

DUTY TO ACT FOR A PROPER PURPOSE– Section 181(1)(b)

Step 1 - Establish that they are a director officer

Step 2- The Law

- The duty to act for a proper purpose is a general law principle restated in s 181(1)(b)
- The onus of proving that the directors acted improperly rests with those who allege the breach: *Australian Metropolitan Life Assurance v Ure*

Overview

- What is the purpose for which the power is granted as a matter of law?
- What is the purpose for which the power has been exercised as a matter of fact?
- Compare those!

Step 3 – Analyse the nature of the power

- Key Question - What is the purpose for which the power has been granted as a matter of law?
- → The nature of the power and the purpose for which it was conferred must be analysed to ascertain the limits on the exercise of the power: *Howard Smith*

Power to issue shares

- Starting point: Constitution usually confers unqualified power on directors to issue shares
- Proper purpose: Too narrow to say the only valid purposes for which shares may be issued is to raise capital for the company: *Howard Smith*
 - Issuing shares for consideration of purchasing property;
 - Rewarding employees;
 - Giving employees incentives;
 - Raise capital (e.g. *Mills v Mills*; *Harlowe's*)
- Improper purposes: Not to be used with a substantial motive of defeating the voting power of existing shareholders by creating a new majority (*Howard Smith*; *Ngurli*; *Whitehouse v Carlton Hotel*)
 - Maintaining control of the company (*Harlowe's*; *Ngurli*)
 - Destroying existing majority or creating a new majority (*Howard Smith*)
 - *Howard Smith*– Power to issue share can't be used by directors to displace an existing majority
 - Diluting voting power (*Whitehouse*)

Directors' power to influence control

- Proper: Legitimate commercial objective not related to control (*Teck Corp*)
 - *Teck Corp* – ☺ No breach in these circumstances
 - Proper purpose: Avoiding substantial damage to the company
 - Directors of Acton were motivated to get best agreement they could, not purely motivated by wanting to defend the takeover
- Proper: Entering into transaction because it was believed to be in the interests of the company as a whole (*Darvall v North Sydney*)
 - *Darvall v North Sydney* ☺ Directors acted with the proper purpose
 - Justice Mahoney said it is within the power of directors to ensure where an unsatisfactory takeover offer is made, an alternative option is available at a better price

- Court was satisfied that directors did not act for a substantial purpose of defeating takeover/preventing current bid from succeeding
- Improper: Perpetuating their own control (*Howard Smith*)
 - Examples – Preserve the existing majority or to displace them: *Howard Smith*; *Ngurli*
 - *Howard Smith* – Court did not accept evidence of directors, said the purpose was fabricated after the fact, it wasn't the true motivating purpose

Other examples of improper purposes

- ☹ Using company funds to promote re-election of directors: *ABA v FAIR Insurances*
- ☹ Exercising management for an improper purpose (*PBS v Wheeler*)
- ☹ Exercising a power for the benefit of a third party (i.e. a bank or holding company): *Bell Group*

Step 4 – Determine the purpose of a particular exercise of power

- → Key Question – What is the purpose for which the power has been exercised as a matter of fact?
 - Consider subjective reasons/bona fide opinions of the directors in the circumstances surrounding their state of mind – so as to show whether they were acting honestly in the discharge of their powers in the interests of the company or were acting some by-motive, possibly of personal advantage or for any other reason (*Hindle v John Cotton*)
- → **Is that purpose outside the scope of proper purposes?**
- *Howard Smith*
 - Each of the four majority directors testified that the alleged purpose in voting for the issue of shares to Howard Smith was to raise finance for the company
 - Court found overwhelming evidence to the contrary – e.g. haste of calling directors' meeting, board's failure to consider tax consequences, absence of any obvious reason for not making a rights issue to existing SH, rather than a placement to Howard Smith, share issued to Howard was at a discounted price etc.
 - Finding: ☹ Justice Street said the substantial purpose was to help Howard Smith's takeover and hinder any takeover by Ampol and Bulkships
- *Permanent Buildings Society v Wheeler*
 - Improper purpose found ☹ Some of the directors of PBS (controlled by CHS) caused it to enter into sale agreement for the improper purpose of persuading a prospective bidder to proceed with purchase of a related company (JCLD)
 - Potential benefit accruing to CH if the purchaser of JCLD went ahead was an impermissible purpose for PBS to enter sale agreement

TEST FOR MIXED PURPOSES

- Test: Need to show the substantial purpose for exercising the power is improper and that, but for the improper purpose, the director(s) would not have exercised the power: *PBS v Wheeler*; *Haselhurst v Wright*