"BONA FIDES" AND "PROPER PURPOSES" IN CORPORATE DECISIONS

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INTRODUCTION

Few things in company law are as simple as they used to be — and on this occasion, for once, I am not referring to the great volume and complexity of our legislation: my topic is in the realm of case-law. We have inherited from our fathers some well-worn and fairly simplistic rules and concepts, largely laid down a hundred years or so ago in the English courts of chancery; and with these we have been able to make do, aided by a little adaptation and fudging, for much of the present century. But it is becoming apparent that we cannot rely on yesterday's law for much longer; and some major shifts are already perceptively under way, both in the rules and concepts being used, and in judicial attitudes and techniques.

It is not difficult to find underlying explanations for this. The English companies whose affairs came before the courts of last century were largely stereotypes: substantial commercial enterprises dedicated to the maximising of profit, with widely dispersed shareholdings. There was a pervading *laissez-faire* philosophy, and both the rules of chancery and the judges who administered them were well suited to enforcing standards of honesty and integrity, but not to undertaking the review of corporate decision-making on any objective basis: a simple test of *bona fides* and a doctrine of *ultra vires* still tolerably vigorous were sufficient to enable at least the more egregious irregularities to be struck down. But nowadays company law rules can no longer be formulated with reference to a notional paradigm commercial enterprise — we have on the one hand incorporated quasi-partnerships, small family concerns, members' clubs and property-owning co-operatives which bring intimate human considerations to the fore; and we have also joint ventures, conglomerates and the multinationals with complexities of quite a different order. That modern phenomenon, the take-over bid, was beyond the experience and perhaps even the imagination of Lindley or Buckley — yet it is no coincidence that many of the cases that we are about to refer to are concerned with it. Today, in contrast, at least in Australia, we have judges who have themselves sat at boardroom tables and are no strangers to corporate power struggles and intrigues; and the same judges have evolved intricate and far-reaching principles for the review of administrative decisions in the public law field. It is not surprising that we are witnessing the emergence of a new

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corpus of rules and concepts for the review of corporate decisions, and a fresh judicial approach in this area which is unashamedly more interventionist. Necessarily, this is taking place at the expense of the simplicity of the old law, and perhaps also of a degree of predictability.

Our study is concerned with one small aspect of this change: the shift in emphasis from "*bona fides*" to "proper purposes" as a test for the validity of directors' decisions, and the coincidental displacement of subjectivity by objectivity, of *laissez-faire* by interventionism. There will be occasion also to ask incidentally how far a parallel development may be occurring in relation to corporate decisions made by shareholders at general meetings and class meetings.

It is not the object of this article to contend that any one view is immutably correct and another wrong, or even that one approach is better than another. Rather, it is to observe a judicial process in action, and to follow it over a period of time. We should not think in terms of right and wrong, but bear in mind the wise observations of Jacobs J. in *Crumpton* v. *Morrine Hall Pty. Ltd.*[1] spoken in relation to shareholders' resolutions to alter articles, but applicable generally to our subject:

> "It seems to me that the truth is that the courts in each generation or in each decade have set a line up to which shareholders have been allowed to go in affecting the rights of other shareholders by alterations of Articles of Association, and beyond which they have not been allowed to go. It seems to me that no amount of legal analysis or analytical reasoning can conceal the fact that the decision has in the past turned, and must turn ultimately, on a value judgment formed in respect of the conduct of the majority — a judgment formed not by any strict process of reasoning or bare principle of law but upon the view taken of the conduct."

"BONA FIDES" AND "PROPER PURPOSES"

It is something of a curiosity that the first edition of Gower's Modern Company Law,[2] does not mention the present topic as a subject in its own right at all. Current English texts, following Gower's lead in his second edition, now commonly set out under separate heads a "duty to act bona fide" and a "duty to use powers for proper purposes", in consequence of the line of cases beginning with *Hogg* v. *Cramphorn Ltd.* [3] in which it appeared that a distinction was being made between these two requirements. In contrast, Australian books such as *Ford* focus solely on the latter duty and explain the "*bona fides*" requirement as "just another way of saying that the power must be used for the purpose for which it was conferred".[4] There is thus room for

[1] [1965] N.S.W.R. 240 at 244 (S.C.N.S.W.); cf. J.H. Farrar, [1974] C.L.J. 221 at 223, referring to the concept of "substantial purpose": "a crypto value judgment of the kind which courts find useful but which produces flexibility at the price of certainty."

[2] L.C.B. Gower, *Principles of Modern Company Law* (London, Stevens, 1954).

[3] [1967] Ch. 254 (C.A.).

[4] H.A.J. Ford, *Principles of Company Law* (Sydney, Butterworths, 4th ed., 1986) para. 1503 (hereafter "Ford"); following *Australian Metropolitan Life Assurance Co. Ltd.* v. *Ure*

debate whether we are to regard these duties as one phenomenon or two and, indeed, this is a debate in which I once rashly joined;[5] but I now believe that this is to ask the wrong question.[6]

DIRECTORS' DECISIONS AND SHAREHOLDERS' RESOLUTIONS

A starting-point for our discussion is the well-known extract from the judgment of Lord Greene M.R. in *Re Smith & Fawcett Ltd.*:

> "[W]here the articles of a company confer a discretion on directors . . . [t]hey must exercise their decision *bona fide* in what they consider — not what a court may consider — is in the interests of a company, and not for any collateral purpose."[7]

There are echoes here of the words of an earlier Master of the Rolls, Lord Lindley — speaking this time, however, of the power conferred by statute upon the *shareholders* of a company to alter its articles of association:

> "Wide, however, as the language of [the section[9]] is, the power conferred by it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also *bona fide* for the benefit of the company as a whole, and it must not be exceeded."[8]

In view of the common themes evident in these remarks, it is a simple step to run them together into a composite formulation, as was done by the High Court in *Ngurli Ltd.* v. *McCann*:

> "[T]he powers conferred on shareholders in general meeting and on directors by the articles of association of companies can be exceeded although there is a literal compliance with their terms. These powers must not be used for an ulterior purpose . . . Voting powers conferred on shareholders and powers conferred on directors . . . must be used *bona fide* for the benefit of the company as a whole."[10]

These attempts to synthesise the law may not be wholly legitimate, for they ignore the fact that the two sets of rules may be traced to different sources,[11] and they overlook the crucial element, so far as directors' decisions are concerned, that their powers are fiduciary — so that, for example, they may not contract to fetter their discretion, while shareholders may lawfully do so. But in the present context, the similarities appear to be more relevant than the differences. Even so, we plainly ought to ask whether and for what purposes it may be useful to make a distinction between the two sets of rules. And as a

(1923) 33 C.L.R. 199 at 217, per Isaacs J. (H.C.A.), *Provident International Corpn.* v. *International Leasing Corpn.* [1969] 1 N.S.W.R. 424 at 436 (S.C.N.S.W.).

[5] [1967] C.L.J. 33.

[6] See section headed "Corporate Decisions: One Duty, or Several, or None?"

[7] [1942] Ch. 304 at 306 (C.A.).

[8] *Allen* v. *Gold Reefs of West Africa Ltd* [1900] 1 Ch. 656 at 671 (C.A.).

[9] *Companies Act* 1862 (UK), s.14 [*Companies Code* (Aus.), s.76].

[10] (1953) 90 C.L.R. 425 at 438, *per cur.* (H.C.A.).

[11] P.D. Finn, *Fiduciary Obligations* (Sydney, Law Book Co., 1977) para. 139.

supplementary issue, we may ask whether the "*bona fide*" test, as it is applied to decisions reached by members of a class at a class meeting,[12] calls for any special comment.

CORPORATE DECISIONS: ONE DUTY, OR SEVERAL, OR NONE?

The textbooks, as we have seen, refer to a "*duty* to act *bona fide*", a "*duty* to use powers for proper purposes", etc.; but I believe that the best approach to this issue is to recognise that we are not, first and foremost, talking about duties, and perhaps not talking about duties at all: we are concerned with the grounds upon which a corporate decision may be challenged as irregular and held to be void or voidable. Where the court holds that a decision is invalid, it may use a variety of explanations for its ruling, some at least of which are interchangeable.[13] This has long been recognised as true in administrative law: "improper motives", "abuse of power", "*ultra vires*", "unreasonableness", "failure to take account of relevant considerations", etc. are criteria which it is "impossible to separate cleanly".[14] So, too, in company law, the court may say that the relevant power has been abused, or exceeded, or not genuinely exercised, or that those who exercised it acted upon irrelevant considerations, or from an improper motive. Any one of these factors, if shown to have been present, may be considered sufficient to strike a decision down; it does not follow that this will necessarily or always be the case, still less that the absence of every one of them must affirmatively be proved before a decision can stand. It is therefore misleading to speak of a director or a shareholder as being under a "duty" to vote in any particular way — for example, to cast his vote in the interests of the company or the relevant class.[15] If there were such a duty, selfish votes cast in opposition by a minority shareholder ought to be disallowed as well.[16]

SOME LATENT AMBIGUITIES

In addition to the proliferation of expressions used as tests for pronouncing a decision invalid, the move towards greater judicial intervention has benefited from the fact that many of the key terms used admit of several interpretations or shades of meaning. This uncertainty has given much scope for many creative rulings, as the following sections show.

[12] *British America Nickel Corpn. Ltd.* v. *O'Brien* [1927] A.C. 369 (P.C.).

[13] In *Australian Metropolitan Life Assurance Co. Ltd.* v. *Ure* (1923) 33 C.L.R. 199 (H.C.A.), for instance, the three members of the Court reached the same conclusion on the basis of contrasting lines of reasoning: Knox C.J. spoke in terms of *bona fides*, Isaacs J. asked whether the power had been exercised for a proper purpose, and for Starke J. the inquiry was whether the decision had been based on relevant grounds. Again, in *Advance Bank Australia Ltd.* v. *FAI Insurances Ltd.* (1987) 9 N.S.W.L.R. 464 (C.A.N.S.W.), there were differences of opinion on whether the directors' purpose was a proper one, but agreement that they had abused or exceeded their authority.

[14] See H.W.R. Wade, *Administrative Law* (6th ed., Oxford, 1988), ch. 12, and esp. at p. 411.

[15] As in *Re Holders Investment Trust Ltd.* [1971] 1 W.L.R. 583 (Ch.D.), based on *British America Nickel Corpn. Ltd.* v. *O'Brien* [1927] A.C. 369 (P.C.).

[16] But they are not: see *Re Hellenic & General Trust Ltd.* [1976] 1 W.L.R. 123 (Ch.D.).

BONA FIDE

The expression *"bona fide"* itself is not free from ambiguity. The dictionary gives two meanings: "in good faith", and "genuine". The former, a subjective application, is more naturally used in relation to human beings, in the sense of "honestly, with the best of intentions". In contrast, and more objectively, we may describe an act, activity or state of affairs as "*bona fide*", meaning "genuine": for example, we can speak of a shareholders' resolution as being a *bona fide* expression of corporate opinion when it has not been distorted by some irregularity such as the rigging of votes or the bribery, intimidation or improper bias of some of the members.

Much confusion would have been avoided if the time-honoured phrase, "*bona fide* in the interests of the company as a whole" had always been understood in the second of these senses. The current English view that regards "proper purposes" as a separate test probably developed because the words "*bona fide*" had wrongly become separated from the composite phrase, leading to a contention that a subjective honesty of purpose was all that needed to be shown in order to repel a challenge to the exercise of a discretion. This has never been the case, either in relation to powers generally or more specifically in the context of corporate powers. In *Hutton* v. *West Cork Rly. Co.*,[17] in a judgment (dealing with implied powers) which appears to embrace both directors' and shareholders' decisions, Bowen L.J. said:[18]

> "What would be the natural limit of their power . . . ? *Bona fides* cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly *bona fide* yet perfectly irrational."

We shall return to the "amiable lunatic" phenomenon shortly; for the moment, let us look at the term "*bona fide*", and accept that for our purposes it is better taken to mean "genuine" rather than "honest". This is well brought out in the modern case of *Re Halt Garage Ltd*,[19] where Oliver J. struck down as not a "genuine award of remuneration" the payment of a substantial salary to a bedridden director.

"THE COMPANY AS A WHOLE"

This is a phrase of notoriously elusive meaning.[20]

Modern commentators strive to make it mean all things to all men by adding gloss after gloss — shareholders present and future, employees, credi-

[17] (1883) 23 Ch.D. 654 (C.A.).

[18] Id. 671 (C.A.). The issue was one of *ultra vires*, and so Bowen L.J.'s remarks were applicable equally to the decision of either organ.

[19] [1982] 3 All E.R. 1016 (Ch.D.).

[20] F.G. Rixon, "Competing Interests and Conflicting Principles: an Examination of the Power of Alteration of Articles of Association" (1986) 49 M.L.R. 446 at 448; C. Baxter, "The True Spirit of *Foss* v. *Harbottle*" (1987) 38 N.I.L.Q. 6 at 30.

tors — so that what emerges is an ill-focused conglomerate.[21] The better view, surely, is to say that it can mean different things in different contexts.

After *Salomon* v. *Salomon & Co. Ltd.*,[22] we ought most naturally to understand the phrase as meaning the company as a commercial entity ("it", "the enterprise"); and we probably should do so, so long as some benefit to "it" is discernible as relevant to the issue. Thus, it is arguable that any corporate decision which is justifiable by reference to the long-term profitability or well-being of the commercial entity will not, or not merely, be open to objection because it is harmful to some of the interests which collectively make up the enterprise — for example a section of the members, or even, in the short term, all the members.[23] We must not, of course, make the mistake of thinking that such a finding will be conclusive of the validity of the decision: the decision-making organ may have exceeded or in some other respect abused its powers, for instance.

The other well-known meaning ascribed to "the company as a whole" is "the membership", "the shareholders, collectively". In *Greenhalgh* v. *Arderne Cinemas Ltd.*, Lord Evershed M.R. distinguished between "the company as a commercial entity, distinct from the corporators" and "the corporators as a general body", and went on to say that "*at any rate in such a case as the present*"[24] the latter meaning was the appropriate one. This was undoubtedly both natural and correct: the issue was an alteration of articles, that is to say, an amendment of the social contract between the members, and what they as a body thought it was best in their own interests to do was their own business. But I do think it important not to overlook the passage which has been italicised. There are other decisions which fall to be made by shareholders where they must be entitled to make the benefit of the company as a commercial entity the paramount consideration. In such a situation there will always, of course, be room to argue that there will be derivative benefits for the members and so the two definitions of "the company as a whole" add up to much the same thing; but it must surely be more helpful to focus attention on the corporate body when that is what most matters. In such a case, a higher degree of discrimination against a minority might be thought acceptable than when the issue is purely one affecting the rights of members *inter se*. It is not wrong even for shareholders voting at a class meeting to put the well-being of the entity above the personal interests of the class members.[25]

Thus, "the company as a whole" may include longer-term interests when we are dealing with an ongoing commercial entity, but not when a winding up is imminent.[26] Creditors' interests may be irrelevant in the former case, but

[21] See, e.g. *Darvall v. North Sydney Brick & Tile Co. Ltd.* (1987) 12 A.C.L.R. 537 at 554 (S.C.N.S.W., since affd. on appeal (1989) 7 A.C.L.C. 659 (C.A.N.S.W.).

[22] [1897] A.C. 22 (H.L.).

[23] *Mutual Life Insce. Co. of New York* v. *Rank Organisation Ltd.* [1985] B.C.L.C. 11 (Ch.D.); contrast *Galloway* v. *Halle Concerts Society* [1915] 2 Ch. 233 (Ch.D.), where the suggested benefit to the company was regarded as insufficient to justify a directors' discriminatory decision.

[24] [1951] Ch. 286 at 291 (C.A.), emphasis added.

[25] *Rights and Issues Investment Trust Ltd.* v. *Stylo Shoes Ltd.* [1965] Ch. 250 (Ch.D.).

[26] *Hutton* v. *West Cork Rly. Co.* (1883) 23 Ch.D. 654 (C.A.); *Parke* v. *Daily News Ltd.* [1962] Ch. 927 (Ch.D.).

paramount in the latter.[27] And where a decision is not justifiable one way or the other by reference to the well-being of the enterprise, the court can rightly shift the emphasis to the question of fairness as between the individual corporators.[28]

But every attempt to generalise is fraught with danger. We cannot disregard the particular features of the individual company. Even where "the company" is properly regarded as the collective membership, the law will be much more astute to protect membership rights where the company exists to facilitate a home-ownership scheme[29] and far less concerned if it is simply a members' club.[30] *Dicta* explaining concepts such as "the company as a whole", tacitly formulated by reference to the commonplace stereotype of commercial company, are of little value in these special contexts.[31]

POWERS

Most of the discussion of "proper purposes" is concerned with the powers of directors. Sometimes, as in the extract from *Ngurli Ltd.* v. *McCann*[32] cited above, there is reference to the powers of shareholders. In contrast, in what appears to be carefully chosen language, Browne-Wilkinson L.J. in *Rolled Steel Products (Holdings) Ltd.* v. *British Steel Corpn.* refers to "excess or abuse of the powers of *the company*" and "a wrongful exercise of *its* powers".[33] This, I believe, contains a useful clue to our discussion as a whole. After the abolition of the doctrine of *ultra vires*, we can no longer speak of a company exceeding its own powers, for it has unlimited capacity. It is also unnatural to think of the company itself, as an abstraction, abusing its powers or exercising them wrongfully. It is much more straightforward to attribute misdeeds of this kind to the organ or agent who makes the decision or performs the act in question. If, then, we are concerned with corporate powers which are capable of being limited to "proper" purposes (for example a power to borrow, to give guarantees or to alienate property, which even after the abolition of *ultra vires* may only "properly" be used for the purposes of the company's business), it should not be material whether the improper act is that of the directors or the shareholders; and it ought to follow that the shareholders cannot regularise an improper act of the directors.

But the issues are quite different when we put aside the company's own powers and look at those of the particular organ or agent. The first step is to determine what the division of powers is between the different organs of the

[27] *Kinsela* v. *Russell Kinsela Pty. Ltd.* (1986) 10 A.C.L.R. 395 (C.A.N.S.W.); *Nicholson* v. *Permakraft (N.Z.) Ltd.* [1985] 1 N.Z.L.R. 242 (C.A.N.Z.); *West Mercia Safetywear Ltd.* v. *Dodd* (1988) 4 B.C.C. 30 (C.A.).

[28] *Mills* v. *Mills* (1938) 60 C.L.R. 150 (H.C.A.).

[29] *Crumpton* v. *Morrine Hall Pty. Ltd.* [1965] N.S.W.R. 240 (C.A.N.S.W.); *Estmanco (Kilner House) Ltd.* v. *G.L.C.* [1982] 1 W.L.R. 2 (Ch.D.).

[30] *Gaiman* v. *National Assn. for Mental Health* [1971] Ch. 317 (Ch.D.).

[31] These considerations are also relevant to the question of determining the scope of a power: see section headed "Powers".

[32] Supra n. 10.

[33] [1986] Ch. 246 at 303ff. (C.A.), emphasis added.

company, under its articles of association. The standard division will be between the general meeting and the board of directors, along the lines of Table A;[34] but exceptionally some powers may be allocated to other persons or bodies.[35]

In the early, formative days of company law, there was no strict demarcation of function between the board and the general meeting. It was accepted that, within the limits of legality and *vires*, the shareholders were sovereign and the directors no more than their delegates or agents. The only other limit on the power of the shareholders that would have been recognised would have been the embryonic "fraud on the minority", as exemplified in the cases of *Atwool* v. *Merryweather*[36] and *Menier* v. *Hooper's Telegraph Works*[37] — self-serving abuses of majority power so blatant that judges in equity did not need concepts as subtle as a "proper purposes" test to strike them down: the label "fraud" was well understood, and sufficient.

Today, it is accepted that the general meeting and the board of directors cannot normally usurp each other's powers: each holds exclusive sway within its own sphere. Any direct attempt to transgress these limits of autonomy will automatically be ruled incompetent; an act in excess of the organ's powers. But what of an act which is on the face of it within the powers of one organ — say, the board of directors — but which also brings about an *indirect* result which might more properly be seen as being within the province of the other? For example, the well-known instances in which directors have used defensive tactics in the face of a take-over bid which deprive the shareholders of their normal freedom to sell their shares and to decide who should wield control in their company? A "proper purposes" test has a real role to play here, because it allows the issue of constitutionality to be raised:

> "[I]t must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with that element of the company's constitution which is separate from and set against their powers."[38]

It is not so easy to conceive of a converse case, in which the shareholders have indirectly invaded territory which belongs constitutionally to the directors, but perhaps the *Estmanco* case[39] comes somewhere near to it: the Council, as the sole voting shareholder, used its votes (and its influence as the employer of the directors) to bring about the discontinuance of an action

[34] *Companies Code* (Aus.), Sch. 3, Table A, art. 66; Companies (Tables A to F) Regulations 1985 (U.K.) (S.I. 1985 No. 805), Table A, art.70.

[35] E.g., in *Whitehouse* v. *Carlton Hotel Pty. Ltd.* (1987) 11 A.C.L.R. 715 (H.C.A.) and in *Ngurli Ltd.* v. *McCann* (1954) 90 C.L.R. 425 (H.C.A.) the constitution of the company conferred plenary powers on a single director.

[36] (1867) L.R. 5 Eq. 464n. (V.-C.).

[37] (1874) 9 Ch.App. 350 (C.A.).

[38] *Howard Smith Ltd.* v. *Ampol Petroleum Ltd.* [1974] A.C. 821 at 857 (P.C.); *cf. Hogg* v. *Cramphorn Ltd.* [1967] Ch. 254 at 268 (Ch.D.); *Whitehouse* v. *Carlton Hotel Pty. Ltd.* (1987) 11 A.C.L.R. 715 at 718 (H.C.A.); *Advance Bank Australia Ltd.* v. *FAI Insurances Ltd.* (1987) 9 N.S.W.L.R. 464 at 477; *Darvall* v. *North Sydney Brick & Tile Co. Ltd.* (1987) 12 A.C.L.R. 537 at 552 (S.C.N.S.W.).

[39] *Estmanco (Kilner House) Ltd.* v. *Greater London Council* [1982] 1 W.L.R. 2 (Ch.D.).

which the directors had instituted against it, thereby "stultifying the purpose for which the company was formed". Accordingly, the Council's intervention was ruled to be improper. (The "purpose" in question was the management of a block of owner-occupied flats; the Council wished to use part of the block to house the needy.)

In a well-known passage in his judgment in *Winthrop Investments Ltd.* v. *Winns Ltd.*,[40] Mahoney J.A. left open the question whether a decision of the directors which was voidable on "proper purposes" grounds could be validated by a resolution of shareholders who were motivated by the same purposes as the directors — in the case in question, to repel a take-over bid. The answer, on the argument advanced above, ought surely to have been "yes", since the reason why the directors' act was under attack as "improper" was that they were usurping the constitutional role of the shareholders themselves — *i.e.*, to determine where control of the enterprise should ultimately lie. In the circumstances, it would have been entirely "proper" for the shareholders to ratify the directors' acts. In contrast, if the directors' act can be regarded as an abuse of the company's *corporate* powers, the propriety of the shareholders' resolution to ratify may be vulnerable to attack on the same grounds as the decision of the directors.[41] [42]

To return to the notion of "corporate" purposes: although we may no longer have a doctrine of *ultra vires*, it is open to a shareholder to challenge an act or proposed act as being beyond the company's powers, as expressed in its memorandum of association, or as being an abuse of those powers. The *Rolled Steel* case[43] makes it plain that it may still be relevant to construe the memorandum in order to ascertain the scope of a corporate power for this purpose. It is of course possible, by taking advantage of the various benign rulings of the courts over the years, to ensure that a modern-day memorandum is drafted so as to impose rather less restriction on the company's activities than would have been the case last century; but gratuitous and self-serving dispositions, and analogous transactions such as guarantees, can still be caught under the rubric of an improper use of powers — and, indeed, this is now

[40] [1975] 2 N.S.W.L.R. 666 at 700-702 (N.S.W.C.A.).

[41] *Kinsela* v. *Russell Kinsela Pty. Ltd.* (1986) 10 A.C.L.R. 395 (S.C.N.S.W.). This analysis may help to explain some other puzzling cases. In *North-West Transportation Co. Ltd.* v. *Beatty* (1887) 12 App. Cas. 589 (P.C.), it was not an abuse of corporate powers to buy the ship: the shareholders could therefore "properly" ratify the purchase which the directors were not competent to agree to; but in *Cook* v. *Deeks* [1916] 1 A.C. 554 (P.C.), the shareholders were no more competent than the directors themselves to sanction what in the view of the court was the expropriation of corporate property. (However, some even more baffling cases, *e.g. Regal (Hastings) Ltd.* v. *Gulliver* [1967] 2 A.C. 134n., cannot be disposed of quite so easily.)

[42] The above reasoning may contain a clue to the vexed but still unresolved question whether, or at least in what circumstances, an individual shareholder may, notwithstanding *Foss* v. *Harbottle* (1843) 2 Hare 461, maintain an action to restrain an act of the directors which is allegedly in furtherance of an improper purpose. If the directors are acting unconstitutionally, the case for allowing a shareholder standing is stronger than if they are in some other way acting in breach of their fiduciary duties. (*Cf. Residues Treatment and Trading Co. Ltd.* v. *Southern Resources Ltd.* (1988) 6 A.C.L.C. 1160 (S.C.S.A.). There is unfortunately not space in this article to consider this difficult issue.

[43] *Rolled Steel Products (Holdings) Ltd.* v. *British Steel Corpn.* [1986] Ch. 246 (C.A.).

likely to be one of the courts' best weapons to strike down the unjustifiable dissipation of corporate assets. In construing a memorandum, the judges will necessarily have to identify those purposes which can be regarded as "corporate" and for which, accordingly, powers may legitimately be used. Some objects clauses may make this plain: a charitable company, a flat-ownership company, a members' club. Many, indeed most, others may allow a judge to apply broad commercial criteria as a matter of inference.[44] It will, no doubt, be open to a court to give weight to the fact that a company has been set up to run a family business or a quasi-partnership and accordingly, if the memorandum is drawn in broad enough terms, to sanction dispositions by way of salary, pension, etc. which might in another context be thought unjustified. However, in those jurisdictions where the objects clause has been made optional or been abolished, the courts may lack an important guide to aid them in this interpretative task.

PURPOSES

We have been talking of corporate purposes in an abstract and objective sense: commercial purposes, charitable purposes, etc. But when we use the word "purpose" in relation to individuals, we are more likely to be referring to the end or object that they have in view, which may be immediate (such as concluding a contract) or rather more remote (such as establishing or maintaining an important business connection); and from this it is easy to slip into language of motive and reason, which is likely to be partly or wholly subjective. My motive may be to return a favour or, progressing to the purely abstract, it may be pleasure or ambition, greed or anger — attributes which cannot sensibly be ascribed to a company, and cannot be termed corporate purposes, or in themselves considered determinative of the "proper" exercise of a power. In a similar way, we can talk of the "reason" or "reasons" for a person's actions both in a sense which may overlap with the notion of purpose (for example, maintaining a business connection), or may not (because someone was holding a gun to his head), and which may also lead into the purely abstract (panic).

There is much scope for confusion here between one sense of the word "purpose" and another. In *Peters' American Delicacy Co. Ltd.* v. *Heath*,[45] Dixon J. pointed to the contrast between the motives of individuals and the purpose of a resolution, but it is easy to overlook this distinction. A court wishing to strike down a decision may refer to an individual's purpose (in subjective terms), such as the desire to see off a corporate raider, and then declare that this is not a "proper" corporate purpose (slipping into objective language). This is surely a false comparison.

In two important recent decisions, courts of high standing have made a distinction between "purpose" and "reason" in relation to a corporate act. In

[44] Cf. Nourse L.J. in *Brady* v. *Brady* [1988] B.C.L.C. 20 at 38 (C.A., reversed on other grounds [1988] 2 W.L.R. 1308. H.L.).
[45] (1939) 61 C.L.R. 457 at 513 (H.C.A.).

the first, *Whitehouse* v. *Carlton Hotel Pty. Ltd.*,[46] the governing director of a company used his exclusive power to allot controlling (but otherwise valueless) shares to his sons because he believed that it was in the overall interests of the company that control should pass after his death to them rather than his estranged wife; but a majority of the High Court said that this was merely a "reason" for the impermissible allotment and not a competing permissible purpose. The entire judgment, however, is not so much reasoned as question-begging — though no doubt defensible on the merits of the particular case.

In *Brady* v. *Brady*[47] the House of Lords had to construe a statutory provision[48] which permits the giving of financial assistance if *the company's purpose* in doing so is "but an incidental part of some larger purpose *of the company*". The argument was that it was in the company's interests to have a deadlock in its management resolved, and this was a "larger purpose". Lord Oliver conceded that to end the dispute was both subjectively (in the eyes of the directors) and objectively in the interests of the company. But the contention failed. The judgment comes close to holding that nothing which can be characterised as a motivation of the directors or shareholders is capable of being a corporate purpose — or at least a corporate purpose "larger" than the giving of financial assistance itself. Such matters as avoiding liquidation, preserving goodwill, securing a more competent directorate which would make the company more profitable, as well as the breaking of a management deadlock, might be "excellent reasons", but could not constitute a "larger purpose" justifying the provision of financial assistance.

The *Brady* case may perhaps be explained by reference to the particular wording of the statutory provision, and the presumed legislative object underlying it; but it is apparent from these two cases that a "purpose" which might *prima facie* be claimed to be "proper" may not survive even the first round of argument if the court chooses to debase it by characterising it as a mere "reason". However, fortunately there is support for a contrary argument: in *Peters' American Delicacy Co. Ltd.* v. *Heath*,[49] the High Court considered that the power conferred *upon the members* to alter articles could properly be used for the purpose of resolving an internal dispute.

Another differentiation which a court may make is that between the various purposes for which a power may be exercised, using the term "purpose", this time, in a narrower sense: we know, for instance, that the directors' power to issue shares may be used to raise needed capital, but not, *prima facie* (at least as the cases have held)[50] to ward off an asset-stripper whose intentions may be thought inimical to the well-being of the company. To lay down the limits of the purposes within which a power may be properly exercised is a question of

[46] (1987) 11 A.C.L.R. 715 (H.C.A.).
[47] [1988] 2 W.L.R. 1308 (H.L.).
[48] *Companies Act* 1985 (U.K.), s.153(2).
[49] (1939) 61 C.L.R. 457 at 513 (H.C.A.).
[50] But see *Cayne* v. *Global Natural Resources p. l. c.* (unreported, Megarry V.-C., 12 August 1982, noted (1982) 56 A.L.J. 600, affd. on other grounds [1984] 1 All E.R. 225, C.A.).

law[51] — although the exact nature of the process involved is largely concealed from us, first, because the judges have consistently declared that the question can be settled only "upon broad lines"[52] and, secondly, because in practice they work with hindsight, by first determining on the evidence what the directors' purpose (or, frequently, motive) in fact was, and then declaring without closely reasoned argument whether it lies within or without the bounds of permissibility. One has only to read the Australian cases dealing with share issues made in the context of a threatened bid[53] to become aware that the learned language only serves to conceal the reality: the courts are in truth making naked value judgments. Even the High Court's somewhat surprising *obiter dictum* in *Whitehouse* v. *Carlton*[54] that a "single causative" test should replace a "substantial purpose" test does not seem to have affected judicial attitudes in subsequent cases: lip-service is paid to the new formula, but essentially the same value judgment is made.[55]

As has been observed above,[56] the identification of a purpose or the characterisation of a purpose as "substantial" is also a value judgment, which affords much scope for flexibility. In the *Advance Bank* case,[57] for instance, there are suggestions at different times that the directors' purpose may have been: to further the best interests of the company, to hold a proper election, to further the directors' own policies (which they believed were in the best interests of the company), to secure the re-election of certain directors sympathetic to those policies, and to ensure the defeat of the rival candidates. It is easy to see that what may be little more than an impressionistic judgment on this question may prove determinative of the entire issue before the court.

[51] This must be so, for it ultimately turns on the construction of the articles or other document conferring the power. The courts will readily hold that a power to refuse registration of transfers may be used to keep out an unwanted member, but not a power to issue shares — even shares created with no other function but to regulate control (*Whitehouse* v. *Carlton Hotel Pty. Ltd.* (1987) 11 A.C.L.R. 715; contrast *Australian Metropolitan Life Assurance Co. Ltd.* v. *Ure* (1923) 33 C.L.R. 199 (H.C.A.), and cf. *T.C. Newman (Qld.) Pty. Ltd.* v. *D.H.A. Rural (Qld.) Pty. Ltd.* (1987) 12 A.C.L.R. 257 at 275 (S.C.Qd.: power to reallocate shares of retiring shareholder). But even in the *Whitehouse* case it was conceded that the article could have been drafted in a way that made such a purpose legitimate (at p. 719).

[52] *Howard Smith Ltd.* v. *Ampol Petroleum Ltd.* [1974] A.C. 821 at 835 (P.C.); *Darvall* v. *North Sydney Brick & Tile Co. Ltd.* (1987) 12 A.C.L.R. 537 at 556 (S.C.N.S.W.).

[53] See, e.g., *Harlowe's Nominees* v. *Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483 (H.C.A.); *Ashburton Oil N.L.* v. *Alpha Minerals N.L.* (1971) 123 C.L.R. 614 (H.C.A.); *Ampol Petroleum Ltd.* v. *R.W. Miller (Holdings) Ltd.* [1972] 2 N.S.W.L.R. 850 (Eq.D.N.S.W., affd. *sub nom. Howard Smith Ltd.* v. *Ampol Petroleum Ltd.* [1974] A.C. 821, P.C.); *Pine Vale Investments Ltd.* v. *McDonnell & East Ltd.* (1983) 8 A.C.L.R. 199 (S.C.Qd.); *Condraulics Pty. Ltd.* v. *Barry & Roberts Ltd.* (1984) 8 A.C.L.R. 915 (S.C.Qd.); and the cases cited in n. 55, infra.

[54] (1987) 11 A.C.L.R. 715 at 721, *per* Mason, Deane and Dawson JJ.

[55] See, e.g., *Darvall* v. *North Sydney Brick & Tile Co. Ltd.* (1987) 12 A.C.L.R. 537 (S.C.N.S.W.); *McGuire* v. *Ralph McKay Ltd.* (1987) 12 A.C.L.R. 107 (S.C. Vic.).

[56] Farrar op. cit. supra n. 1.

[57] *Advance Bank Australia Ltd.* v. *FAI Insurances Ltd.* (1987) 9 N.S.W.L.R. 464 (C.A.N.S.W.).

OBJECTIVE OR SUBJECTIVE?

Traditionally (though not without occasional aberrations),[58] it has always been understood that corporate decision-making is solely a matter for the *bona fide* subjective determination of the appropriate organ, and that the court will not intervene to overrule any such decision or to substitute its own view. This goes hand in hand with the view that business decisions are a matter for business men, and not subject to review by the courts. However, even under this venerable test, there has always been a bottom line, an objective threshold of reasonableness below which *bona fides* will not of itself be sufficient for a decision to stand. If the decision is one that no reasonable body of directors or shareholders acting upon proper considerations could conceivably have reached, the court can strike it down. This is hallowed in company folklore as the "amiable lunatics" test:[59] administrative lawyers will recognise it as similar to their own concept of irrationality (or "*Wednesbury*" unreasonableness);[60] and it is not dissimilar from the basis upon which an appeal court may reverse a finding of primary fact. To put the matter another way, a decision of a corporate organ can normally be attacked only by impugning the integrity or regularity of the process, and not the reasonableness of the result; but, exceptionally, a result may be so unreasonable that the court is entitled to infer that it has not been reached by a proper process. In this way, an element of objectivity can, in theory, be introduced into an inquiry that is basically determined by subjective considerations. But in practice the "amiable lunatics" test, as such, has not been used: it is hard to find a single example of its application in the *rationes decidendi* of all the company law cases ever reported.

However, the modern emphasis on "proper purposes" has let in criteria which give judges of an interventionist inclination far greater scope to go into the evidence, to assess matters objectively, and in effect to impose their own views. What is novel is not the approach,[61] but the frequency with which it is now invoked. When the emphasis was on *bona fides*, and the onus of proof of want of it was on the plaintiff, and a judicial attitude of *laissez-faire* prevailed, it was very hard indeed to upset the subjective opinion of the directors or of the majority that what they were deciding was in the interests of the company; but the "proper purposes" test virtually obliges the decision-makers to go into the witness-box and justify their actions and, further, to run the risk that their evidence may be rejected. Of course, this will not be a practical possibility for

[58] E.g. *Dafen Tinplate Co. Ltd.* v. *Llanelly Steel Co. Ltd.* [1920] 2 Ch. 124 (Ch.D.).

[59] *Hutton* v. *West Cork Rly. Co.*, supra n. 17.

[60] *Associated Provincial Picture Houses Ltd.* v. *Wednesbury Corpn.* [1948] 1 K.B. 223 (C.A.); cf. *Re a Company* [1988] 1 W.L.R. 1068, a company law case where *Wednesbury* was actually cited.

[61] This may be seen from the now frequently cited statement of Viscount Finlay in *Hindle* v. *John Cotton Ltd.* (1919) 56 Sc. L.R. 625 at 631 (H.L. Sc.): "Where the question is one of abuse of powers, the state of mind of those who acted, and the motive on which they acted, are all important, and you may go into the question of what their intention was, collecting from the surrounding circumstances all the materials which genuinely throw light upon that question of the state of mind of the directors".

shareholders' decisions in a company with widely dispersed shareholdings,[62] but the cases show that the courts can and do look to the question of motive, and draw adverse inferences where they feel that this is necessary, when the number of shareholders is small.[63]

CONCLUSION

It is clear from our examination of the cases that our judges now have a myriad of overlapping formulae which they can invoke if they are disposed to review corporate decisions, and particularly directors' decisions. The "proper purposes" concept may at one time have been little more than a fifth wheel on the coach, a rephrasing of the traditional test of *bona fides*; but (to change the metaphor) it has become a springboard for a major development in the law — a development that appears to have begun earlier, and has since been taken further,[64] in Australia than in England. It may still be true, in principle, that "business decisions are for business men", and not a matter for review by the courts, but for a judge of sufficiently robust disposition that principle is not the deterrent that it may once have been.

[62] Cf. Ford, para. 1703: "The test as to whether a resolution of a majority is an abuse of power is a wholly objective one if only because in a large public company it would be impracticable to canvass the intention of each member at the time of voting."

[63] *Clemens* v. *Clemens Bros. Ltd.* [1976] 2 All E.R. 268 (Ch.D.); *Pennell Securities Ltd.* v. *Venida Investments Ltd.* (Ch.D., unreported, 25 July 1981, noted by S. Burridge, (1981) 44 M.L.R. 40).

[64] This development may have been inhibited to some extent in England by the rule of the Take-over Code which prohibits virtually all forms of defensive action by the board of a target company: see the *City Code on Take-overs and Mergers*, General Principle 7.