interest but *bound* to do so; but the borderline between 'may' and 'must' in this context is probably meaningless, for there is no requirement that the interests of the employees should be *preferred* to those of the members. Additionally, there will be many cases in which a decision adverse to the employees will be justifiable by reference to the benefits of long-term profitability and thus the interests of the members. However, this is an argument that can cut both ways: a decision that is unpopular with the members or shareholders or adverse to their interest may also be defended because in reaching it the directors took account of its effect on the company's employees.
In *Re Welfab Engineers Ltd* [1990] BCLC 833, the company's liquidator alleged that the company's directors, faced with insolvency, had improperly sold the company's business for less than its full value. But Hoffmann J held them not liable because the purchaser was prepared to take on the company's workforce and work in progress, whereas another, higher, offer which they might have been able to accept was for the company's freehold premises alone, and would have led to all the employees being made redundant.

(p. 330) ➢ Questions

1. What difference does an enactment such as CA 1985 s 309(1) or CA 2006 s 172(1)(b) make in theory or in practice to company law?

2. The CLR described CA 1985 s 309 as 'ambiguous and unsatisfactory', but its repeal as 'neither desirable nor politically sustainable'. Has CA 2006 s 172(1)(b) resolved the issues?

Scope and nature of directors' general duties: CA 2006 s 170

The next sections of this chapter examine, in turn, each of the general duties imposed by CA 2006 Pt 10, ss 170ff.[23] The provisions themselves are not generally repeated in the text. It is essential, therefore, to have a copy of the Act close at hand.

Section 170 restates the fundamental principle that directors' duties are owed to the company (see earlier). This means that only the company can bring actions for a breach of these duties. Such actions may be initiated on behalf of the company by the board of directors, a liquidator, etc, or by means of a derivative action (see 'The statutory derivative action: CA 2006 ss 260ff', pp 642ff.

In addition, the duties in ss 175 (conflicts of interest) and 176 (benefits from third parties) *may* continue after a person has ceased to be a director, but they apply only 'to the extent stated' in s 710(2), and 'subject to any necessary adaptation', indicating that the courts may be flexible. Existing case law is likely to remain relevant, but this provision offers some clarification: see *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443; *CMS Dolphin Ltd v Simonet* **[7.31]**.

Importantly, s 170(3) explains that these general statutory duties replace the common law rules and equitable principles from which they are derived. Actions against directors will have to be based on breach of some statutory provision, not breach of related common law rules and equitable principles. But s 170(4) then provides a new way of interpreting and applying the statute. It requires the court to have regard to the existing interpretation and the continuing development of the common law rules and equitable principles on which the statutory statement is based. This is not normally allowed. In Grand Committee Lord Goldsmith explained the government's intention:

> Although the duties in relation to directors have developed in a distinctive way, they are often manifestations of more general principles. Subsection (4) is intended to enable the courts to continue to have regard to developments in the common law rules and equitable principles applying to these other types of fiduciary relationship. The advantage of that is that it will enable the statutory duties to develop in line with relevant developments in the law as it applies elsewhere. (HL GC Day 3, Hansard HL 678, 6/2/06, cols 243–245)

The practical effect of this is that reference will have to be made to the statutory statement of duties, but in order to

understand and apply these duties the surrounding case law must also be read. Practitioners and judges will therefore continue to be required to refer back to the cases.

(p. 331) Duty to act within powers: CA 2006 s 171

Section 171 requires directors to (a) act in accordance with the company's constitution (as defined in s 257, which is wider than s 17), and (b) only exercise powers for the purposes for which they are conferred.

Section 171(b) codifies the *proper purposes doctrine* as it applies to directors, thus putting to rest earlier debates about whether such a duty exists. The precursor equitable duty to 'act *bona fide* in what they [ie the directors] consider—not what a court may consider—is in the interests of the company, and not for any collateral purpose' (*Re Smith and Fawcett Ltd* **[11.10]**) was variously urged as imposing either one duty or two. CA 2006 separates the two limbs, with the proper purposes aspect appearing here in s 171, and the 'interests of the company', reformulated as the 'duty to promote the success of the company', appearing in s 172. The separation, and in particular the objective test embraced by the proper purposes doctrine, allows for greater judicial intervention in corporate decision-making than might otherwise be the case.

The positive formulation of the proper purposes obligation in s 171(b) (a director 'must … exercise powers for … [proper] purposes') as opposed to the negative version in*Smith and Fawcett* (must not act for any collateral purpose) also aligns the duty more closely with the common law version that is familiar in public and administrative law (*Associated Provincial Picture Houses Ltd v Wednesbury Corporation* [1948] 1 KB 223, Lord Greene MR).

Nominee directors in particular are at risk of breaching this duty: they may be tempted to use their powers improperly to advance the interests of their nominator, not the interests of the company itself (see *Scottish Co-operative Wholesale Society Ltd v Meyer* **[13.24]**; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* **[7.45]**).

Failure to act in accordance with the company's 'constitution'

See the cases in Chapter 3, 'Interpreting objects clauses', pp 90ff.

Failure to act for proper purposes

Older cases, such as *Re Smith & Fawcett Ltd* **[11.10]**, put together the two elements (good faith and proper purposes) that are separated by ss 171 and 172. So in that case it was said: '[Directors] must exercise their discretion *bona fide* in what they consider—not what a court may consider—is in the interests of the company, and not for any collateral purpose.'

Later cases reflect a slow working out by the courts of the nature of these two duties, and, in particular, the recognition of a separate duty to act for proper purposes (so that directors might act in complete good faith, but nevertheless find themselves in breach of the requirement to act for proper purposes).[24] As will be seen from the following extracts, the good faith duty is assessed subjectively, but the proper purposes duty objectively. Any objective assessment of breach gives the courts far greater opportunity to intervene in corporate management decisions. Some of the most common allegations of improper purpose concern the directors' power to allot shares, especially in response to a hostile takeover bid—this is the issue in the next four cases.

➢ Question

For each of the following four cases, consider the following: How was the directors' duty described? Would such a duty apply generally, beyond the context of issues of shares by **(p. 332)** directors? Was the test of breach of duty objective or subjective? What remedy was awarded by the court? Would the outcome have been different if the law had been as prescribed in CA 2006 s 171?

[7.10] Punt v Symons & Co Ltd [1903] 2 Ch 506 (Chancery Division)

[For the facts and another part of the decision, see **[4.21]**.] In order to secure the passing of a special resolution, the directors had issued new shares to five additional members. This was held to be an abuse of their powers.

> BYRNE J: I now come to the last and most important point. It is argued on the evidence that but for the issue by the directors of the shares under their powers as directors, and, therefore, in their fiduciary character under the general power to issue shares, it would have been impossible to pass the resolution proposed; and that the shares were not issued bona fide, but with the sole object and intention of creating voting power to carry out the proposed alteration in the articles. On the evidence I am quite clear that these shares were not issued bona fide for the general advantage of the company, but that they were issued with the immediate object of controlling the holders of the greater number of shares in the company, and of obtaining the necessary statutory majority for passing a special resolution while, at the same time, not conferring upon the minority the power to demand a poll. I need not go through the affidavits. I am quite satisfied that the meaning, object and intention of the issue of these shares was to enable the shareholders holding the smaller amount of shares to control the holders of a very considerable majority. A power of the kind exercised by the directors in this case, is one which must be exercised for the benefit of the company: primarily it is given them for the purpose of enabling them to raise capital when required for the purposes of the company. There may be occasions when the directors may fairly and properly issue shares in the case of a company constituted like the present for other reasons. For instance, it would not be at all an unreasonable thing to create a sufficient number of shareholders to enable statutory powers to be exercised; but when I find a limited issue of shares to persons who are obviously meant and intended to secure the necessary statutory majority in a particular interest, I do not think that it is fair and bona fide exercise of the power …
>
> If I find as I do that shares have been issued under the general fiduciary power of the directors for the express purpose of acquiring an unfair majority for the purpose of altering the rights of parties under the articles, I think I ought to interfere. I propose to grant an injunction …

[7.11] Hogg v Cramphorn Ltd [1967] Ch 254 (Chancery Division)

The directors of the defendant company, acting in good faith, had issued 5,707 shares with special voting rights to the trustees of a scheme set up for the benefit of the company's employees, in an attempt (which proved successful) to forestall a takeover bid by one Baxter. This was held to be an improper use of the directors' power to issue shares, but to be capable of ratification by the shareholders in general meeting.

> BUCKLEY J: I am satisfied that Mr Baxter's offer, when it became known to the company's staff, had an unsettling effect upon them. I am also satisfied that the directors and the trustees of the trust deed genuinely considered that to give the staff through the trustees a sizeable, though indirect, voice in the affairs of the company would benefit both the staff and the company. I am sure that Colonel Cramphorn and also probably his fellow directors firmly believed that to keep the management of the company's affairs in the hands of the existing board would be more advantageous to the shareholders, the company's staff and its customers than if it were committed to a board selected by Mr Baxter. The steps which the board took were intended not only to ensure that if Mr Baxter succeeded in obtaining a shareholding which, as matters stood, would have been a controlling **(p. 333)** shareholding, he should not secure control of the company, but also, and perhaps primarily, to discourage Mr Baxter from proceeding with his bid at all …
>
> Accepting as I do that the board acted in good faith and that they believed that the establishment of a trust would benefit the company, and that avoidance of the acquisition of control by Mr Baxter would also benefit the company, I must still remember that an essential element of the scheme, and indeed its primary purpose, was to ensure control of the company by the directors and those whom they could confidently regard as their supporters. Was such a manipulation of the voting position a legitimate act on the part of the directors?

[His Lordship referred to *Punt v Symons & Co Ltd* **[7.10]** and *Piercy v S Mills & Co Ltd*,[25] and continued:] Unless a majority in a company is acting oppressively towards the minority, this court should not and will not itself interfere with the exercise by the majority of its constitutional rights or embark upon an inquiry into the respective merits of the views held or policies favoured by the majority and the minority. Nor will this court permit directors to exercise powers, which have been delegated to them by the company in circumstances which put the directors in a fiduciary position when exercising those powers, in such a way as to interfere with the exercise by the majority of its constitutional rights; and in a case of this kind also, in my judgment, the court should not investigate the rival merits of the views or polices of the parties … It is not, in my judgment, open to the directors in such a case to say, 'We genuinely believe that what we seek to prevent the majority from doing will harm the company and therefore our act in arming ourselves or our party with sufficient shares to outvote the majority is a conscientious exercise of our powers under the articles, which should not be interfered with'.

Such a belief, even if well founded, would be irrelevant. A majority of shareholders in general meeting is entitled to pursue what course it chooses within the company's powers, however wrong-headed it may appear to others, providing the majority do not unfairly oppress other members of the company. These considerations lead me to the conclusion that the issue of the 5,707 shares, with the special voting rights which the directors purported to attach to them, could not be justified by the view that the directors genuinely believed that it would benefit the company if they could command a majority of the votes in general meetings … The power to issue shares was a fiduciary power and if, as I think, it was exercised for an improper motive, the issue of these shares is liable to be set aside. …

[His Lordship then went on to hold that the shareholders by majority could have ratified a *proposed* defective exercise of power by the directors.] It follows that a majority in a general meeting of the company at which no votes were cast in respect of the 5,707 shares could [equally, after the event] ratify the issue of those shares. Before setting the allotment and issue of the 5,707 shares aside, therefore, I propose to allow the company an opportunity to decide in general meeting whether it approves or disapproves of the issue of these shares to the trustees. Mr Goulding will undertake on behalf of the trustees not to vote at such a meeting in respect of the 5,707 shares …

[The action of the directors was ratified by the members at the subsequent meeting. Compare *Bamford v Bamford* **[4.32]**.]

[7.12] Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821 (Privy Council)

Rival takeover offers for all the issued shares in RW Miller (Holdings) Ltd had been made by Howard Smith Ltd and Ampol Ltd. Since Ampol, with an associated company ('Bulkships'), already owned 55% of Millers' shares, there was no prospect that Howard Smith's offer would succeed; but a majority of Millers' directors favoured this offer, both because its terms were more generous and because of fears as to the future of Millers if it were to pass into **(p. 334)** Ampol's control. Millers' directors resolved to issue some $10 million worth of new shares to Howard Smith. This served the dual purposes of providing Millers with much needed capital to finance the completion of two tankers, and of converting the Ampol-Bulkships holding into a minority one, so that the Howard Smith offer was likely to succeed. In these proceedings, Ampol challenged the validity of the share issue. At first instance, Street J found that, while Millers' directors were not motivated by any consideration of self-interest or desire to retain control, their primary purpose was not to satisfy Millers' admitted need for capital but to destroy the majority holding of Ampol and Bulkships. He rejected as 'unreal and unconvincing' the directors' own statements to the contrary in the witness-box, and set aside the allotment. The Privy Council upheld his decision.

The opinion of their Lordships was delivered by LORD WILBERFORCE: The directors, in deciding to issue shares, forming part of Millers' unissued capital, to Howard Smith, acted under clause 8 of the company's articles of association. This provides, subject to certain qualifications which have not been invoked, that the shares shall be under the control of the directors, who may allot or otherwise dispose of the same to such persons on such terms and conditions and either at a premium or otherwise and at such time as the directors may think fit. Thus, and this is not disputed, the issue was clearly intra vires the directors. But,

intra vires though the issue may have been, the directors' power under this article is a fiduciary power: and it remains the case that an exercise of such a power, though formally valid, may be attacked on the ground that it was not exercised for the purpose for which it was granted. It is at this point that the contentions of the parties diverge. The extreme argument on one side is that, for validity, what is required is bona fide exercise of the power in the interests of the company; that once it is found that the directors were not motivated by self-interest—ie by a desire to retain their control of the company or their positions on the board—the matter is concluded in their favour and that the court will not inquire into the validity of their reasons for making the issue. All decided cases, it was submitted, where an exercise of such a power as this has been found invalid, are cases where directors are found to have acted through self-interest of this kind.

On the other side, the main argument is that the purpose for which the power is conferred is to enable capital to be raised for the company, and that once it is found that the issue was not made for that purpose, invalidity follows.

It is fair to say that under the pressure of argument intermediate positions were taken by both sides, but in the main the arguments followed the polarisation which has been stated.

In their Lordships' opinion neither of the extreme positions can be maintained. It can be accepted, as one would only expect, that the majority of cases in which issues of shares are challenged in the courts are cases in which the vitiating element is the self-interest of the directors, or at least the purpose of the directors to preserve their own control of the management …

Further it is correct to say that where the self-interest of the directors is involved, they will not be permitted to assert that their action was bona fide thought to be, or was, in the interest of the company; pleas to this effect have invariably been rejected …

But it does not follow from this, as the appellants assert, that the absence of any element of self-interest is enough to make an issue valid. Self-interest is only one, though no doubt the commonest, instance of improper motive: and, before one can say that a fiduciary power has been exercised for the purpose for which it was conferred, a wider investigation may have to be made … On the other hand, taking the respondents' contention, it is, in their Lordships' opinion, too narrow an approach to say that the only valid purpose for which shares may be issued is to raise capital for the company. The discretion is not in terms limited in this way: the law should not impose such a limitation on directors' powers. To define in advance exact limits beyond which directors must not pass is, in their Lordships' view, impossible. This clearly cannot be done by enumeration, since the variety of situations facing directors of different types of company in different situations cannot be anticipated. No more, in their Lordships' view, can this be done by the use of a phrase—such as 'bona fide in the interest of the company as a whole', or 'for some corporate purpose'. Such phrases, **(p. 335)** if they do anything more than restate the general principle applicable to fiduciary powers, at best serve, negatively, to exclude from the area of validity cases where the directors are acting sectionally, or partially: ie improperly favouring one section of the shareholders against another …

In their Lordships' opinion it is necessary to start with a consideration of the power whose exercise is in question, in this case a power to issue shares. Having ascertained, on a fair view, the nature of this power, and having defined as can best be done in the light of modern conditions the, or some, limits within which it may be exercised, it is then necessary for the court, if a particular exercise of it is challenged, to examine the substantial purpose for which it was exercised, and to reach a conclusion whether that purpose was proper or not. In doing so it will necessarily give credit to the bona fide opinion of the directors, if such is found to exist, and will respect their judgment as to matters of management; having done this, the ultimate conclusion has to be as to the side of a fairly broad line on which the case falls.

The main stream of authority, in their Lordships' opinion, supports this approach. In *Punt v Symons & Co Ltd* **[7.10]** Byrne J expressly accepts that there may be reasons other than to raise capital for which shares may be issued. In the High Court case of *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL*,[26] an issue of shares was made to a large oil company in order, as was found, to secure the financial stability of the company. This was upheld as being within the power although it had the effect of defeating

the attempt of the plaintiff to secure control by buying up the company's shares … [Reference was also made to *Teck Corpn Ltd v Miller*.[27]]

By contrast to the cases of *Harlowe* and *Teck*, the present case, on the evidence, does not, on the findings of the trial judge, involve any considerations of management, within the proper sphere of the directors. The purpose found by the judge is simply and solely to dilute the majority voting power held by Ampol and Bulkships so as to enable a then minority of shareholders to sell their shares more advantageously. So far as authority goes, an issue of shares purely for the purpose of creating voting power has repeatedly been condemned … And, though the reported decisions, naturally enough, are expressed in terms of their own facts, there are clear considerations of principle which support the trend they establish. The constitution of a limited company normally provides for directors, with powers of management, and shareholders, with defined voting powers having power to appoint the directors, and to take, in general meeting, by majority vote, decisions on matters not reserved for management. Just as it is established that directors, within their management powers, may take decisions against the wishes of the majority of shareholders, and indeed that the majority of shareholders cannot control them in the exercise of these powers while they remain in office (*Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* **[4.05]**), so it 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. If there is added, moreover, to this immediate purpose, an ulterior purpose to enable an offer for shares to proceed which the existing majority was in a position to block, the departure from the legitimate use of the fiduciary power becomes not less, but all the greater … Directors are of course entitled to offer advice, and bound to supply information, relevant to the making of such a decision, but to use their fiduciary power solely for the purpose of shifting the power to decide to whom and at what price shares are to be sold cannot be related to any purpose for which the power over the share capital was conferred upon them. That this is the position in law was in effect recognised by the majority directors themselves when they attempted to justify the issue as made primarily in order to obtain much needed capital for the company. And once this primary purpose was rejected, as it was by Street J, there is nothing legitimate left as a basis for their action, except honest behaviour. That is not, itself, enough.

(p. 336) Their Lordships therefore agree entirely with the conclusion of Street J that the power to issue and allot shares was improperly exercised by the issue of shares to Howard Smith.

[7.13] Mills v Mills (1938) 60 CLR 150 (High Court of Australia)

The plaintiff, Ainslie Mills, and his uncle, Neilson Mills (the defendant), were two of the directors and the largest shareholders of a family company. Neilson Mills (who was managing director) held mostly ordinary shares, and Ainslie Mills mostly preference shares. A resolution was passed by a majority of the directors, including Neilson Mills, by which accumulated profits were capitalised and distributed to the ordinary shareholders in the form of fully paid bonus shares. Such profits would have gone to the ordinary shareholders had the same sums been paid as dividends rather than bonus shares. This resolution greatly strengthened the voting power of the ordinary shareholders (and in particular of Neilson Mills) and diminished the rights of the preference shareholders to share in assets in a winding up. However, it did not encroach upon the rights to dividends of either preference or ordinary shareholders. Lowe J found that the majority of directors had acted honestly in what they believed to be the best interests of the company, and he held that the fact that Neilson Mills stood to gain from their decision did not invalidate it. This view was upheld by the High Court.

LATHAM CJ: … It is urged that the rule laid down by the cases is that directors must act always and solely in the interests of the company and never in their own interest …

It must, however, be recognised that as a general rule, though not invariably … directors have an interest as shareholders in the company of which they are directors. Most sets of articles of association actually require the directors to have such an interest, and it is generally desired by shareholders that directors should have a substantial interest in the company so that their interests may be identified with those of the

shareholders of the company. Ordinarily, therefore, in promoting the interests of the company, a director will also promote his own interests. I do not read the general phrases which are to be found in the authorities with reference to the obligations of directors to act solely in the interests of the company as meaning that they are prohibited from acting in any matter where their own interests are affected by what they do in their capacity as directors. Very many actions of directors who are shareholders, perhaps all of them, have a direct or indirect relation to their own interests. It would be ignoring realities and creating impossibilities in the administration of companies to require that directors should not advert to or consider in any way the effect of a particular decision upon their own interests as shareholders. A rule which laid down such a principle would paralyse the management of companies in many directions. Accordingly, the judicial observations which suggest that directors should consider only the interests of the company and never their own interests should not be pressed to a limit which would create a quite impossible position.

Directors are required to act not only in matters which affect the relations of the company to persons who are not members of the company but also in relation to matters which affect the rights of shareholders inter se. Where there are preference and ordinary shares a particular decision may be of such a character that it must necessarily affect adversely the interests of one class of shareholders and benefit the interests of another class. In such a case it is difficult to apply the test of acting in the interests of the company. The question which arises is sometimes not a question of the interests of the company at all, but a question of what is fair as between different classes of shareholders. Where such a case arises some other test than that of 'the interests of the company' must be applied, and the test must be applied with knowledge of the fact already mentioned that the law permits directors, and by virtue of provisions in articles of association often requires them, to hold shares, ordinary or preference, as the case may be. A director who holds one or both classes of such shares is not, in my opinion, required by the law to live in an unreal region of detached altruism and to act in a vague mood of ideal abstraction from obvious facts which must be presented to the mind **(p. 337)** of any honest and intelligent man when he exercises his powers as a director. It would be setting up an impossible standard to hold that, if an action of a director were affected in any degree by the fact that he was a preference or ordinary shareholder, his action was invalid and should be set aside …

DIXON J: When the law makes the object, view or purpose of a man, or of a body of men, the test of validity of their acts, it necessarily opens up the possibility of an almost infinite analysis of the fears and desires, proximate and remote, which, in truth, form the compound motives usually animating human conduct. But logically possible as such an analysis may seem, it would be impracticable to adopt it as a means of determining the validity of the resolutions arrived at by a body of directors, resolutions which otherwise are ostensibly within their powers. The application of the general equitable principle to the acts of directors managing the affairs of a company cannot be as nice as it is in the case of a trustee exercising a special power of appointment. It must, as it seems to me, take the substantial object, the accomplishment of which formed the real ground of the board's action. If this is within the scope of the power, then the power has been validly exercised. But if, except for some ulterior and illegitimate object, the power would not have been exercised, that which has been attempted as an ostensible exercise of the power will be void,[28] notwithstanding that the directors may incidentally bring about a result which is within the purpose of the power and which they consider desirable …

RICH and STARKE JJ delivered concurring judgments.

EVATT J concurred.

➢ Questions

1. How are the 'proper purposes' for the exercise of any given power determined? Can directors be confident they are acting for 'proper purposes'?

2. Is *Mills v Mills* a 'proper purposes' case or a 'bona fide/good faith in the interests of the company' case? Does it

matter?

3. Was the judge in *Re Halt Garage (1964) Ltd* **[5.03]** applying a 'proper purposes' test when he examined the 'genuineness' of the payment of the directors' remuneration? If so, why did he not think that a similar payment made out of undistributed profits was wrong? If not, was he applying merely a 'bona fides' test?

4. Do these takeover cases miss the real issue by focusing on the scope of the power exercised by the directors on the particular occasion? Would it be more satisfactory to build on the basis of such cases as *John Shaw & Sons (Salford) Ltd v Shaw* **[4.07]**, where the separate roles of the different constitutional organs are recognised, and to say that the real issue is which organ should have control of this decision? If it were seen to be the members, then the sanction of a members' vote would be required in all such cases, not simply under the guise of ratifying an ill-purposed act of the directors, but because the decision involved a matter which was not within the directors' sphere of action. This point was recognised, but was not made the *ratio decidendi*, in the speech of Lord Wilberforce in *Howard Smith*, earlier. It is also in keeping with CA 2006 s 551(1), which allows directors to allot shares only where authorised under the company's articles or by resolution of the company (see 'Limiting access to shares: directors' allotment rights and shareholders' pre-emption rights', pp 496ff).

5. When, if ever, might it be proper for the directors to use their powers to ensure that they retain control? Could it ever be their *duty* to do so?

6. A quite different approach to the problem is mooted in *Criterion Properties plc v Stratford Properties LLC* **[3.13]**. The former managing director of the claimant company had caused it to enter into a contract which left it with a 'poison pill' in the form of a right by an outsider to demand a potentially crippling payment if control of the company**(p. 338)** should change hands or if the managing director or chairman should leave office. Lord Scott pointed out that the payment would have to be made even if the directors resigned voluntarily or there was a wholly beneficial takeover, and questioned whether the managing director had *authority* (real or apparent) to make the contract (see 'Actual and ostensible authority of corporate agents', pp 108ff). On this approach, what remedies are available to the various affected parties, and how do these differ from the remedies available on an approach that relies on proper purposes? Is this approach defensible? In determining whether the directors have actual authority, is it material that their decision is for proper or improper purposes? Can a 'poison pill' arrangement ever be entered into for proper purposes?

7. Where the directors are motivated by more than one purpose, the decision in *Howard Smith* indicates that regard is to be held to their *primary* purpose in deciding whether the court will intervene. However, in *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285, the High Court of Australia appeared to favour a narrower interpretation. The majority (Mason, Deane and Dawson JJ) in a joint judgment said (at 721):

> In this court, the preponderant view has tended to be that the allotment will be invalidated only if the impermissible purpose or a combination of impermissible purposes can be seen to have been dominant —'the substantial object' (per Williams ACJ, Fullagar and Kitto JJ, *Ngurli Ltd v McCann*[29] quoting Dixon J in *Mills v Mills***[7.13]** and see *Harlowe's Nominees*); 'the moving cause' (per Latham CJ, *Mills v Mills*). The cases in which that view has been indicated have not, however, required a determination of the question whether the impermissible purpose must be *the* substantial object or moving cause or whether it may suffice to invalidate the allotment that it be one of a number of such objects or causes. As a matter of logic and principle, the preferable view would seem to be that, regardless of whether the impermissible purpose was the dominant one or but one of a number of significantly contributing causes, the allotment will be invalidated if the impermissible purpose was causative in the sense that, but for its presence, 'the power would not have been exercised' per Dixon J, *Mills v Mills*.

What difference, if any, would the different tests make in these cases?

8. There does not, as yet, seem to be an explicitly recognised parallel concept of 'proper purposes', as a test separate from that of bona fides, in *members*' decision-making, although cases such as *Re Halt Garage (1964) Ltd* **[5.03]**, in which decisions have been struck down as not 'genuine', come very close.[30] In Australia, by

contrast, the High Court has declared a 'proper purpose' test to be preferred over one based on bona fides for the review of some, and perhaps all, members' resolutions: see*Gambotto v WPC Ltd* (1995) 182 CLR 432, Aust HCt. For an example from Canada, see *Western Mines Ltd v Shield Development Co Ltd* [1976] 2 WWR 300. Is such a test emerging in the UK? Revisit *Kinsela v Russell Kinsela* **[7.08]**, the cases on alteration of the company's constitution ('Alteration of the articles', pp 219ff), variations of class rights ('Variation of class rights', pp 563ff), and ratification of directors' wrongdoing ('Members' decisions concerning directors' breaches', pp 235ff, and 'Ratification of breaches of duty', p 372, 'Ratification of acts of directors: CA 2006 s 239', pp 437ff). In the context of ratification, note especially CA 2006 s 239(3) and (4).

(p. 339) Duty to promote the success of the company: CA 2006 s 172

This section is one of the more important and controversial provisions in the Act, and took up much of the discussion through the various stages of the Companies Bill that produced CA 2006. Its approach purports to end the debate over the meaning of 'the company', and 'in the interests of the company' (see 'Directors' duties are owed to the company', p 319). Section 172 specifies that the director's duty is to promote the success of the company for the benefit of its members as a whole (not for the benefit of other stakeholders or constituencies). This rejects the 'pluralist approach' and adopts the 'enlightened shareholder value' recommendations of the Law Commissions and CLR.[31] One important reason for this choice is that the pluralist view risks leaving directors accountable to no one, since there is no clear yardstick for judging their performance.[32] The section also explicitly favours a long-term, rather than short-term, outlook in corporate decision-making (see s 172(1)(a)).[33]

The crucial elements of s 172

Section 172(1) enshrines a number of important elements:

(i) 'The success of the company for the benefit of its members as a whole'

This statement relates the success of the company to the interests of its members as a whole. This approach was advocated by the CLR (CLR, *Modern Company Law for a Competitive Economy: Developing the Framework* (URN 00/656) (2000), para 3.51):

> We believe there is value in inserting a reference to the success of the company, since what is in view is not the individual interests of members, but their interests as members of an association with the purposes and the mutual arrangements embodied in the constitution; the objective is to be achieved by the directors successfully managing the complex of relationships and resources which comprise the company's undertaking.

The primacy of the company is significant. If the interests of the company as a separate entity are in conflict with the interests of the members as a whole, or at least some of them, it would appear that the interests of the company should be preferred (*Mutual Life Assurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11 at 21 (Goulding J); *Re BSB Holdings Ltd (No 2)* [1996] 1 BCLC 155 at 251 (Arden J)).

(ii) Directors and members to decide what 'success' means

Directors' good faith business judgements must be calculated to promote the success of the company. 'Success' is to be determined on a company-by-company basis. It is for the directors to interpret the company's objectives and make practical decisions about how best to achieve them. At its simplest, success may often mean the long-term increase in financial value of the company, but even this has its difficulties. It is not clear, for example, whether the directors should favour increased dividend rates, increased market price for the shares or some other manifestation of the long-term growth and stability of the company.

(p. 340) ***(iii) Success for the members as a whole***

The directors must make decisions that are calculated to be for the long-term benefit of the members as a whole.

It follows that promoting sectional interests would be a breach of the duty to promote the success of the company (see *Mills v Mills* **[7.13]**).

(iv) Directors to make decisions—subjective test

The essential principle is that it is for *directors* to make decisions, in good faith, as to how to promote the success of the company for the benefit of the members as a whole. This test repeats the common law rule from which it is derived (*Re Smith and Fawcett Ltd* **[11.10]**, and 'Duty to act within powers: CA 2006 s 171', p 331). A court will not inquire whether, objectively, the decision was actually the best decision for the company (*Howard Smith Ltd v Ampol Petroleum Ltd* **[7.12]**; *Regentcrest plc v Cohen***[7.14]** at 105), nor whether the director's honestly held belief was a reasonable one (*Smith v Fawcett*; *Regentcrest plc v Cohen*).

(v) Regard to the specified factors

Section 172(1), especially when read with s 170, makes it clear that the duty imposed on directors is to consider the interests of persons other than the company (eg employees, suppliers, customers, the community) but that directors do not owe a duty directly to those persons. A director's duties are owed to the company alone (s 170).

(vi) Conflicting factors

Where consideration of different 'factors' suggests conflicting courses of action, it seems directors must simply take their own 'good faith business decisions' to promote the success of the company (HC Comm D, 11/7/06, cols 591–593, Margaret Hodge).

(vii) Failure to have regard to the specified matters

If a director acts *without* adopting the form of consideration required by subs (1), how will a court respond? If there is no basis on which a director could reasonably have concluded that the action was likely to promote the success of the company, a court is likely to find the director in breach of this duty (see *Item Software (UK) Ltd v Fassihi***[7.16]**). But if a reasonable director, giving due consideration, might well have concluded that the action was likely to promote the success of the company, the court's reaction is not so clear. Assuming the director acted bona fide, perhaps a court will find there has been no breach of duty (see *Charterbridge Corporation Ltd v Lloyds Bank Ltd* **[3.03]**), or at least that the breach has caused no harm (also see Attorney General, Lord Goldsmith, Hansard HL, 9/05/06, col 846).

But on a strict legal interpretation it is also possible that the decision may be subjected to review, and deemed voidable because it has been made without taking into account all material considerations (see the earlier discussion in relation to s 171). Subsection (1), in effect, specifies some (not all) of the matters deemed to be relevant to decisions made by directors. Setting out such a list may expand the grounds for judicial review of directors' decision-making, whether under s 172 or s 171.

(viii) No need for a paper trail

Concerns were expressed during the legislative process that s 172 would require directors to keep a 'paper trail' of all business judgements made, and that the section would lead to an increase in litigation. The concerns are linked insofar as an increase in litigation would require directors to undertake more defensive practices and procedures, and, conversely, the lower the threat of litigation the less the requirement for paper trails. The government strongly denied that the section introduced a 'tick-box culture' whereby directors would be required to consider each factor one by one. The list of factors is non-exhaustive and is intended to illustrate elements of the wider principle that directors are required to make good faith business judgements to promote the success of the company for the long-term benefit of its members **(p. 341)** as a whole. As such, directors should not be liable for a 'process failure'. (On the other hand, see s 417 (contents of directors' report: business review), especially s 417(2).)

(ix) No risk of increased litigation

The second fear expressed was that a failure to take into account specific factors may lead to increased litigation. This fear was said to be over-exaggerated (see HC Comm D 11/7/06, cols 568–575). The only duty at stake is the

duty to promote the success of the company, and so long as directors have made good faith business judgements with reasonable care, skill and diligence they are unlikely to be in breach of this duty (see HL Rep, Hansard HL 681, 9/5/06, cols 845–846). In Committee Stage in the House of Commons, David Howarth made the important additional observation that the class of potential litigants is limited, and that it will also often be difficult to identify any loss. For these reasons, the risk of litigation is minimal. The class of potential litigants is limited to the board, a majority of members, a minority of members under Pt 11 and liquidators acting on behalf of an insolvent company. It is only during a takeover that a board or a majority of members is likely to bring an action against a director; in most cases there are far better remedies available against directors, for example removal of the director. Further, a derivative action under Pt 11 is extremely difficult to advance against the wishes of the majority of members. In reality, it is only during takeovers and liquidation proceedings that the section is likely to be utilised. Moreover, an action will only be useful where there is a loss to the company: a breach of the duty to promote the success of the company is unlikely, alone, to give rise to significant calculable financial loss.

(x) A defence rather than duty?

Although the 'enlightened shareholder value' approach was designed to avoid the problems of director accountability inherent in the 'pluralist approach', it is not clear that this ambition is achieved. Subsection (1) sets out proper considerations for director decision-making, but these considerations will allow directors to justify almost any bona fide approach to delivering the success of the company. Where directors have made a good faith business judgement to favour employees' interests[34] over short-term financial gain, for example in order to promote the success of the company for the benefits of its members as a whole, then this legitimate decision cannot be challenged (see *Re Welfab Engineers Ltd* (1990) BCLC 833). Similarly, directors are not compelled to make decisions according to the wider interests of community and the environment, and they are protected from reproach if they choose to do so. *Is* there any decision directors might take which would self-evidently fall outside the requirements of s 172(1)?

(xi) Duty to disclose misconduct?

The controversial finding in *Item Software (UK) Ltd v Fassihi* **[7.16]** at [44], may be embraced by the terms of s 172. *Fassihi* suggests that a director who acts in breach of his fiduciary duty is under a further duty to disclose the breach to the company if disclosure is required by the general equitable duty to act bona fid *e* in what the director considers to be the interests of the company. The analogy with the statutory duty in s 172(1) is obvious. It is difficult to see when it would not be in the company's interest to know of a breach of duty, and on that basis any breach of duty will always involve a further breach in failing to disclose. The further breach may result in loss of employment benefits (eg termination rights, share options, pension bene fits), and may provide justification for summary dismissal (*Tesco Stores Ltd v Pook* [2003] EWHC 823 (Ch); *Fulham Football Club (1987) Ltd v Tigana* [2004] EWHC 2585 (QB)). On the other hand, this aspect of the *Fassihi* decision represents a radical extension of the traditional **(p. 342)** equitable duties owed by directors, and the approach to these statutory rules advocated in s 170 may argue against its acceptance.

Less controversially, a director also has an equitable duty to disclose breaches of duty committed by fellow directors if this is what the director, acting bona fide, considers to be in the best interests of the company (*British Midland Tool Ltd v Midland International Tooling Ltd* [2003] EWHC 466 (Ch), [2003] 2 BCLC 523). Again, the analogy with the statutory duty in s 172(1) is apparent. Also see *Brandeaux Advisers (UK) Ltd v Chadwick* [2010] EWHC 3241 (QB), referred to later.

The duty to act in good faith for the success of the company

Re-read the cases at **[7.05]**–**[7.12]**.

Duty to act in good faith.

[7.14] Regentcrest v Cohen [2001] BCC 494 (Chancery Division)

Liquidators sought damages for a breach of fiduciary duty arising from the second defendant's agreement, in his capacity as a director of the claimant company, R, to waive that company's entitlement to claw back a sum from the vendors of a company, G. The liquidators contended that by his actions, the second defendant had disposed of