

This codifies the common law rules that directors should exercise their powers under the terms that were granted for a proper purpose. A directors powers are normally derived from the company's constitution, i.e. its memorandum and articles of association.

Section 171 CA 2006 provides that a director must:

- (a) **Act in accordance with the company's constitution**
- (b) **Only exercise powers for the purposes for which they are conferred**

Part (a) □ A company's constitution includes the company's articles and any shareholder resolutions and agreements.

RE SMITH & FAWCETT LTD (1942) in which he explained that:

"Directors must exercise their discretion bona fide in what they consider- not what a court may consider- in the best interests of the company, and not for any collateral purpose."

Part (b) restates the 'proper purposes doctrine' formulated by Lord Greene in: The proper purpose doctrine has been frequently applied. The consequences of this doctrine are that the voting rights of majority shareholders, those that control the company, may be adversely affected.

DOCTRINE OF PROPER PURPOSE:

EXTRASURE TRAVEL INSURANCES V SCATTERGOOD (2002):

- o This case concerned the power of directors to deal with corporate assets. The directors of Extrasure had transferred company funds, some £200,000, to another company in the group, Citygate insurance brokers Ltd (the parent company), to enable it to pay a creditor who had been pressing for payment.
- o One of the arguments put forward by the claimant was that the directors had exercised their power for improper purpose.

The test for determining whether or not a power has been exercised for an improper purpose came to the fore in this case.

The law relating to proper purposes is clear, and was not in issue. It is unnecessary for a claimant to prove that a director was dishonest, or that he knew he was pursuing a collateral purpose. In that sense, the test is an objective one. It was suggested by the parties that the court must apply a 3-part test, but it may be more convenient to add a fourth stage. The court must:

1. **Identify the power whose exercise is in question**
2. **Identify the proper purpose for which that power was delegated to the directors**
3. **Identify the substantial purpose for which the power was in fact exercised**
4. **Decide whether the purpose was proper**

The application of the doctrine of proper purpose arose in the case of:

In summary, the decision in **Howard Smith** lays down that where directors exercise a power with mixed motives the court will seek to determine the principal purpose of their conduct. If it is found improper then the exercise of the power in question will be

TECK CORP v MILLER (1972):

Concerning: Doctrine of Proper Purpose:

Facts + Legal Principle This is the leading case decision on a corporate director's fiduciary duty to resist a takeover bid. Berger J held that a director may resist a takeover so long as they are acting in good faith, and they have reasonable grounds to believe that the takeover will cause substantial harm to the interests of the corporation.

This case represented a major change away from the standard set in the English Case HOGG v CRAMPHORN LTD. The decision of Hogg was criticised by Berger J as laying down the principle that directors have no right to issue shares in order to defeat a takeover bid even if they consider that in doing so they are acting in the company's best interest. He took the view that this was inconsistent with the law as the law laid down in **RE SMITH & FAWCETT LTD.** Berger J stressed that directors are entitled to consider the reputation, experience and policies of anyone seeking to takeover the company and to use their power to protect the company if they decide, on reasonable grounds, that takeover will cause substantial damage to the company. Declining to follow **HOGG v CRAMPHORN LTD** he reasoned:

"How can it be said that directors have right to consider the interests of the company, and to exercise their power accordingly, but there is an exception when it comes to the power to issue shares, and that in the exercise of such power the directors cannot in any circumstances issue shares to defeat an attempt to gain control of the company?"

The judge concluded that directors must act in good faith and must have reasonable grounds for their belief. The absence of reasonable grounds 'will justify a finding that the directors were actuated by an improper purpose'.

Berger J said that the onus of proof is on the person challenging an exercise of power. On the particular facts of Teck it was held that 'the plaintiff has failed to show that the directors had no reasonable grounds for believing that a takeover by Teck would cause substantial damage to the interests of the company and its shareholders'.

voidable. (**Bamford v Bamford**).

S.172: DUTY PROMOTE THE SUCCESS OF THE COMPANY:

Section 172 CA 2006 provides that:

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

- (a) The likely consequences of any decision in the long term,
- (b) The interests of the company's employees,
- (c) The need to foster the company's business relationships with suppliers, customers and others,
- (d) The impact of the company's operations on the community and the environment,
- (e) The desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) The need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

It can be seen that amongst other things, this duty introduces wider corporate social responsibility into a director's decision making process.

'Success' is not defined in the Act. The DTI's guidance to the Bill suggests that a success in relation to a commercial company is considered to be its "long-term increase in value"

It remains to be seen how in practice a director is to balance all these sometimes conflicting factors in his decisions, for example, an environmental consideration might not always be consistent with shareholders' interests.

However, it is suggested that a director will exercise the same level of care, skill and diligence as he carries out any other functions in deciding which factors he will take into consideration when making a decision subject to his overall responsibility to the success of the company. Inevitably, the court will set out the 'perimeters' in the interpretations of this duty.

Section 172(1) CA 2006:

The CLR (Commonwealth Law Reports) proposed that directors should promote 'enlightened shareholder value'. (see below for explanation of this)

Enlightened shareholder value: according to the is approach, directors while ultimately be required to promote the shareholder interests, must take account of a range of factors affecting the company's relationships and performance.

The leading company law decision is in the case of **REGAL HASTINGS V**

REGAL HASTINGS V GULLIVER (1942):

Concerning: Duty to avoid conflicts no profit rule:

Facts: Regal owned a cinema in Hasting. They took out leases on two more, though a new subsidiary, to make the whole lot an attractive sale package. However, the landlord first wanted them to give personal guarantees. They did not want to do that. Instead the landlord said they could up share capital to £5,000. Regal itself put £2,000, but could not afford more. Four directors each put £500, the chairman, Mr G, got outside subscribers to put in £500 and board asked the company solicitor, Mr G, to put in the last £500. They sold the business and made a profit of nearly £3 per share, but then the buyers bought an action against the directors, saying that this profit was in breach of their fiduciary duty to the company. They had not gained fully informed consent from the shareholders.

Legal principle: The HoL held that the defendants had made their profits “by reason of the fact that they were directors of Regal and in the course of the execution of that office.” They therefore had to account for their profits to that company.

GULLIVER (1942).

The no-conflict and no-profit rules have in recent times manifested themselves under the guise of so-called corporate opportunities.

The CA and the courts will tolerate directors being interested in transactions with the company provided that certain disclosure and approval requirements are satisfied.

Corporate opportunities:

Professor Prentice: (1974): defines corporate opportunity as a doctrine as a principle which ‘**makes it a breach of fiduciary duty by a director to appropriate for his own benefit an economic opportunity which is considered to belong rightly to the company which he serves...**’

A corporate opportunity, under s.175, is regarded as an asset belonging to the company, which may not therefore be misappropriated by directors.

Receiver at the direction of the Secretary of State. The matter is heard, and decided by the court, unless the Secretary of State accepts a disqualification undertaking from a director.

What is the likely period of disqualification?

- The minimum period of disqualification is 2 years and the maximum 15 years.
- A disqualification order usually carries with it an order to pay the costs and expenses of the Secretary of State or the Official Receiver or both.

What is the effect of a disqualification order or disqualification undertaking?

- Unless he or she has court permission, the person is disqualified for the period stated in the order or undertaking from:
 - being a director of a company;
 - acting as receiver of a company's property;
 - directly or indirectly being concerned or taking part in the promotion, formation or management of a company; or
 - being a member of or being concerned or taking part in the promotion, formation or management of a limited liability partnership.

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