

DIRECTOR RECOMMENDATIONS IN SCHEMES REVISITED

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Legal Briefings - By **David Gray and James Sippe**

We previously reported on suggestions by Courts that target directors who will receive a bonus on the implementation of a scheme of arrangement should not make a recommendation to shareholders as to how to vote.¹ A recent decision rejects those suggestions and emphasises that the law ordinarily expects directors to make a recommendation.

IN BRIEF

- In June, we reported on decisions by Courts indicating that, despite previous practice, interested directors should generally not make a recommendation to shareholders as to how to vote on a scheme, and that there may be circumstances in which a recommendation could lead a Court to decline to approve the scheme.
- At the first Court hearing for the Wesfarmers/Kidman scheme, the Federal Court rejected this position.
- The Court held that the law ordinarily expects directors to make a recommendation and that the appropriate way to deal with the directors' interests is to ensure they are properly disclosed to shareholders.

THE PREVIOUS DECISIONS

We reported in June¹ on recent decisions by the Federal Court in NSW and the Supreme Court of Western Australia regarding directors who stand to receive a bonus on implementation of a scheme of arrangement (or have some other interest in the outcome of the scheme).

Starting in *Re Gazal Corporation Limited* [2019] FCA 701, the decisions indicated that interested directors should, in general, not make a recommendation to shareholders as to how to vote on a scheme. The decisions further indicated that a Court might decline to approve a scheme if, because of a recommendation by an interested director, it could not be assured of the integrity of the shareholder vote. These decisions surprised many practitioners as there is a general view that, provided the nature of a director's interest is disclosed, shareholders are perfectly capable of taking that interest to account when considering what weight to put on the recommendation of that director and there is a general expectation that all directors will give a recommendation even if they do have an interest.

Notably, however, none of the decisions resulted in the Court declining to approve the scheme. The Courts had regard to the prominent disclosure of the relevant directors' interests, the favourable report from the independent expert, and the strong shareholder support – factors that would apply to any number of schemes that come before the Courts for approval. On the basis of these factors, the Courts approved the relevant scheme.

Nor did the decisions address the implications of the reasoning that the involvement of interested directors could affect the integrity of the shareholder vote – for example, whether the interest amounted to a material personal interest that could have affected the involvement of the director in considering the scheme at all at board level.

KIDMAN

In *Re Kidman Resources Limited* [2019] FCA 1226, Justice O'Callaghan of the Federal Court in Victoria made orders approving the convening of a scheme meeting to consider the proposed acquisition of Kidman, a lithium mining company listed on the ASX, by a subsidiary of Wesfarmers Limited.

The scheme booklet included a unanimous recommendation by the Kidman board. It also disclosed that the Managing Director of Kidman will receive a bonus payment of one year's salary if the scheme is implemented.

Justice O'Callaghan noted the decision in *Gazal* and stated that he respectfully disagreed.

His Honour referred to the Corporations Regulations which require a recommendation from each target director as to whether target shareholders should approve the scheme unless the director does not wish to make, or does not consider himself or herself justified in making, a recommendation.

In his Honour's view, this ordinarily requires directors to make a recommendation, one way or the other, whether they stand to gain if the scheme is approved or not.

Justice O'Callaghan considered that shareholders should have the benefit and guidance of the knowledge and expertise of the directors who are responsible for the operation and management of the target company and are therefore best placed to express a view on whether the scheme is in shareholders' best interests.

His Honour considered that the appropriate way to deal with the bonus or other interest is to ensure that it is sufficiently explained to shareholders in the scheme booklet.

KEY TAKEAWAYS

It remains to be seen how other Courts around the country respond to the decision in *Kidman*. In any event, there may still be circumstances in a particular case in which a director's interest gives rise to concerns for a Court.

However, as we previously reported, we consider that proper disclosure of directors' interests to shareholders is, in general, the appropriate way to deal with these issues. It seems correct to us that, as a general principle, shareholders should receive the benefit of a recommendation from each director, along with appropriate disclosure of any interests held by those directors in the outcome of the scheme.

We see this position as consistent with the Court's reasons for approving the *Gazal* scheme,² despite the concerns expressed in the judgement about the recommendation.

It is worth noting that the scheme booklet published by Kidman indicated that the Managing Director had considered his own position and determined that it was appropriate that he make a recommendation, and that the rest of the board had, in the Managing Director's absence, separately considered his position and determined that it was appropriate that he make a recommendation. Justice O'Callaghan noted this process, and the disclosure of it in the scheme booklet, in his decision.

Target boards have regularly considered these issues in the past, and, as a matter of good practice, we expect to continue to see prominent disclosure of any bonuses or other interests of directors.

ENDNOTES

1. ['Now it's personal: The role of Target Directors with a Bonus Linked to the Outcome of a Scheme'](#), published on 28 June 2019.
2. And similarly the Court's reasons for approving the scheme in *Re Navitas Ltd (No 2)* [2019] WASC 218: see ['Now it's personal: The role of Target Directors with a Bonus Linked to the Outcome of a Scheme'](#), published on 28 June 2019.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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