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Zoher Adenwala
Bond University

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Directors' Generous Remuneration: to be or not to be Paid?

Abstract

Several recent instances of the premature termination of directors' service contracts and of the companies facing dire straits have drawn attention to the lavish scale on which the directors of some companies are remunerated. Not only may directors be paid enormous salaries but these are often supplemented by generous pension rights and a wide range of non-monetary benefits, either free of charge or on very favourable terms. This article is an attempt to determine the directors' right in various situations in which they may claim to be paid and the extent to which the Corporations Law controls the amount of directors' remuneration.

Keywords

directors' remuneration, corporate law, directors' rights

DIRECTORS' GENEROUS REMUNERATION: TO BE OR NOT TO BE PAID?



by
Zoher Adenwala
Research Fellow
Bond University School of Law

Introduction

Several recent instances of the premature termination of directors' service contracts and of the companies facing dire straits have drawn attention to the lavish scale on which the directors of some companies are remunerated.¹ Not only may directors be paid enormous salaries but these are often supplemented by generous pension rights and a wide range of non-monetary benefits, either free of charge or on very favourable terms. Cowen² has quoted the saying 'If you pay directors peanuts, you must expect monkeys.' The spectacular failures of large-size Australian companies³ only prove that this is not necessarily so.

Most of the hundred biggest companies in the United States now pay their chief executives ten or fifteen times as much as State Governors or the President of the United States are paid. Some even pay fifty times as much.⁴ If one thinks 'these heady numbers boggle the imagination, just wait until the next [year]'⁵ as no downward trend is expected. Though the Australian top executives may not earn as much as their counterparts in the United States,⁶ they are often pioneers in controlling their private company which exists with the main object of safeguarding the interests of the public company that

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- 1 The latest example is *Guinness plc v Saunders* [1990] 1 All ER 652.
 - 2 Cowen, 'Company Directors: Their Powers Duties and Responsibilities' (1967) 2 U Tas LR 361.
 - 3 For example TNT Limited a giant company paid in 1990 \$28 million to directors when the profits were down by 21% as compared to the previous year: *The Business Australian* at 31 Oct 1990. Similarly, Bond Corporation Holdings Ltd proposed to pay \$41.5 million to directors when shareholders funds dropped from \$891 million to \$-115 million in 1989: *The Australian Financial Review* dt 17 Nov 1990.
 - 4 *Business Week* reports that the Chairman of McCaw Cellular Communications seized the top spot in an executive pay survey by earning US\$53.9 million: (1990) 22(5) *Compensation and Benefits Review* at 5. The president of the Walt Disney Corporation took US\$32 million and its chairman took US\$40 million mostly in realised stock options. In Australia, about fifty directors are believed to take \$1 million or more.
 - 5 *Ibid.*
 - 6 According to the survey carried out by an executive search group Korn/Ferry International non-executive directors' fees rose from an average of \$571 a day in 1982 to \$890 a day in 1989 and the average fee for 21 days of their time was \$18,700: *The Australian Financial Review* dt 15 June 1990 at 31.

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they direct.⁷

Recently, the Minister for Industrial Relations told the Parliament that the research carried out by his office showed the average remuneration for directors rose 12% in 1990 outstripping the rise in average weekly earnings by ordinary workers.⁸ The research also showed that the largest pay increase of 56% was to the managing director of The Adelaide Steamship Co who took \$1.2 million last year. The group that this managing director presided over is now in debt of around \$4 billion. Consequent to these startling facts, the Government is examining how the pay rates for executives were set and is also considering whether action is necessary!

In the United States, Steven Ross of Time Warner Inc was the highest paid chief executive in 1990, receiving US\$78.1 million in total compensation. The chief executive of UAL Corp., earned US\$18.3 million even though the company's profits fell by 71%. Yearly compensation as high as US\$78 million made one of the Senators say that it 'disgusts even the heartiest proponents of capitalism'.⁹ This has led the Securities and Exchange Commission to consider giving shareholders a greater role in setting the pay policy for executives at the companies they own.

To be or not to be paid?

Often the board members, particularly the outside directors, are invited to join with the management to enhance the quality of strategic decisions. Such involvement can come at a high cost.¹⁰ In the United States, the big salaries are most often based around bonuses related to profits including share options,¹¹ but conversely 'loss sharing' is unheard of¹² as the simple remedy is considered to be sacking such high-fliers.

No figure for the just price of directorial services has been suggested so far. But the fears of generous remuneration are somewhat dissipated by the existence of a market for such services.¹³ Evidence of the value of top executives to a company is also provided by studies on abnormal stock price declines on their unexpected deaths.¹⁴ In the United States, legal concern about generous remuneration is most evident in the case of share option

7 Stretton, 'Laughing All the Way to the Bank' (1990) 9 (10) *Australian Society* at 16.

8 Davis, 'No Restraint on Top Directors' Pay Rises' *The Australian* at 21 June 1991 at 15.

9 Day, 'SEC May Give Shareholders More Say in Executive Pay' *The Washington Post* at 16 May 1991 at B10.

10 Buckley & Connelly, *Corporations: Principles and Policies* (1988) (2ed) at 392.

11 The reason 'is to put far more equity into the hands of professional managers to make them behave as if they were the true owners of the company with a bigger stake in its performance': *Business Week* as reported in (1990) 22(5) *Compensation and Benefits Review* at 5.

12 The elimination of bonuses related to profits in view of corporate losses as argued is tantamount to 'loss sharing': Shavell, 'Risk Sharing Incentives in the Principal-Agent Relationship' (1979) 10 *Bell J Econ & Mgt* 55 at 56.

13 See Note 'The Executive Compensation Contract: Creating Incentives to Reduce Agency Costs' (1985) 37 *Stan L Rev* 1147.

14 Johnson, Magee, Nagarajan & Newman 'An Analysis of the Stock Price Reaction to Sudden Executive Deaths' (1985) 7 *J Acc & Econ* 151.

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plans. A duty of loyalty issue also arises in the context of remuneration arrangements alleged to be excessive.¹⁵

Overly-generous remuneration is obviously prejudicial to the interests of shareholders and may be harmful to employees and also to creditors where a company is insolvent or in danger of becoming so.¹⁶ However, the *amount* of remuneration to be paid to directors is a matter of internal management and is not normally interfered with by the courts. Therefore, in most of the cases of dispute, the judicial system has evaluated the *entitlement* to the remuneration.¹⁷

Mr Justice Dawson, of the High Court of Australia once remarked:¹⁸

[There has been a] phenomenon of recent years whereby executives of large public companies become enriched to quite an extraordinary extent at what can ultimately only be the expense of the shareholders. No doubt the schemes which are devised to achieve this go before a general meeting of shareholders for approval as a matter of prudence, if not necessity. But the approval of a general meeting of shareholders in a large public company may often be an illusory safeguard, since a great many shareholders are unable or unwilling to organise themselves as an effective voice. Even if they were able to do so, in all likelihood they would not achieve the necessary majority. Moreover, if the company concerned is making large profits, shareholders will often fail to perceive that in achieving these results, the executives are doing no more than performing their proper function and do not as a matter of course deserve huge rewards in recognition of their achievement. I hasten to say that I am not for one moment advocating that the market should not set the appropriate level of remuneration for managers. I am merely suggesting that the mechanism provided by corporate structures and by the law may not be adequate to ensure that sufficient restraint is always shown.

This article is an attempt to determine the directors' right in various situations in which they may claim to be paid and the extent to which the *Corporations Law* controls the amount of directors' remuneration.

Evolution

The law relating to directors' remuneration has largely emerged out of the relationship between the director and the company. Originally, directors were regarded as trustees. This conception arose out of the position of directors in joint stock companies which were generally unincorporated and therefore vested the company's property in the hands of directors as trustees

- 15 Feuer, *Personal Liabilities of Corporate Officers and Directors* (1974) (2ed) at 63-75.
 16 The freedom of directors becomes limited by the interests of creditors when the company is in danger of becoming insolvent: Drake, 'Disqualification of Directors: The Red Card' (1989) *JBL* 474 at 491.
 17 The reason for the paucity of reported decisions challenging directors' remuneration is not hard to find. Apparently the market for top executives is a highly specialised one and there is no ready yard-stick by which to measure the worth of an executive: *Rogers v Hill* 289 US 582 (1933).
 18 In an address delivered to the Second Business Lawyers Conference on 10 April 1989 (at 4-5 of the speech).

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for the members. The situation gradually changed with the advent of the incorporated company which was treated as a separate legal entity¹⁹ and therefore could hold property in its own name.

The director for most purposes is regarded as an agent of the company and as such under the general law of agency owes fiduciary duties to his principal. These duties are not explicitly defined by reference to those of a trustee, but the director's general relationship to the company is analogous to that of the trustee to the trust and is still regarded as fiduciary.²⁰ While the trustee origin of the modern director has disappeared its impact still remains in the area of directors' remuneration.

Even now judges use the language of trusts and rely upon trust authorities when discussing the nature of the director's office and duties.²¹ Both directors and trustees are fiduciaries and the equitable obligations imposed upon a director 'are in many respects identical with those imposed on a trustee'.²² But as pointed out by both commentators²³ and cases,²⁴ directors are not trustees, either in a technical legal sense or in terms of the nature of their functions and duties.

There is 'no analogy which is absolutely perfect'²⁵ to describe directors' position. But their position is unique to themselves,²⁶ which one should bear in mind while considering what their rights or powers and duties are and ought to be.

It does not matter much what you call them so long as you understand what their true position is, that they are really commercial men managing a trading concern for the *benefit of themselves* and of all the other shareholders in it.²⁷

Modes of Remuneration

Generally, remuneration or emolument is understood as 'profit or gain arising from ... employment'.²⁸ Section 237(19) of the *Corporations Law* defines emoluments in relation to a director as the amount or value of any money, consideration or benefit given, directly or indirectly, to that person in connection with the management of affairs of the body corporate or of any holding company or subsidiary of the body corporate but does not include amounts in payment or reimbursement of out-of-pocket expenses incurred

19 See *Salomon v A Salomon & Co* [1897] AC 22.

20 *Re City Equitable Fire Insurance Co* [1925] 1 Ch 407 at 426 per Romer J; Sealy, 'The Director as Trustee' (1967) 25 CLJ 83.

21 *Selangor United Rubber Estates Ltd v Cradock* (No3) [1968] 2 All ER 1073.

22 Cowen, 'Company Directors' (1967) 2 UTas LR 361 at 362.

23 *Gower's Principles of Modern Company Law* (1979) (4ed) at 571-2; Sealy, 'The Director as Trustee' (1967) 25 CLJ 83 at 86; Jones, 'Unjust Enrichment and Fiduciary's Duty of Loyalty' (1968) 84 LQR 472 at 491.

24 *Sheffield & South Yorkshire Permanent Building Society v Aizlewood* (1890) 44 ChD 412 at 452; *Grimwade v Mutual Society* (1884) 52 LTR 409 at 416.

25 *Re Faure Electric Accumulator Co* (1888) 40 Ch D 141 at 151 per Kay J.

26 *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 at 387.

27 *Re Forest of Dean Coal Mining Co* (1878) 10 Ch D 450 at 451-2 per Jessel MR (Emphasis added).

28 See The Oxford English Dictionary Vol VIII.

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for the benefit of the body corporate. Further, it has been said:

...I think the word 'remuneration' means a *quid pro quo*. If a man gives his services, whatever consideration he gets for giving his services seems to me a remuneration for them.²⁹

Directors' remuneration is of two types : payments usually referred to as 'directors' fees' and payments made under a contract of service or a contract for services. In the latter situation a director assumes contractual obligations to the company for some specified period in return for a right to payment. In some cases, such a contract may be implied if specific terms exist in the company's articles.

A company's articles normally specify a process for the fixing and payment of directors' remuneration.³⁰ As to regards contractual remuneration, in the absence of a specific article³¹ or the ratification of the contractual remuneration in a general meeting,³² a contract of employment between a director and the company is voidable. The director becomes liable to account for profits made under such a contract.³³

Unauthorised remuneration must be repaid, and this will be so in some cases even though it may have been awarded, or its payment ratified, in general meeting.³⁴ However, where the payment of unauthorised remuneration is acquiesced in by all the shareholders entitled to vote, it will not be susceptible to any attack whether formally ratified or not.³⁵ This is because where the agent's unauthorised act has been ratified, it binds the company. It may be noted that the payments made in breach of fiduciary duty, as opposed to payments which are merely procedurally irregular, may not be ratified without the concurrence of all shareholders.³⁶ In fact no director is allowed to obtain for himself a profit unless by resolution a general meeting approves or all the shareholders acquiesce. It does not matter that the profit is of such kind 'that no loss is caused to the company by the gain of the director'.³⁷ Of course, the amounts paid to a director as fees,³⁸ interest³⁹ or commission⁴⁰ in any capacity other than that of a director will not be considered as director's remuneration.

29 *R v Postmaster-General* (1876) 1 QBD 658 at 663 per Blackburn J.

30 See article 63 of Table A.

31 *Young v Naval & Military Cooperative Society* [1905] 1 KB 687.

32 *Bamford v Bamford* [1970] Ch 212.

33 *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443.

34 *Boschoek Proprietary Co Ltd v Fuke* [1906] 1 Ch 146.

35 *Re Duomatic Ltd* [1969] 1 All ER 161.

36 *Foster v Foster* [1916] 1 Ch 532.

37 *Furs Ltd v Tomkies* (1936) 54 CLR 583 at 592 per Rich Dixon and Evatt JJ.

38 For example, professional charges paid to a director for professional consultancy services irrespective of mode of payment.

39 For example, interest paid to a director for advancing a loan to the company. Such interest would be an investment income which the director could have even otherwise earned by investing his money at some other place.

40 For example, payment of guarantee commission to a director for standing guarantee in respect of any loan borrowed by the company will not be treated towards remuneration.

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Level of Remuneration

The amount of remuneration awarded to a director is a matter of company management and, provided there has been no fraud on creditors or minority shareholders,⁴¹ the courts will not express any opinion as to whether the amount is too large or too small.⁴² There is no implication or requirement that the remuneration should come only out of profits.⁴³

The objection to overly-generous remuneration is that resources are diverted which could be better used to benefit the company, shareholders, employees, and creditors. However the major difficulty in supervising the level of payments to directors is the absence of an objective means of measuring a director's worth to the company. Except in small companies, to calculate the value of director's services is virtually impossible. Moreover, varying talents of directors and the different demands made by their positions,⁴⁴ determine only a vague market value. This, together with the courts' long-standing tendency to regard such matters as an internal concern of the shareholders,⁴⁵ means that very few cases exist in which the level of remuneration has been considered.

Recently, Oliver J⁴⁶ rejected the applicability of the famous three-fold test⁴⁷ and held that, except to the extent of the value of the directors' services, the remuneration paid to them was ultra vires. Once the transaction is established to be ultra vires, then it becomes irrelevant whether the transaction is beneficial to the company or not.⁴⁸ Though the inactivity of the company is considered to be of no importance and the mere holding of the office of the director may warrant financial benefits, remuneration beyond the justifiable reward must be based on the standard of reasonableness.⁴⁹ In the United States also the courts have long agreed that directors' remuneration is generally measured by a reasonable standard.⁵⁰

Where corporate funds are applied to incentive or other compensation of corporate officers, such remuneration must bear a reasonable relation to the value of the services for which the funds are applied.⁵¹

To come within the rule of reasonableness the remuneration must be in

41 *Re Halt Garage (1964) Ltd* [1982] 3 All ER 1016 at 1023.

42 *Henderson v Bank of Australasia* (1888) 40 Ch D 170 at 181 per North J.

43 *Lundy Granite & Co Ltd Lewis's Case* (1872) 26 LT 673.

44 *Farrar's Company Law* (1988) (2ed) at 277.

45 *Burland v Earle* [1902] AC 83.

46 *Re Halt Garage (1964) Ltd* [1982] 3 All ER 1016.

47 See *Re Lee Behrens & Co* [1932] 2 Ch 46. The three-fold test is the three questions to test the validity of grants to directors: (1) Is the transaction reasonably incidental to the conduct of the company's business? (2) Is the transaction bona fide? (3) Is it done for the benefit and to promote the prosperity of the company?.

48 *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1969] 2 All ER 1185 at 1193-94 per Pennycuik J.

49 *Re Halt Garage (1964) Ltd* [1982] 3 All ER 1016 at 1044 per Oliver J (Emphasis added).

50 *Blish v Thompson Automatic Arms Corp* 64 A 2d 581 (1948); *Miller v Magline* 256 NW 2d 761 (1977).

51 *Wyles v Cambell* 77 F Supp 343 at 346-47 (1948).

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proportion to the director's ability, services and time devoted to the company, difficulties involved, responsibilities assumed, success achieved, corporation earnings, profits and prosperity, and all other relevant factors. The remuneration should also not be unfair to shareholders in unduly diminishing dividends properly payable. Although the standard of reasonableness can be determined, the difficulty arises in the application of the standard.

Assuming, arguendo, that the compensation should be revised, what yardstick is to be employed? Who or what is to supply the measuring rod? The conscience of equity? Equity is but another name for a human being temporarily judicially robed. He is not omnipotent or omniscient. Can equity be so arrogant as to hold that it knows more about managing this corporation than its stockholders?⁵²

Individuals may only be prepared to serve if they are paid, especially in large size companies. It could, consistently with this rationale, be argued that a company could only pay its directors such amount as is necessary to retain their services.⁵³ But even if the relevant amount could be determined, the payment may not correspond to the value of the benefit which the directors' services confer on the company. The shareholders may appoint whoever they see fit as directors, and some appointees might only serve for a fee disproportionate to the value of their services. Therefore, a company's capacity to remunerate its directors is not legally limited to the objective value of their services.

[T]he amount, whether it be mean or generous must be a matter of management of the company to determine...shareholders are required to be honest but...there is no requirement that they must be wise...⁵⁴

In determining the amount of remuneration, shareholders are expected to act objectively and satisfy the standard of reasonableness. However, in the absence of evidence of actual intention, it will be difficult to distinguish between remuneration which is merely generous and payments which are of such an unreasonable amount that they constitute a gift. Thus, the remuneration of directors 'is a contentious issue, generally not determined in a manner which relates to effort and performance.'⁵⁵

The Right to be Paid

Probably most people who allow their names to go forward as candidates for a directorship expect some financial advantage to accrue to them as a result of their appointment.⁵⁶ But just as trustees render services gratuitously unless the trust deed provides for their remuneration, directors also render services gratuitously unless they have been specifically employed for services.

52 *Heller v Boylan* 29 NYS 2d 653 (1944).

53 This approach is more related to the supply and demand situation than the prosperity of the company or legal or social issues.

54 *Re Halt Garage (1964) Ltd* [1982] 3 All ER 1016 at 1039 per Oliver J.

55 Hart, 'Director's Rewards' (1990) 6(1) *Company Director* at 30.

56 Parkinson, 'Directors' Remuneration' (1984) 34 NLJ at 130.

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The mere fact that a person is a director does not imply that he or she has a right to be paid.⁵⁷ Directors also cannot claim remuneration for doing what is their duty. The courts do not allow directors to retain company money on the pretext that they have not been paid or that their services are worth much more.⁵⁸

But what is the remuneration of directors...it is a gratuity...In some companies there is a special provision for the way in which the director should be paid, in others there is not. If there is a special provision...you must look to the special provision to see how to deal with it. But if there is no special provision their payment is in the nature of a gratuity.⁵⁹

The unsettling question of entitlement to remuneration has been resolved largely by Lindley LJ:

Directors have no right to be paid for their services, and cannot pay themselves or each other, or make presents to themselves out of the company's assets, unless authorised to do so by the instrument which regulates the company or by the shareholders at a properly convened meeting.⁶⁰

In the United States, directors have no inherent power to fix their own remuneration, and where an executive has been appointed from the board, the question arises of fiduciary restrictions on directors contracting with their own corporation. Where various directors are interested in the common object of procuring a salary, or a salary increase, the device of passing several resolutions for each instead of one joint resolution for all will not be effective. The mutual 'back scratching' or reciprocal voting invalidates the action as to each.⁶¹

In light of the general rule, therefore, that the director's services are rendered gratuitously, no right to fees exists. The remuneration should be authorised either by the articles or by a resolution of the company in general meeting. Directors need to establish their right to be paid, either by a cause of action or a contract.⁶²

The question now is whether the articles or a resolution of the company would amount to a contract upon which directors can sue to recover remuneration.

The Articles: A Binding Contract?

Section 180 of the *Corporations Law* provides that the articles shall have the effect of a contract under seal between the company and each member, the company and each director, a member and each other member, under which

57 *Dunstan v Imperial Gas Light and Coke Co* (1832) 110 ER 47; *Re Waipuna Investments Pty Ltd* [1956] ALR 460.

58 *York and North-Midland Railway Co v Hudson* (1845) 51 ER 866 at 874 per Romilly MR.

59 *Hutton v West Cork Railway Co* (1883) 23 Ch D 654 at 672 per Bowen LJ.

60 *Re George Newman & Co* [1895] 1 Ch 674 at 686.

61 *Ballantine on Corporations* at 190.

62 *Dunstan v Imperial Gas Light and Coke Co* (1832) 110 ER 47 at 50 per Tauntan J.

each of such persons agrees to observe the provisions of the articles.

The predecessor of this section has been the subject of several decisions.⁶³ While articles do create rights and obligations between members and the company, no right given by an article to a person who is not a member,⁶⁴ can be enforced against the company. It is generally established that the articles do not constitute a contract on which a director or a director/member could sue for remuneration.⁶⁵

The courts have struggled to apply this rule consistently. Sometimes, the courts have treated the articles as evidence of the terms of a separate verbal contract on which a director can sue to recover fees. If directors act on the basis of the articles which are construed as an offer by the company, they will be deemed to be employed on the terms in the articles,⁶⁶ as in the case of an implied contract.

This frequently quoted view⁶⁷ would logically apply to an article which provides that the remuneration is to be fixed by the general meeting. Such an article, the argument runs, forms part of the contract between the company and the director.⁶⁸ But such an article creates only a possibility of payment, since the company has discretion as to whether or not the director is to be paid. Therefore the article of this nature creates only an illusory promise upon which no claim to recover fees can be based.⁶⁹

Considering the articles as evidence of a verbal contract, the courts view that an authorised right to fees is presumably related to payment for future and not past services.⁷⁰ Such a contract is valid since good consideration exists. But where this presumption is rebutted and the articles provide for remuneration in respect of past services the evidence of a verbal contract cannot be upheld.

The intricate question is to what extent contractual rights against a company are immune from interference by changes in the articles of association. No doubt, a company cannot restrict by contract its *power* to change its

63 These were discussed by Ashbury J in *Hickman v Kent or Romey Marsh Sheepbreeders' Association* [1915] 1 Ch 881 at 900.

64 For example, a director.

65 In *Re Richmond Gate Property Co Ltd* [1965] 1 WLR 335 at 337 Plowman J held a contrary view saying that an article providing the remuneration of a managing director was to be fixed by the board created an express contract between the company and the managing director.

66 In *New British Iron Co ex parte Beckwith* (1898) 1 Ch 324 at 326 Wright J said:
That article is not in itself a contract between the company and the directors...but where on the footing of that article the directors are employed by the company and accept office the terms of [the articles] are embodied in and form part of the contract between the company and the directors. Under the article as thus embodied the directors obtain a contractual right to [their] remuneration.

67 *Salton v New Beeston Cycle Co* [1899] 1 Ch 775; *Molineaux v London Birmingham and Manchester Insurance Co Ltd* [1902] 2 KB 589; *Re TN Farrer Ltd* [1957] Ch 352.

68 *Swabey v Port Darwin Gold Mining Co* (1889) 1 Megone 385.

69 *Loftus v Roberts* (1902) TLR 532.

70 *Re London Gigantic Wheel Co* (1908) 24 TLR 618; *Matthews v Newport Block & Tile Co Pty Ltd* (1950) 80 CLR 269.

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constitution.⁷¹ Yet a change of the articles may involve the breach of a contract with a third party.⁷² When the alteration of articles is challenged, the person complaining bears the onus of showing that the power has not been properly exercised. The courts will not consider fraud, oppression, or other abuse⁷³ when the alteration is apparently bona fide and is in the interest of the company.⁷⁴ Nevertheless, the provisions creating contractual obligations in a company's articles cannot limit its statutory power to alter the articles.

A Resolution of the Company

A resolution duly passed by the shareholders remunerating directors in itself does not constitute a contract with the company⁷⁵ similarly, the informal discussions over coffee between directors does not seem to qualify as a directors' meeting.⁷⁶ Therefore any such 'discussion' leading to payment of remuneration will be void due to lack of a 'resolution' for determination of remuneration.

The courts have treated a company resolution as an evidence of a contract on which a director can recover remuneration, but a resolution will be so construed only where it relates to future services and not past services.⁷⁷ Such a resolution would invariably be pursuant to an article reserving the fixing of directors' remuneration to the general meeting. It is highly unlikely that the articles would make no provision for remuneration and that the question would largely depend upon the general meeting.

A resolution cannot be amended at the general meeting to revise the amount of directors' remuneration upwards. This is because any amendment which alters the nature of business should not be such as to make members wish they had not stayed away from the business of the meeting.⁷⁸ The downward revision in the remuneration would be valid 'since a member who was prepared to swallow a camel could hardly strain at a gnat'.⁷⁹

Payments of Quantum Meruit

A quasi-contractual quantum meruit claim is an action founded on restitution⁸⁰ and permits the recovery of reasonable remuneration for work done and accepted under a contract which is or has become unenforceable.⁸¹ The principle is established that the work done at the request of another even

71 Section 176 of the *Corporations Law*.

72 *Southern Foundries (1926) Ltd and Federated Foundries Ltd v Shirlaw* [1940] 2 All ER 445.

73 *Peter's American Delicacy Co Ltd v Heath* (1938-9) 61 CLR 457.

74 *Sidebottom v Kershaw Leese & Co* [1920] 1 Ch 154; *Brown v British Abrasive Wheel Co* [1918-19] All ER 308.

75 *Putaruru Pine & Pulp Co (NZ) Ltd v MacCulloch* [1934] NZLR 639 at 647 per Reed J.

76 *Society Management Pty Ltd v Pickering* [1986] SR(NSW) 106 at 109 per Clarke J.

77 *Re A 1 Biscuit Co* (1899) WN 115. See also *Re Lundy Granite Co* (1972) 26 LT 673 where it was held that the remuneration voted to directors is a debt due from the company.

78 *Gordon Hotels' case* (1953) 97 SJ 465.

79 *Gower's Principles of Modern Company Law* (1979) (4ed) at 546.

80 Goff and Jones, *The Law of Restitution* (1978) (2ed) ch 24.

81 *Pavey & Mathews Pty Ltd v Paul* (1987) 69 ALR 577.

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during negotiations entitles recovery of an amount on a quantum meruit.⁸² Failure to convert negotiations into a contract is not relevant. This principle, applicable to all types of services, is to the effect that a recipient of services must pay a reasonable amount for what has been received.⁸³ Quantum meruit payments presuppose the existence of a contract either expressed or implied.⁸⁴ Such a claim could not be made unless the contract had been terminated⁸⁵ but this requirement seems to be unnecessary now.⁸⁶

To determine the value of compensation on quantum meruit is a difficult task. The valuation of the plaintiff's services may be based on the contract price⁸⁷ or:

What the concept of monetary restitution involves is the payment of an amount which constitutes, in all the relevant circumstances, fair and just compensation for the benefit or enrichment actually or constructively accepted. Ordinarily, that will correspond to the fair value of the benefit provided.⁸⁸

The fair value of the benefit provided can be determined as stated by Lord Atkin:

[I]f no trade usage assists the court as to the amount of [remuneration], it appears to me clear that the court may take into account the bargainings between the parties, not with a view to completing their bargain for them, but as evidence of the value which each of them puts upon the services.⁸⁹

To be paid on quantum meruit, a director must establish that his services were rendered at the request of the company and were accepted. Thus, the majority of remuneration claims on a quantum meruit are contractual.⁹⁰ Otherwise, first, where there is an express contract governing the remuneration⁹¹ the recovery on a quantum meruit is excluded.⁹² Secondly, when the director has expressly or impliedly indicated that his services are without remuneration, he is equally precluded from any quantum meruit claim. The services in the latter case are not services for which a director would expect to be paid. Expectation is therefore an essential requirement for both contractual and quasi-contractual quantum meruit liability.⁹³

82 *OTM Ltd v Hydranautics Ltd* [1981] 2 Lloyd's Rep 211 at 214 *per* Parker J.

83 *Craven-Ellis v Cannons Ltd* [1936] 2 KB 403; *William Lacey Ltd v Davis* [1957] 1 WLR 932.

84 *British Steel Corp v Cleveland Bridge and Engineering Co Ltd* [1984] 1 All ER 504.

85 *Flett v Deniliquin Publishing Co Ltd* [1964-65] NSW 383.

86 The majority of the High Court of Australia in *Pavey (supra n 81)* formed by Mason, Wilson and Deane JJ held that quantum meruit claims are not based on implied contract but are claims for restitution based on unjust enrichment.

87 Greig and Davis *The Law of Contract* (1987) at 1287.

88 *Pavey & Mathews Pty Ltd v Paul* (1987) 69 ALR 577 at 609.

89 *Way v Latilla* [1937] 3 All ER 759 at 764.

90 Evans, 'Quantum Meruit and the Managing Director' (1966) 29 MLR 608. Here, contract also includes quasi-contract: *Guinness plc v Saunders* [1990] 1 All ER 652.

91 *Cutter v Powell* (1795) 101 ER 573.

92 *Re Richmond Gate Property Co Ltd* [1965] 1 WLR 335 at 337 *per* Plowman J.

93 *Re Rhodes* (1890) 44 ChD 94.

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The law relating to directors' remuneration provides that in the absence of a provision to the contrary, the implication is that a director's services are on a gratuitous basis. When a person acts as a director but fails to show title to the position of director, he cannot claim any payment on a quantum meruit.⁹⁴

Determination of Remuneration

It has already been noted that the directors' right to remuneration must be authorised either by the articles or by a resolution of a company. A resolution fixing remuneration is often traced to the articles. Articles fix remuneration of directors in different ways. Some of the most common methods are discussed here. Often combinations and variations of these methods and a different basis of payment for different directors are used. In some cases the payment of remuneration may be conditional upon the happening of certain events or determination of a certain time.⁹⁵

A Fixed Sum to Each Director

This method of fixing remuneration is fast becoming outdated. Most companies prefer other ways of remunerating their directors. A typical provision in an article is:

Each director shall be paid out of the funds of the company remuneration at the rate of \$2000 per annum.

Such an article will give an absolute right to receive the specific sum once the director has performed the services. The approval of shareholders in general meeting for payment or ratification is not necessary. A fixed sum as provided in the articles becomes a debt due for which the director can sue.⁹⁶

This method has some advantages and some disadvantages. They are that a fixed sum is assured to each director irrespective of the loss made by the company or efforts made by each director. The directors also know beforehand the extent to which their services will be remunerated. The directors' efforts are not remunerated in a manner commensurate with the financial performance of the company or with the efforts of each director. Moreover, during inflation the specified sum may soon become unrealistic.

A Fixed Sum for Division by Directors

In cases where articles provide for a fixed sum to be divided by the board, a director cannot sue for his fees until the board has made a formal division of the authorised sum.⁹⁷ A typical provision in an article is:

94 *Woolf v East Nigel Gold Mining Co Ltd* (1905) 21 TLR 660.

95 In *Caridad Copper Mining Co v Swallow* [1902] 2 KB 44 it was held that the right of a director to remuneration was based on a condition precedent that the time for payment should have been determined by the directors.

96 *Nell v Atlanta Gold and Silver Consolidated Mines* (1895) 11 TLR 407.

97 *Morrell v Oxford Portland Cement Co* (1910) 26 TLR 682; *Joseph v Sonora (Mexico) Land and Timber Co* (1918) 34 TLR 220; *Moriarty v Regents Garage & Engineering Co* [1921] 2 KB 766.

Directors' Generous Remuneration

The remuneration of the board of directors shall be \$20,000 per annum payable out of the funds of the company and such remuneration shall be divided among the directors in such proportion and manner as they may determine.

The advantage of this method is that despite a fixed sum being available for division, the remuneration can be linked to the efforts made by each director. This eliminates the anomaly of the previous method. The disadvantages of the previous method apply here also. Additionally, the directors may not be able to reach agreement on the mode of division. To avoid such uncertainty the article may include a provision for division of the remuneration equally in case the directors fail to determine the remuneration themselves. No contract exists between the directors inter se, and therefore no action is maintainable by directors against each other for mandamus to compel division of remuneration.⁹⁸

Determination by General Meeting Resolution

Of all the methods of fixing directors' remuneration this method is most common. The companies adopting Table A⁹⁹ also are covered by this method. The general meeting usually determines the remuneration by an ordinary resolution. A typical provision in an article is:

The directors shall be paid such remuneration as is from time to time determined by the company in general meeting.

A general meeting may resolve to fix the remuneration for either past or future services¹⁰⁰ and may award the directors a salary, fees or a percentage of the company's profits.¹⁰¹ In such cases, the directors are virtually at the mercy of the shareholders who retain not only the power to determine the remuneration but also to vary the form or the amount of remuneration from time to time.

A resolution determining remuneration to directors will be invalid if the meeting is not properly constituted, and directors will be without authority to be paid. If such remuneration is in fact paid it may be recovered by the company as unauthorised.¹⁰²

Where a general meeting has been held but only implied approval is obtained still the remuneration may be considered as authorised if it can be shown that all the members were aware of the situation that they were approving remuneration.¹⁰³ Similar considerations will apply where no general meeting is held and therefore no resolution is passed.

98 *Dashwood v Cornish & Others* (1897) 13 TLR 337.

99 See article 63 of the Table A.

100 *Colhoun v Green* (1919) 25 ALR 127.

101 The Australian Stock Exchange Listing Rules prohibit payment of a percentage of profits to non-working directors of listed companies.

102 *Re J Franklin & Sons Ltd* [1937] 4 All ER 43; *Boschoek Proprietary Co Ltd v Fuke* [1906] 1 Ch 146.

103 *Felix Hadley & Co Ltd v Hadley* (1897) 77 LT 13.

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...where a transaction is *intra vires* and honest and especially if it is for the benefit of the company, it cannot be upset if the assent of all the corporators is given to it...it matters [not] in the least whether that assent is given at different times or simultaneously.¹⁰⁴

By approving the accounts, the directors' fees, although not authorised as strictly required by the articles, if paid with the concurrence of all the shareholders, would be treated as valid, because shareholders' consent would be tantamount to a resolution of the general meeting.¹⁰⁵

The only difference between the meeting held but no resolution passed and the meeting not held and therefore no resolution passed, is that in the latter case stricter requirements must be met before an authorised right to be paid can arise. The payment must be *intra vires*, honest and for the benefit of the company with the assent of all the members, so that assent is as binding as a resolution of the company.

Apart from overcoming the disadvantages of the previous two methods, the principal advantage of this method is that it allows control by shareholders and furnishes them with an opportunity to review the amounts paid to the directors. The disadvantages are that the real control¹⁰⁶ of shareholders can be circumvented by fixing the remuneration for a period more than one year before the company becomes widely held and also the directors may lavish on themselves fancy fringe benefits not covered under 'remuneration'.

To some extent such practices can be overcome in public and listed companies.¹⁰⁷ In the absence of such control, it is not surprising that many private companies carry on business with extreme informality and often the directors draw money without any authority whatsoever. When companies face an economic squeeze and are forced into liquidation or in cases of company takeovers, many shareholders/directors have been compelled to repay substantial sums paid to them without authority.¹⁰⁸

Payment by Distribution of Profits

The articles may provide for payment of directors' remuneration as a percentage of the company's profits. This method obviously is to encourage directors to enlarge the profits of the company, if only out of self interest. A typical provision in an article is:

The directors shall be paid such percentage of net profits each year as may be determined by the general meeting to be distributed equally among themselves.

104 *Parker and Cooper Ltd v Reading* [1926] Ch 975 at 984 per Astbury J.

105 *Re Duomatic Ltd* [1969] 2 WLR 114; *Cane v Jones* [1981] 1 All ER 533.

106 Even when the directors themselves are shareholders it will *pay* them better to receive payment by way of remuneration rather than by way of dividend. The reason being the remuneration as an earned income is a deductible expense for the company and is payable irrespective of profits made.

107 Section 239 of the *Corporations Law* requires the directors to disclose emoluments and other benefits received by the directors of the company when demanded by at least 10% of the number of members or holders of 5% of the issued share capital.

108 See 'How Limited is your Liability' (1968) *Accountants Journal* 103.

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In companies where large profits are made, this mode of payment invariably results in disproportionate remuneration when calculated in cash. Probably to avoid this situation the Australian Stock Exchange prohibits listed companies from remunerating their directors other than working directors by a percentage of the profits.¹⁰⁹ In practice, this method is largely used for working directors in conjunction with other methods of fixing remuneration.

The advantage of this method is that directors tend to concentrate more on profitable activities to increase their own benefit. However the remuneration may actually be disproportionate to the efforts made by the directors in monopolistic companies. The directors may also overlook the social factors of running the business.

Payment of Fees for Attendance

Usually the articles fix a specific amount for directors on their attending each board meeting. On the basis of attendance, each director's remuneration is calculated and paid. A high rate of attendance will necessarily result in larger remuneration irrespective of whether the attending directors carry any worthwhile business at such meetings. A typical provision in an article is:

Each director shall be paid \$250 as the fee for attending each board meeting in addition to the reimbursement of...

The advantages of this method are that the directors are induced to attend board meetings regularly. The regular attendance could make them contribute more to the affairs of the company. On most of the occasions, the remuneration turns out to be proportionate to the efforts made by non-executive directors. The disadvantages are that the directors located far away from the usual place of meetings lose for their inability to attend the board meetings regularly, irrespective of their willingness.

Specimen Articles

The articles providing for directors' remuneration should be drafted carefully as per the company policy. A private company may provide for a slightly different method than a public company where different considerations apply.

In the case of private companies, the most suitable article could be :

The board of directors shall be paid out of the funds of the company by way of remuneration, a sum at the rate of \$X per annum, and such sum shall be divided among them in such proportions and manner as the directors may determine and in default of such determination equally.

In the case of public companies, the most suitable article could be :

The board of directors shall be paid out of the funds of the company by way of remuneration at the rate of such sum per annum as the shareholders in general

109 See para 3L (7) of the Australian Stock Exchange Listing Rules.

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meeting shall determine and upon any sum being voted the same sum shall be payable in each succeeding year until altered by a resolution of the shareholders. No resolution altering the remuneration shall be passed unless due notice of the intention to propose the same is given in the notice convening the meeting and such notice shall specify the amount of any proposed alteration. The remuneration shall be divided among them in such manner and proportions as the directors may determine and in default of such determination equally. No remuneration of the non-working directors shall be by way of commission on or percentage of turnover or division of profits. If any director serves on any committee or performs extra services or exercises any special qualifications or otherwise performs services which in the opinion of the directors are outside the scope of the ordinary duties of a director, he may be paid such additional sum by way of special remuneration as the directors may determine and such remuneration may be in addition to or in substitution for his share in the remuneration referred to earlier.

In private companies, the separation of management from ownership is rare as the managers are also large shareholders and sometimes the only shareholders. Thus careful drafting of articles does not play an important role as the directors on the strength of their share holding can easily alter the article by a special resolution. However, a global sum as provided in the suggested article is preferable to a fixed sum for each director since the directors do differing amounts of work and their comparative value can best be determined by the directors themselves.

In public companies, determination of directors' remuneration is based on democratic shareholder control of management. Though, the suggested article keeps the flexibility with the directors for not approaching shareholders every year, the shareholders keep the power to alter the remuneration at any stage.

Disclosure of Remuneration

When one has to choose between having a fixed rule and having no fixed rule as to what a company must do but whatever the company does has to be openly disclosed, then within the traditions of company law one would opt for the latter approach.¹¹⁰ Disclosure is not only the law's preferred solution but it is relied on by the stock exchanges too.¹¹¹ Disclosure is also what the companies habitually provide for in their articles in regard to matters such as directors' contracts.

There are many ways¹¹² in which the 'disclosure' can be made and probably the best way to disclose the directors' benefits is in the company's financial statements. The practice in Australia, however, seems to be that since the annual financial statements are the major source of information to the

110 Sealy, *Company Law and Commercial Reality* (1984) at 21.

111 See the provisions in the Australian Stock Exchange Listing Rules.

112 For example, registration of documents with the registering authority maintenance of registers by the company and publication of financial position.

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shareholders, no data to alert them as to the reality should be disclosed.¹¹³ But on requisition of members¹¹⁴ disclosure of directors' emoluments can be enforced on. The wide definition of 'emoluments'¹¹⁵ applies and the disclosure must then be of the emoluments of each director to which the requisition relates. This is contrary to the recommendation¹¹⁶ that the privacy of the income of each director should be respected.¹¹⁷ The court has held that disclosure should be regarded as an 'incident of commercial life'.¹¹⁸

The Cohen Committee expressed the view that 'the best safeguard against an improper transaction by directors...is to ensure that disclosure is made of all their transactions'.¹¹⁹ But the Jenkins Committee did not show the same faith in the policy of disclosure regarding directors' transactions with their company¹²⁰ and, in particular, receipts of emoluments. These views are in contrast with the views taken in the United States.¹²¹ There the argument is that if management transactions are so frequent that disclosure would be a burden, there is all the more reason why the transactions would be of great interest to the shareholders.¹²² Perhaps the judges and legislators in the United States have less faith in the deterring effect of publicity.¹²³ The shareholders have an obvious interest in knowing how well rewarded are the company's executives. Their interest should outweigh any interest of the directors in the privacy of their financial status. The interest of creditors also must be taken into account in the matters of disclosure as:

Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them. The creditor of a company...must look to that company for payment. His interests may be prejudiced by the movement of funds between companies in the event that the companies become insolvent.¹²⁴

One of the major reforms proposed by the *Corporations Amendment Bill* 1991 is to require full and prompt disclosure to the Australian Securities Commission, and in the company's annual report, of details of all remuneration and benefits paid by a company to directors and their relatives.¹²⁵ The Companies and Securities Advisory Committee which drafted the Bill believed that in the area of disclosure of directors' benefits,

113 Department of the Attorney-General and the Justice NSW Bureau of Crime Statistics and Research, Research Report 4 '*Company Investigations 1975-77*'.

114 Section 239 of the *Corporations Law*.

115 Section 237(19) of the *Corporations Law*.

116 *Committee on Company Law Amendment* (the Cohen Committee) Cmnd 6659.

117 Parsons 'The Directors Duty of Good Faith' (1967) Melb ULR 395. Perhaps Australians are not as sensitive: salaries especially those of academics, public servants and parliamentaries seem to be newsworthy.

118 *Re Australian Newsprint Mills Ltd* (1988) 14 ACLR 355 at 356 per Cox J.

119 Cmnd 6659.

120 Cmnd 1749.

121 Carey, 'Corporate Standards and Legal Rules' (1962) 50 Cal LR 408.

122 *Ibid* at 412.

123 Aftermann, *Company Directors and Controllers* (1982) (2ed) at 80.

124 *Walker v Wimborne* (1976) ALJR 446 at 449 per Mason J.

125 Public Exposure Draft of the proposed *Corporations Amendment Bill* 1991 at 3 (Emphasis added).

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legislative amendment is more appropriate in principle than reliance on accounting standards. Therefore these obligations should be given more prominence.¹²⁶

Conclusion

The non-interference rule, though practical and sensible, is open to abuse. It may, therefore, be feared that the efforts of the legislation and the administrative machinery will be frustrated if the courts adopt too complacent an attitude towards directorial delinquency, particularly in respect of their remuneration. No doubt, the judges have to walk a tight rope, taking care not to give directors an opportunity to play with other people's money whilst, possibly, paying themselves generous remuneration. The time has come for the entire judicial system to begin paying attention to the propriety of levels of directors' remuneration instead of just the entitlement to it. Unfortunately, merit is not always commensurately rewarded, whilst mediocrity sometimes unjustly brings incredibly lavish returns.

126 *Ibid* at 16 (Emphasis added).