary on *Sangara (Holdings) Ltd v Hamac Holdings Ltd (1970)* (Full Court of the Supreme Court of the Territory of Papua and New Guinea, unreported) referred to it as a "rather common phenomenon" ((1977) 1 MLJ no2 76). This phenomenon may be attributed to ignorance on the part of those involved in the management of companies of the relevant legal requirements. This ignorance may in turn be attributed to lack of affordable but competent legal advice. It is also possible those involved in the management of companies are simply ignoring the relevant legal requirements and preferring to run and manage companies the 'Melanesian' way. What is clear, though, is that the phenomenon is a glaring example of the gap between company law and company practice.

A 'meeting' of one!

In analysing the events of March 2 1979 to ascertain whether a general meeting of the company was held for the purpose of removing the plaintiff as a director of the company the judge observed, obiter, that a meeting of 'one' is impossible. With due respect, this observation is clearly wrong and unfounded. Section 147 of the Act empowers the Court in situations in which it is impracticable to call or conduct a meeting in the prescribed manner, on its motion or on the application of an interested person, to summon a

meeting to be called and to direct that one person present in person or by proxy shall be deemed to constitute a meeting.

### CONCLUSION

Apart from the legal principles discussed, one notable feature of the case is the way management disregarded the articles of association and flouted provisions of the Act. What is even more disturbing is that the directors of the company at the time were not what one would call illiterate or unsophisticated people. In fact most, if not all, of them were fairly knowledgeable and experienced persons. One of the directors, T, was described as a man with commercial experience who had a good grasp of business and financial matters. He was also an experienced parliamentarian who had been chairman of the Parliamentary Accounts Committee. Another, R.D., was described as a politician of some years' experience. He was a Minister of State at the time of hearing the case. Yet another T.A., was described as a respected politician with a wealth of experience. He had been Leader of the Opposition, a Minister of State and a leader of one of the political parties in the country. And yet another, L, had been deputy speaker of the pre-Independence House of Assembly. More importantly, another director, a Mr. Hay, was a solicitor. He was specifically appointed a director of the company in order to give professional advice to the management of the company.

How does one explain the thoroughly unsatisfactory performance on the part of the board of directors in view of the composition of the board and the availability of professional advice? How would one expect a board whose members were not as sophisticated, experienced and professionally advised as the members of the defendant company's board to perform? Probably worse.

The case provides yet another example of the disparity between company law and company practice. It may well be that the company is not an ideal business legal form for Papua New Guinea and its people.

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