5.13 Granting of leave to bring derivative proceedings under section 237 of the Corporations Act

(By Glen Wright, Freehills)

Hannon v Doyle [2011] NSWSC 10, New South Wales Supreme Court, Justice Barrett, 3 February 2011

The full text of this judgment is available at:

http://www.caselaw.nsw.gov.au/action/PJUDG?jgmtid=150097

(a) Summary

Mr David Hannon (Hannon) applied for leave to bring proceedings under section 237 of the Corporations Act 2001. The Judge considered in detail whether there were serious questions to be tried under section 237(2)(d).The Judge held that claims that the companies in question had made loans to directors, "alienated" share options to directors' companies, provided excessive remuneration, diverted business to another company and engaged in oppressive conduct each satisfied the test in section 237(2)(d).

(b) Facts

Hannon applied for leave to bring proceedings on behalf of Afro Pacific Holdings Pty Ltd (APH) and Afro Pacific Capital Ltd (APC), in which it owned 88% of the shares, under section 237 of the Corporations Act 2001. This section provides that the court must grant leave to member of a company (under section 236(2)(a)(i)) where it is satisfied that, inter alia:

- it is probable that the company will not bring the proceedings (section 237(2)(a));
- the applicant is acting in good faith (section 237(2)(b));
- it is in the best interests of the company that the applicant be granted leave (section 237(2)(c)); and
- there is a serious question to be tried (section 237(2)(d)).

As a member and former director of the companies, Hannon qualified under section 236(2)(a)(i) and (ii), leaving the court to assess whether he met the criteria of section 237.

Relating to whether a serious question existed, Hannon argued the following:

- APC made unsecured loans to Doyle and Turner, some of which were interest free;
- APC's 15 million options in Transvaal Ferro Chrome Ltd (TFC) were "alienated" to two companies owned by two directors of ACP, Mr Doyle (Doyle) and Mr Turner (Turner) and the options were sold at below market value;
- APC provided Doyle and Turner excessive remuneration;
- APC lent money to Africa Pacific Capital Pty Ltd (Africa), a company established and owned by Doyle and Turner; Doyle and Turner caused Africa to supply services to companies when it was APC that had the existing client relationship on which the procurement of the services was based; Doyle and Turner transferred or diverted to Africa assets to which APC was entitled; and
- APC never paid a dividend, even though there were profits out of which a dividend could prudentially have been paid, thus a claim under section 232 (oppressive conduct of affairs) arises.

(c) Decision

The judge considered each issue separately as follows.

In relation to the loans, it was not contested that they had been made. The Judge noted that each loan made to a director or director-related entity violates the "fundamental principle" in *Aberdeen Railway Co v Blaikie* (1854) 1

Macq HL 461 that "no [agent of a company] shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect ... So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into". The Judge held that sections 237(2)(c) and (d) were satisfied in relation to these claims.

The Judge applied the same reasoning to the TFC options claim. In particular the Judge noted that it was of no consequence whether the options were sold at a price below market value, reiterating that "no question is allowed to be raised as to the fairness or unfairness" of such a contract. The Judge held that sections 237(2)(c) and (d) were satisfied in relation to these claims.

Addressing the claim of overcompensation, the Judge noted that Doyle and Turner received "consulting fees" of $1,566,960 and $1,570,234 respectively in the financial year ended 29 February 2008, a sum far higher than could reasonably be expected for such fees in the circumstances. Again sections 237(2)(c) and (d) were taken to be satisfied.

With regards the last set of substantive claims, relating to Africa, the Judge noted that:

- Africa deliberately adopted a letterhead designed to be deceptively similar to that of APC and made misrepresentations on its website which gave the impression that Africa and ACP were the same business;
- Africa informed it bankers that it was to receive income from a sale of shares when those shares belonged to APC, not Africa; and
- Africa and ACP were operated as, and considered to be, one and the same.

Thus the Judge concluded that there was a serious question to be tried.

The Judge held that a serious question existed with regards to Hannon's claim of oppression regarding the non-payment of dividends. The Judge noted that absence of dividends itself is insufficient for a section 232 claim, but that the claim must be assessed in light of the whole circumstances. In the present case the lack of dividends "may properly be made part of the matrix" of a section 232 claim, along with the specific allegations of breach of duty.

Finally, the Judge held that sections 237(2)(a) and (b) were met. The Judge concluded that Hannon honestly believes that a good cause of action exists, as shown by the evidence Hannon assembled and the effort to which he had gone to in pursuing the claims, coupled with the findings that serious questions exist and that the claims are in the best interests of the company.