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Succession planning for private companies

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For those wanting to ensure that a particular family member or a person they have specifically chosen becomes the director of a family company when the current director passes away, it can be a minefield.

You have a private company (that is, one with 'Pty Ltd' after its name). It might be the trustee of your family trust or your self-managed superannuation fund (SMSF) or it might simply be the company that operates your small business.

You are a director of the company. You might be the only director or your spouse or some of your kids or even your business partner might be the other director(s).

You control, or at the very least have a material say in, the company through the shares in the company that you own, because in a standard company constitution, the shareholders control the appointment and removal of directors.

Directorships are not 'property'

Now, let us suppose that you want a particular person to become the director of the company when you pass away. You may want to make your spouse a director of the company to protect their interests against attack by your children from an earlier marriage. Or you might want a particular child to take the directorship, again to protect them against being besieged by their siblings or half-siblings.

It might be someone you have chosen as part of your specific estate planning arrangements. Or it might just be that you want to protect your family and do not want your business partner to have complete control of the company after you have gone.

Whatever the reason, and there are many, you want that person to become the director in your place.

Seems easy enough? Actually, no. It is probably more complex than you would think.

The problem is that directorship and the right to be a director of a company is not 'property'. It is not an 'asset'; a thing that can be owned. It is an office to which a person is appointed rather than property which can be owned and transferred.

So, you can't just say in your Will, 'I give my directorship in my company to ...' That is like saying, 'I give my presidency of the Rotary Club to my son' or 'I give my chairmanship of the P&C to my daughter'. There is nothing to give because these things are not property, and on your death you cease to hold those offices.

Company shares as protection

If you want to appoint your successor director, you have to work out firstly how to do that within the scope of the laws and rules that apply to the operation of companies and, second, how to ensure that the other shareholders and directors in the company will not undermine your wishes when the time comes.

The laws and the rules that apply are the easy part. The law is

the *Corporations Act 2001* (Corporations Act), and the rules are set out in the company's constitution. It is those sources that you need to satisfy in protecting your chosen appointee.

The fundamental protection comes with the shares in the company. The constitutions of most private companies permit the shareholders to appoint the directors by majority vote (though this may not be the case if you have a shareholders' agreement that says something to the contrary).

If you give your chosen appointee your shares, then they can vote those shares to appoint themselves. What rights they have then, as directors, is governed by a raft of laws, but is also dependent on what share of the directors' vote they have at a board meeting. You will need to fully understand your strategy in appointing your 'anointed' person and be sure it is appropriate.

In the case of a one-director/one-shareholder company, things are a lot easier, though there are still things to consider.

In such a situation, you give the shares in that company to the person you want to become the director, and they vote the shares to appoint themselves as director.

Applications of Corporations Act section 201F

Further, section 201F of the Corporations Act is relevant here and, depending on the circumstances, could be either positive or negative. That section allows the executor of a deceased director in a one-director company to appoint the successor director, including themselves.

The section could work in your favour if the executor is doing what you wish. However, what if the executor is your spouse and you want them to appoint your son from your first marriage as the director? This could lead to problems.

The section 201F power would only be of any use if the shareholders of the company agreed to your appointment or were prevented from appointing someone else. It is therefore a good idea to ensure that you give the shares in the company to the person you want to appoint.

That way, you will not leave it up to others to decide what will happen to the shares and therefore the directorship of the company.

Companies with multiple directors and shareholders

In companies where there is more than one director and more than one shareholder, things become more interesting.

Simple statements in the constitution of the company or the trust deeds of the family trust or the superannuation fund do not have the necessary power at law to ensure that the person you have chosen to take over your role as director will in fact be appointed.

For example, if you do not give that person a majority shareholding, then the remaining shareholder(s) can change the constitution to take out any such direction.

Generally, this is the same with any trust deed, including a superannuation fund deed.

And in any case, the trust deed is the rule book for the trust or the fund. It does not have the power to deal with the corporate issues relating to the trustee any more than the constitution of the company can dictate the terms of any trust for which the company takes control. These are separate structures with different roles and separate constituent documents not capable of dealing with one another's issues.

One solution that suggests itself is for the directors to pass a resolution now appointing the person you want to be a director, but delaying that appointment until your death. Although it looks good at first glance, it is dangerous because there is nothing to stop the directors from passing a different resolution later.

The law on boards of directors binding themselves in the future by passing irrevocable resolutions is scant indeed. However, it seems that boards are not able to do this because it could fetter their future and might jeopardise their ability to comply with their considerable statutory and common law directors' duties.

Then there is the problem of what happens if the board changes in any way. Will the new director(s) have a different view and argue that they cannot be bound by a previous resolution?

Steps to secure future wishes

Although the idea of action now that binds the future may be fraught with danger, as long as you are careful and thorough in your arrangements, the following steps can help to achieve what you want.

First, amend your company's constitution (via a shareholders' meeting) permitting the passing of irrevocable resolutions by shareholders, giving only to your shares the power of appointment of your successor director and appointing your appointee (by name or description, for instance, 'My first-born son') as the successor to your board position. Do you need a substitute appointment in case the successor director is unavailable at the time?

Avoid the trap of later updating your company's constitution by adopting a whole new constitution and not remembering the successor director clause. You may be able to cover this with wording that says the clause carries over into any new constitution, and any attempt to amend, revoke or delete it is invalid.

Ensure the successor director signs a consent to act as director in the appropriate form now. If the company is the trustee of an SMSF, ensure the successor director signs all the necessary Australian Taxation Office forms and declarations to become a director of an SMSF trustee, and is not a disqualified person.

(In an SMSF context, a non-member can only be a director if there is no surviving member or if the non-member is a deceased member's legal personal representative (executor) and is arranging for the deceased member's death benefits to be paid out from the fund as soon as possible.)



The quote

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Second, pass a shareholders resolution appointing your appointee as a director of the company at the time of your death. Ensure the resolution is stated to be irrevocable without your consent, and which the right to consent dies with you (so your executor cannot consent to a change in order to stymie your appointment).

Third, if you can, have the other shareholders execute a deed declaring that they will give effect to your appointment when the time comes. They do not have to be paid or receive any benefit (what is called 'consideration') to bind themselves in a deed.

If shareholders change before the appointment takes place, you may need to renew the deed with the new shareholders.

This process is clearly cumbersome, but it may be the only way to have any chance of stopping the other shareholder directors from blocking or refusing to implement the appointment of your chosen successor for whatever reasons they may have. **FS**