The Law Society
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28 April 2006

Mr Tim Sheehy
Chief Executive
Chartered Secretaries Australia
Level 10
5 Hunter Street
SYDNEY NSW 2000

Dear Mr Sheehy

Re: Discussion Paper – Expressing the voice of shareholders: a move to direct voting

The Business Law Committee of the Law Society of New South Wales (the "Committee") commends Chartered Secretaries Australia ("CSA") on its Discussion Paper addressing the need for the introduction of direct voting. The Committee thanks you for granting an extension of time in which to lodge this submission.

The Committee is pleased to respond to CSA's invitation to comment on the Discussion Paper and notes that the submission is not intended to address every aspect raised, but will raise debate at a broader level.

Comments on the Discussion Paper

1. Direct Voting

The current situation, at best, is illogical and, at worst, seems to defy the origins of common law. At common law, shareholders had no right to appoint a proxy.[1] The origins of this rule are buried in the old Corporations Law which recognised, "the voting privilege [as being] in the nature of a personal trust, committed to the discretion of the member, and hence not susceptible of exercise through delegation".[2]

The Committee endorses the view that that encouraging shareholder involvement in company governance is a matter of critical importance for shareholders and companies alike. The Committee is of the opinion therefore that the driving focus of corporate governance initiatives must remain on encouraging companies to

[1] Appointment of proxies is an instrument of a company's constitution, as at common law there is no right to appoint a proxy: *Harben v Phillips* (1883) 23 Ch D 14; *McLaren v Thompson* [1917] 2 Ch 231 at 236.
[2] *Walker Johnson* 17 DC App 14.

better value increased shareholder participation, without compromising the rights of shareholders.

2. Problems with the proxy system

(a) 'Cherry-picking' of proxy votes

The *Corporations Act 2001 (Cth)*("the Act') currently obliges only the chair of the meeting to vote on a poll and to vote each and every directed proxy given by a shareholder. Any other proxy is under no obligation to vote on a poll at all.

In *Cousins v International Brick Co Ltd*,[3] Lord Hanworth MR defined a proxy as '[a] person representative of the shareholder who may be described as his agent to carry out a course which the shareholder himself has decided upon'. Similarly, in the same case, Lawrence LJ [at 102] stated '[t]he proxy is merely the agent of the shareholder, and as between himself and his principal is not entitled to act contrary to the instructions of the latter'.

The decision of the United Kingdom Court of Appeal in *Cousins* has never received curial disagreement in Australia and, indeed, has received positive treatment as recently as 2002 by the NSW Court of Appeal in *Cadwallader v Bajco Pty Ltd*[4]). In support, the Committee notes also the unanimous decision of the NSW Court of Appeal in *Whitlam v Australian Securities and Investments Commission*,[5]where the Court commented [at 160] that a proxy 'certainly had a duty as a fiduciary to the proxy givers to act in accordance with their directions'. The Committee acknowledges that the proxy in question was the chair of the annual general meeting; however, in the Committee's view the Court's comments, as extracted, appear to be wider in effect and extend, at least, to all directors acting as proxy.

The common law position has always been that a proxy is the agent of the shareholder making the appointment and, as a result, is obliged to follow the direction of the shareholder as principal. That is, the common law recognises that when a shareholder appoints a person as their proxy, the shareholder is, in essence, directing the proxy to vote on the shareholder's behalf; in the case of a directed proxy, the shareholder is saying 'if I were able to attend the meeting, I would vote and would vote in the following way; I expect you to perform this precise function for me.' Yet, the existing statutory position, under s 250A(4)(d), permits a proxy to decide both whether or not to vote the proxies and which of those proxies to vote.

The Government acknowledges that it 'is good corporate governance to seek to ensure that persons appointed to vote as proxies vote those proxies according to the proxy terms', but considers the imposition of an obligation on all proxies to vote as being 'too onerous on shareholders'.[6] The Government provides two examples; first, that persons may be unknowingly appointed as proxies and, second, that there may be legitimate circumstances where a person other than the chair is unable to vote on a poll at all.[7] Neither of these situations are sufficient justification for not imposing an obligation on all

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[3] [1931] 2 Ch 90, 100.
[4] [2002] NSWCA 328, 152 (Dyson J), with whom Santow JA and Gzell J agreed.
[5] [2003] NSWCA 183
[6] Explanatory Memorandum to the Exposure Draft of the Corporations Amendment Bill (No. 2) 2005 at [2.30].
[7] Ibid.

proxies to vote. Moreover, both of these situations can be catered for within a general obligation to vote. A general obligation on proxies to vote at meetings could be made subject to a condition precedent that it be reasonable for the proxy to attend the meeting.

In the Committee's view, it is an illusionary line that exists between the injustice a shareholder experiences when a proxy votes but does not vote a particular shareholder's proxy and that suffered when a proxy is capable of voting but does not vote at all. The Committee respectfully submits that the Government is "splitting hairs" when it states (emphasis added):

> the situation is different where a proxy is capable of voting and deliberately withholds ***some*** votes that are contrary to their personal views, but lodges other proxies favourable to their views.[8]

Appointing a proxy who decides not to vote on a poll at all is no less disenfranchising for a shareholder than a proxy who 'cherry-picks' the proxies it will vote. The Committee supports the notion of removing the distinction between the obligations on a proxy who is the chair of the meeting and all other proxies. All proxies must be obliged to vote on a poll and vote in accordance with the appointing shareholder's direction. It is essential that the dangers inherent in proxy nonfeasance as well as proxy malfeasance be addressed.

(b) Disclosure of proxy voting

The Committee would like to draw attention to the need to address existing difficulties associated with the interaction of s 250A(3) and 250A(7). In short, these provisions provide scope for a proxy to abuse the appointment process, notwithstanding a shareholder's efforts to subsequently appoint a different proxy.

For a proxy appointment to be effective, the company must receive the proxy appointment document at least 48 hours before the meeting: s 250B(1). However, there is no express prohibition on initial receipt of proxy appointments by a third party, which subsequently forwards the appointments on to the company.

To be valid, a proxy appointment must contain certain information about the company, the appointing shareholder, the proxy to be appointed and the meetings at which the appointment may be used, and must be signed by the appointing shareholder: s 250A(1). Thus, a proxy appointment need not be dated. If it is not dated the appointment will be taken to have been dated on the day it is given to the company: s 250A(3).

If a shareholder, having appointed a proxy, wishes to appoint an alternate proxy they may do so by lodging a subsequent valid appointment; in such a situation, the later appointment revokes the earlier one (if both appointments could not be validly exercised at the meeting): s 250A(7). Essentially, the law currently permits an undated earlier proxy appointment, which has not been lodged initially and directly with the company, to be used to trump a valid

[8] Ibid 2.31.

subsequent appointment, notwithstanding the intention of both the appointing shareholder and s 250A(7).

Another related issue may arise when proxy appointments are received by the company only following initial receipt by a third party. For example, a mischief can arise if a listed company prints on the proxy appointment form the address and fax number of a third party to which all proxy appointments are to be sent (in compliance with s 250BA). If a shareholder lodges with that third party a valid proxy appointment at the very point of expiry of the 48-hour period required by s 250B(1), the third party would be unable to forward on the appointment to the company within the requisite time limit. Thus, the shareholder's appointment would be ineffective, notwithstanding the shareholder's intentions.

The issue of intermediation of proxy appointment receipt was examined in 2002 by the Victorian Supreme Court in *Bisan Ltd v Cellante*[9]. Dodds-Streeton J found a proxy appointment form that provided return details of a third party to be invalid on the grounds that the Corporations Act insists on the *receipt by the company* of the proxy form, because it contemplates the receipt of the proxy form by an entity managed and controlled by persons subject to onerous fiduciary duties in relation to proxies.

3. The path forward

The Committee is of the view that the answer to the problem presented by all of the above scenarios may lie in a legislative amendment expressly prohibiting the intermediated receipt of proxy appointments. That is, the law should require proxy appointments to be valid, to be sent *direct* to the company and to no other third party. The Committee urges consideration of the drafting of an amendment to the current provisions of the Act, without which the law will continue to permit the unintended disenfranchising of shareholders.

However, the Committee also acknowledges CSA's point that if a company's constitution provides for it, direct voting may already be feasible. To this end, the Committee supports the views presented by CSA in its Discussion Paper.

Further submission

The Committee thanks CSA for the opportunity to make this submission, and is keen to contribute to further discussion on the issues raised.

If any further information is required in relation to this submission, please contact Laraine Walker, Executive Member of the Business Law Committee on (02) 9926 0256 or by email to lxw@lawsocnsw.asn.au .

Yours faithfully,

June McPhie
President