THE SUBJECTIVE AND OBJECTIVE ELEMENTS OF A COMPANY BOARD'S POWER TO ISSUE SHARES

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[*Company Directors are required to exercise their discretionary powers for the benefit of their company as a whole. Mr Franzi here examines two theories of this proper purpose requirement, paying particular attention to the support for, and consequences of, each.*]

Company directors as agents are required to confine their actions within the ambit of the power delegated to them by the memorandum and articles of association. As fiduciaries, directors are required by general law to exercise their discretionary powers for the benefit of the company as a whole. The former doctrine of *ultra vires* is concerned with defining the parameters of the directors' powers, while the latter principle of the proper purpose test considers the directors' intentions when they exercise their delegated powers.

Today the Commonwealth courts determine the validity of an exercise of directors' discretionary power by examining the directors' intention subjectively and objectively.

It is the intention[1] of this paper to analyse the subjective and objective elements of the proper purpose test as it has been applied to the directors' discretionary power to issue shares.[2]

For convenience the topic will be considered under the following headings: (1) the significance of directors' intentions when the share issue was for an 'improper purpose'; (2) the general relevance of directors' intentions; (3) the objective elements in the proper purpose test; (4) the significance of directors' intentions when the share issue can be objectively justified.

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[1] Most of the discussion is also relevant to directors' other discretionary powers, such as the right to refuse share registration.

[2] Article 8 of R.W. Miller (Holdings) Ltd reported in *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 857 is drafted in terms typical of this power and in part reads

> '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 with such preferred deferred or other special rights or such restrictions whether in regard to dividend voting or return of share capital and either at a premium or otherwise and at such time or times as the Directors may think fit. . .'.

1. THE SIGNIFICANCE OF DIRECTORS' INTENTIONS WHEN THE SHARE ISSUE WAS FOR AN 'IMPROPER PURPOSE'

Because of the *ad hoc* development of the proper purpose test[3] there was some doubt whether the court as a matter of law would determine what was a proper exercise of the power to issue shares, or whether it was a question of fact to be determined solely by the directors who were entrusted with the power.

The first Commonwealth case to confront the argument that the proper purpose test criterion was confined to the directors' actual intentions was *Hogg v. Cramphorn Ltd.*[4] The directors of Cramphorn Ltd, in order to defend against a takeover bid, established a trust for the benefit of the company's employees and nominated themselves as trustees. They also made an interest-free loan of £5,707 to the trust and allotted 5,707 preference shares with voting rights of ten votes *per* share. The directors' counsel argued that early proper purpose cases concerned directors' *mala fides*, whereas his clients had 'acted throughout in the belief that what they were doing was for the good of the company. . .'.[5] Buckley J. found that the evidence indicated that the directors did have an honest belief,[6] but after examining the earlier cases of *Fraser v. Whalley*[7] and *Piercy v. S. Mills & Co. Ltd*,[8] the learned judge considered that a share issue made solely for the purpose of destroying or creating a majority was an improper exercise and that the directors' beliefs, even if well founded, were irrelevant.[9]

The Australian authorities of *Ansett v. Butler*[10] and *Provident International Corporation v. International Leasing Corporation Ltd*[11] are con-

[3] For the most recent and complete definition of the proper purpose test see *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 697 where their Lordships considered

'[i]t 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 the 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. . .'.

[4] [1967] Ch. 254.

[5] *Ibid.* 262.

[6] *Ibid.* 266. The directors believed that it was in the best interests of the company that the company's corporate identity remain unaltered and the employees not be unsettled by such a change.

[7] (1864) 2 Hem. and M. 10; 71 E.R. 361.

[8] [1903] 2 Ch. 506.

[9] *Hogg v. Cramphorn Ltd* [1967] Ch. 254 *cf. Re Smith and Fawcett Limited* [1942] Ch. 304, 306.

[10] (1958) 75 W.N. (N.S.W.) 299, 303 (Meyer J.):

'Whether the directors believed their policy to be the best or not, and whether their policy was in fact the best or not, I am satisfied that their only purpose in issuing the shares was to ensure that there would always be a majority in the company to carry out the policy which the directors thought would be the best. This is precisely what directors cannot do. . .'.

[11] (1969) 89 W.N. (N.S.W.) 370, 377 (Helsham J.) 'in this area honesty in their

sistent with *Hogg v. Cramphorn Ltd*;[12] the recent Privy Council decision of *Howard Smith Ltd v. Ampol Petroleum Ltd*[13] has confirmed and refined this approach by indicating that the directors' *bona fide* managerial decisions and their opinion of the ambit of their power were considerations the court would take into account when considering the power's proper purposes,[14] but their Lordships thought that where 'there is nothing legitimate left as a basis for their action, except honest behaviour. . . . [t]hat is not, in itself, enough'.[15]

The reported Commonwealth cases have to date decided that to allot shares solely to create or destroy an existing majority,[16] and to raise a facade of capitalization[17] are improper exercises of the power to issue shares.[18] Thus if the directors issue shares for these purposes, notwithstanding their belief that it is in the best interest of the company,[19] the exercise will be invalid.

2. THE GENERAL RELEVANCE OF DIRECTORS' INTENTIONS

Since *Hogg v. Cramphorn* has put beyond doubt that *Fraser v. Whalley*[20] and the early twentieth century Chancery Court cases[21] require directors when exercising their discretionary powers to conform to objective standards and their own conscience,[22] directors when defending their share

belief that they are acting in the best legal interests of the company is not the touchstone against which the directors' acts is to be decided'. Also on this point see *Ngurli Pty Ltd v. McCann* (1953) 90 C.L.R. 425 where the company directors were advised that their actions were legally in the best interest of the company. The closest an academic commentator has come to proposing an exclusive subjective test is Sealy L. S., 'Company-Directors' Powers — Proper Motive But Improper Purpose' [1967] *Cambridge Law Journal* 33, 35 where he remarks 'there should be no test other than the genuineness of the directors' own motive, provided of course that their view is one that could reasonably be held — the line is drawn short of their being "amiable lunatics . . ." '. *Cf.* Parsons R. W., 'The Director's Duty of Good Faith' (1967) 5 *M.U.L.R.* 395, 417 where he says 'a principle which must be tuned to the wavelength of the directors' conscience may be welcome to a theologian but will be of little significance as a legal control. . .'.

[12] [1967] Ch. 254.
[13] [1974] 2 W.L.R. 689.
[14] *Ibid.* 697.
[15] *Ibid.* 699.
[16] The best authorities on this point are *Hogg v. Cramphorn Ltd* [1967] Ch. 254, 995 and *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689.
[17] *Provident International Corporation v. International Leasing Corporation Ltd* (1969) 89 W.N. (N.S.W.) 370, 378.
[18] The Privy Council in *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 697 stated that 'to define in advance exact limits beyond which directors must not pass is, in their Lordships view, impossible'. No doubt there will be other exercises of this power which will be held improper. The only guide on the power's limits is Helsham J.'s remarks in *Provident International Corporation v. International Leasing Corporation Ltd* (1969) 89 W.N. (N.S.W.) 370, 378 where he said 'there must be some nexus between the issue and a desirable capital structure of the company'.
[19] See *Vatcher v. Paull* [1915] A.C. 372, 378 and *Australian Metropolitan Life Assurance Co. Ltd v. Ure* (1923) 33 C.L.R. 199, 217.
[20] (1864) 2 Hem. and M. 10; 71 E.R. 361.
[21] *Punt v. Symons & Co. Ltd* [1903] 2 Ch. 506 and *Piercy v. S Mills & Co. Ltd* [1920] 1 Ch. 77.
[22] *Cf. Re Smith and Fawcett Limited* [1942] Ch. 304, 306.

issue, are likely to recollect that the issue was made for a judicially established proper purpose, such as: to distribute capital reserves by a bonus share issue;[23] to enable the company to trade out of trouble by securing creditors' claims;[24] to avoid an undesirable change in the corporate identity;[25] as part of a contract involving an exchange of shares — 'the ultimate deal';[26] and finally, the prime purpose of the power, to raise capital.[27]

Where the court is confronted with evidence which supports a number of alternative possible actuating purposes, some of which are proper and some improper, then the 'ultimate question'[28] is to find the directors' actual intention or intentions. This is done by 'inference as distinct from confident recognition of an objective fact'[29] and the most important evidence in determining this 'ultimate impossibility'[30] is the evidence given by the directors.[31]

In *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd*,[32] Street C.J. viewed the directors' evidence of their purpose for the share issue, through the 'objective state of Miller's financial position'[33] and found he was unable to accept the directors' claim that their prime purpose in issuing the shares was to raise capital.[34] On appeal before the Privy Council[35] the appellants argued that Street C.J. had erred in objectively reviewing Miller's financial circumstances, as although he could review the directors' intentions, he was bound to accept the directors' evidence of what they considered was the company's financial needs.[36] Their Lordships explained that while the court would not review the merits of managerial decisions,[37] these being matters

[23] *Mills v. Mills* (1938) 60 C.L.R. 150.
[24] *Richard Brady Franks Limited v. Price* (1937) 58 C.L.R. 112.
[25] *Savoy Corporation Limited v. Development Underwriting Limited* [1963] N.S.W.R. 138, 147; *Tech Corporation Ltd v. Millar* (1973) 33 D.L.R. (3d) 288, 315 and comment by the Privy Council in *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 694; *cf. Hogg v. Cramphorn Ltd* [1967] Ch. 254.
[26] *Tech Corporation Ltd v. Millar* (1973) 33 D.L.R. (3d) 288.
[27] *Harlowe's Nominees Pty Ltd* v. *Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 493 cited with approval by the Privy Council in *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 698.
[28] *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 493.
[29] *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 875.
[30] *Ibid.*
[31] For the trial judge's view see Jacobs J. in *Savoy Corporation Limited v. Development Underwriting Limited* [1963] N.S.W.R. 138, 145 and Street C.J. in *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 872-3. For comment at appellate level and the difficulties of reviewing such, see Lord Greene M.R. in *Re Smith and Fawcett Limited* [1942] Ch. 304, 308, Latham C.J. in *Mills v. Mills* (1938) C.L.R. 150, 161, Latham C.J. and Dixon J. in *Richard Brady Franks Ltd v. Price* (1937) 58 C.L.R. 112, 134, 144 and *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 497.
[32] [1972] 2 N.S.W.L.R. 850.
[33] *Ibid.* 872.
[34] *Ibid.* 874.
[35] *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689.
[36] *Ibid.* 694.
[37] *Ibid.*

exclusively between shareholders and directors,[38] they would investigate the facts surrounding the directors' decision, 'in order to estimate how critical or pressing, or substantial or, *per contra*, insubstantial an alleged requirement may have been . . .'[39] to provide a basis on which to accept or reject the directors' assertions.[40]

One of the more interesting objective factors taken into account by Street C.J. in the *Ampol* case was that the directors knowingly breached the rules of the Sydney Stock Exchange,[41] which the learned judge thought 'serves to underline the imprudence of their action, even though of itself it does not establish invalidity. . .'.[42]

The onus of establishing objectively, on the balance of probabilities, that the directors' exercise while valid is in fact invalid, because of an actuating improper purpose, rests on the plaintiff.[43] One of the plaintiff's main aids in establishing invalidity is cross-examination of the directors.[44] Since the court can only infer the directors' intent, the court's approach where the directors refuse to give evidence could be vital in either making the plaintiff's case easier, as difficult, or more difficult to establish.

The High Court in *Australian Metropolitan Life Assurance Co. Ltd v. Ure*[45] had to consider the directors' refusal to register a share transfer to

[38] *Ibid.*

[39] *Ibid.*

[40] A similar approach was taken in *Hirsche v. Sims* [1894] A.C. 654, 660-1; *Shuttleworth v. Cox Brothers & Co. (Maidenhead) Ltd* [1927] 2 K.B. 9, 23; *Australian Metropolitan Life Assurance Co. Ltd v. Ure* (1923) 33 C.L.R. 199, 220; *Mills v. Mills* (1938) 60 C.L.R. 150, 164; *Richard Brady Franks Ltd v. Price* (1937) 58 C.L.R. 112, 136, 137, 144; *Savoy Corporation Limited v. Development Underwriting Limited* [1963] N.S.W.R. 138, 145; *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 494-5.

[41] Rule 11(a) and (b) of the Sydney Stock Exchange. In 1972 the Australian Stock Exchanges agreed to nationalize their rules. Under s. 3.A.5 of the Australian Association Stock Exchange rules a company is required to notify the exchange of any decision to issue securities. S. 3.H.11(b) reads '[w]here Directors of a Company have received notice of an actual or potential takeover scheme . . . not for a period of three months from the date of receipt of such notice by the Directors allot shares . . . unless the proposed issue has first been approved by the company in general meeting. . .'. See *The City Code on Take-Overs and Mergers* (U.K.) (Revised Ed 1972) which provides by Rule 38 that 'if the Board of the offeree company has reason to believe that a *bona fide* offer is imminent, the Board must not . . . without the approval of the shareholders in general meeting issue any authorised but unissued shares . . .'. Also see Helsham J. in *Provident International Corporation v. International Leasing Corporation Ltd* (1969) 89 W.N. (N.S.W.) 370, 379 where the directors knew their action would contravene s. 67 of the new Companies Act 1961 (N.S.W.) which would come into force in the same year as their allotment. While Helsham J. did not have to decide on this point he remarked that such action would 'establish a *prima facie* case of an abuse of the power'.

[42] *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 881.

[43] *Australian Metropolitan Life Assurance Co. Ltd v. Ure* (1923) 33 C.L.R. 199, 221; *Richard Brady Franks Ltd v. Price* (1937) 58 C.L.R. 112, 135; *Mills v. Mills* (1938) 60 C.L.R. 150, 169, *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457, 482; *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 492; *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 869.

[44] *Savoy Corporation Limited v. Development Underwriting Limited* [1963] N.S.W.R. 138, 145; *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 874 and 875.

[45] (1923) 33 C.L.R. 199.

the wife of a solicitor who had been struck off the rolls of the Supreme Court of Queensland. If the directors had allowed registration of the share transfer, the purchaser's husband would probably have been able to secure election as a director of the Assurance Company.[46] The directors refused to provide their reasons to the purchaser and to the court. Knox C.J. considered 'the court would draw no inference against them';[47] Starke J. thought that the directors were 'entitled to the presumption of honesty'.[48] Isaacs J. on the other hand felt that while 'their silence was not a sufficient circumstance in itself on which to base an inference of impropriety',[49] if the plaintiffs established a *prima facie* case then a duty might arise on the directors to give evidence.[50]

Jacobs J., sitting alone in the Supreme Court of New South Wales, had to consider in *Savoy Corporation Limited v. Development Underwriting Limited*[51] the actuating motive of directors who, contrary to earlier assurances,[52] made a call on unpaid share capital. The directors were aware of recent heavy buying of their company's stock by the plaintiff[53] and that the call would facilitate a merger with another company.[54] Notwithstanding that only one director of the defendant company gave evidence and 'was cross-examined at great length',[55] Jacobs J. considered that 'in the light of the evidence as a whole'[56] no adverse inference could be drawn by the refusal of the other directors to give evidence.[57]

It is respectfully submitted that the approach of Isaacs and Jacobs JJ. would and should prevail where company directors are able but refuse to give evidence of their intent.[58]

The directors' intent where the issue is objectively proper is important in two other respects. Firstly, to what degree must directors' intent be single-purposed and secondly, to what extent must directors as individual members of a board apply their minds to the proposed discretionary exercise.

A trustee is required by law to exercise a power 'with an entire and single view to the real purpose and object of the power'.[59] The role of the

[46] *Ibid.* 211.
[47] *Ibid.* 210.
[48] *Ibid.* 228.
[49] *Ibid.* 220.
[50] *Ibid.* 221.
[51] [1963] N.S.W.R. 138.
[52] *Ibid.* 141. On 26 June 1961 the directors advised that they did not intend 'for the time being to make any further call for capital' but some weeks later the directors were exploring the possibility of obtaining more share capital by means of calls.
[53] *Ibid.* 142.
[54] *Ibid.* 146.
[55] *Ibid.* 145.
[56] *Ibid.*
[57] *Ibid.*
[58] Further support for this can be found in Helsham J.'s remarks in *Provident International Corporation v. International Leasing Corporation Ltd* (1969) 89 W.N. (N.S.W.) 370, 379 that where directors act contrary to the Companies Act, this would 'establish a *prima facie* case of abuse of the power calling for an explanation or justification by the actors'.
[59] Hatherly L. C. in *Topham v. Duke of Portland* (1864) 11 H.L.C. 32, 54; 11 E.R. 1242.

company director, however, is more complex and not as clearly defined as that of the trustee. Directors of companies which have commercial objects are expected to take business risks with the corporate property in which they often have an interest as shareholders,[60] executives[61] and sometimes as creditors.[62] Also, the policy they pursue, in theory at least, is subject to the will of the shareholders as the directors can usually be replaced by a majority vote of the shareholders at a general meeting.[63] This conglomerate of considerations led Dixon J. to reflect that to determine a director's purpose is to undertake 'an almost infinite analysis of the fears and desires, proximate and remote, which, in truth, form the compound motives usually animating human conduct . . .'.[64]

In recognition of this Dixon J. proposed that the court disregard incidental motives and concern itself only with the 'substantial object'[65] which the directors hoped to accomplish by the exercise.[66] Thus while directors may be aware of personal advantages, financial and otherwise, of a particular share issue, which they may time to defend against a takeover bid or to facilitate a merger, as long as the substantial object which the directors hope to accomplish is a proper purpose, the issue is a valid one.

Secondly, a collective board decision is normally required for directors as agents to bind the company.[67] The fiduciary duty of good faith, however, is owed individually by each director[68] to the company.[69] It has been thought to follow from this proposition that each or at least the majority of the directors must apply their minds to the issue and decide to make

[60] Companies who appoint outside directors often require them to hold qualification shares so that they are 'more interested' in the company's performance. In the past, if the director was well known, such action additionally served to make capital subscription more easy.

[61] Executive managers are personally linked to the company by their career aspirations.

[62] The directors in Richard Brady Franks Limited were also creditors, *Richard Brady Franks Ltd v. Price* (1937) 58 C.L.R. 112.

[63] Directors can make decisions within their power which are contrary to the wishes of the shareholders. See *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cuninghame* [1906] 2 Ch. 34.

[64] *Mills v. Mills* (1938) 60 C.L.R. 112, 185. Also see Berger J. in *Tech Corporation Ltd v. Millar* (1973) 33 D.L.R. (3d) 288, 325.

[65] *Mills v. Mills* (1938) 60 C.L.R. 112, 186. Also see Latham C.J.'s remarks at page 162.

[66] Dixon J.'s 'substantial object' test has been expressly applied in *Ngurli Ltd v. McCann* (1953) 90 C.L.R. 425, 445; *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 493; *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 857; *Tech Corporation Ltd v. Millar* (1973) 33 D.L.R. (3d) 288, 327; *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 693.

[67] Gower L. C. B., *Modern Company Law* (3rd ed 1969) 517.

[68] *Ibid.*

[69] *Percival v. Wright* [1902] 2 Ch. 421. *Cf.* Dixon J. in *Richard Brady Franks Ltd v. Price* (1937) 58 C.L.R. 112, 143. This raises a moot point as to how individual shareholders have successfully brought an action before the Court in the light of the *Foss v. Harbottle* (1843) 2 Hare 461; 67 E.R. 188 ruling. On this point see Lindgren K. E., 'Company's Power to Issue Shares' (1971) 10 *University of Western Australia Law Review* 364, 383-6 and Thompson C. J. H., 'Share Issues and the Rule in *Foss v. Harbottle*' (1975) 49 *Australian Law Journal* 134.

the issue primarily for a proper purpose. The appellants in *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.*[70] alleged the defendant directors 'were merely compliant with any recommendation made by Withers [the Managing Director]'.[71] The High Court in a joint judgment[72] thought the plaintiffs would establish their case that the issue was improper if they could show 'an absence of attention on the part of the directors other than Withers to any question about the allotment . . .'.[73] Plaintiff's counsel argued before Street C.J. in *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd*[74] that one of the board's directors, the alternate director (Mr Balhorn) was merely complying with the will of his principal director[75] (Mr Duncan). Street C.J. found that 'whilst undoubtedly strongly influenced by Mr Duncan's expressed concurrence, Mr Balhorn's role at the Board meeting was not that of a mere cipher'.[76]

On the other hand, F. J. Willett in his article 'Conflict between Modern Managerial Practice and Company Law'[77] indicates how company law has failed to develop from its early British formulations and concludes 'that directors are barely aware of their review and trustee functions and are powerless to exercise them in the face of a strong chief executive . . .'.[78]

In *Tech Corporation Ltd v. Millar*[79] Berger J. thought that this 'classical theory that once was unchallengeable must yield to the facts of modern life'[80] and without argument the learned judge accepted that the managing director's mind 'was the dominant mind on the board'.[81] The Privy Council in *Howard Smith Ltd v. Ampol Petroleum Ltd*[82] also thought that the nature of discretionary power had to be considered in the light of modern conditions[83] giving 'credit to the *bona fide* opinion of the directors, if such is found to exist'.[84]

It is respectfully submitted that if an Australian court had to consider if a director satisfied his or her duty of good faith, it would do so in the context of that particular board's normal decision-making process. If the board's practice is for directors to play an advisory role, then the directors will have applied their minds to the exercise of power by giving any necessary advice. If the board normally functions democratically, then the fiduciary requirement will be seen in that light. To decide otherwise is to

[70] (1968) 121 C.L.R. 483.
[71] *Ibid.* 499.
[72] Comprising Barwick C.J., McTiernan and Kitto JJ.
[73] *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 499.
[74] [1972] 2 N.S.W.L.R. 850.
[75] *Ibid.* 861.
[76] *Ibid.*
[77] (1967) 5 *M.U.L.R.* 481.
[78] *Ibid.* 494.
[79] (1973) 33 D.L.R. (3d) 288.
[80] *Ibid.* 314.
[81] *Ibid.* 317.
[82] [1974] 2 W.L.R. 689.
[83] *Ibid.* 697.
[84] *Ibid.*

drive the principle of fiduciary duty to demand boards to be constituted by directors endowed with the expensive qualities of time, skill, knowledge and independence[85] to form an opinion and vote according to a decision-making process which may neither be practical nor efficient. It is submitted that in the decided Australian cases[86] the board's directors did vote independently, while the *Tech* and the *Howard Smith* cases indicate that there is no legally required board decision-making process and that even if there once was, it will not stand against modern corporate practice.

3. THE OBJECTIVE ELEMENTS OF THE PROPER PURPOSE TEST

The current major element of the proper purpose test is to examine the exercise under challenge and see if a reasonable board could also have made the same exercise.[87]

An objective review of directors' actions could include all their managerial decisions,[88] or at least those relating to a discretionary power exercise, the decision to exercise a particular power, and finally, whether the purpose the directors hoped to accomplish was within their discretion.

The Courts have consistently[89] declared that

> 'there is no appeal on merits from management decisions to courts of law, nor will the courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at . . .'.[90]

This statement is not a rejection of objective standards since in practice some objective standard is often applied to directors' managerial decisions, and in theory as well as practice the proper purpose test is predominantly[91] an objective test.

[85] Cowen Z., 'Company Director' (1967) 2 *University of Tasmania Law Review* 361 repeats the observation 'that if you pay directors peanuts you must expect monkeys . . .'.

[86] Neither the board of Woodside (Lakes Entrance) Oil Co. N.L. nor that of R. W. Miller (Holdings) Ltd had a large number of executive directors at the time of the contested issue.

[87] Afterman A. B., *Company Directors and Controllers* (1970) 45; Ford H. A. J., *Company Law* (1974) 338; and Gower L. C. B., *Modern Company Law* (3rd ed 1969) 520 are unanimous that directors' discretionary power exercises if challenged are objectively reviewed.

[88] There is no general common law standard of the reasonable competent director. However see Romer J.'s *dictum* in *Re City Equitable Fire Insurance Co. Ltd* [1925] Ch. 407, 428-9 and Menzies J.'s article 'Company Director' (1959) 33 *Australian Law Journal* 156, 163.

[89] In *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 499 the High Court applied the trial judge's finding that 'the directors' opinion of the needs of the company was imprecise, probably intuitive and maybe erroneous . . .'. *Australian Metropolitan Life Assurance Co. Ltd v. Ure* (1923) 33 C.L.R. 199, 215 where Isaacs J. remarked that 'all the directors might well have believed rightly or wrongly . . .'. Also see *Ansett v. Butler Air Transport Ltd* (No. 1) (1957) 75 W.N. (N.S.W.) 299, 303; *Hogg v. Cramphorn Ltd* [1967] Ch. 254, 267.

[90] *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 694.

[91] *Ibid.* 697, where their Lordships considered part of the test would be the *bona fide* opinion of the directors and their managerial judgment.

Street C.J. in *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd*[92] stated that the courts would accept directors' honest managerial mistakes,[93] but then went on to review the managerial data to find that he was 'not satisfied that the company's [R.W. Miller (Holdings) Ltd's] financial affairs were at crisis point . . .'.[94] The learned judge thought that this, when combined with other factors,[95] indicated that the directors' evidence was 'reconstruction and not recollection'.[96] It is respectfully submitted that to weigh the directors' evidence of their managerial assessment against the court's view of the corporate position, while an excellent evidentiary device, also applies an objective standard where no account of the directors' competence is made. Street C.J. does not seem to have tuned his objective findings to the directors' competence.[97] In the sense that it is too easy to assume that the directors are competent and too difficult for the directors to establish or want to establish their incompetence, an objective standard is often applied to directors' managerial assessment of the corporate needs.

A court will review a board's exercise of a discretionary power to determine if a reasonable board would consider that there was sufficient nexus between the corporate need and the particular power chosen to meet that need. In *Shuttleworth v. Cox Brothers & Co. (Maidenhead) Limited*[98] the Court of Appeal had to consider the validity and honesty of the shareholders' vote to alter the company's articles of association. The court was unanimous that a finding that the alteration was oppressive[99] or could not have been based on reasonable grounds[1] might indicate lack of good faith on the part of the shareholders.

Bankes and Scrutton L.JJ.[2] also considered that the decision needed to be a reasonable one[3] or based on reasonable grounds[4] and the absence of such would indicate that 'the shareholders with the best of motives have not considered the matters which they ought to have considered'.[5] These remarks along with those of the Earl of Selborne[6] are the most often cited for the requirement that the power exercise must be a reasonable one.[7] The

[92] [1972] 2 N.S.W.L.R. 850. [93] *Ibid.* 873.
[94] *Ibid.* 872.
[95] *Ibid.* 876-7. Street C.J. found that the company had not concerned itself with relevant accounting data, taxation implications of loan against share, nor the effect of the issue on shareholder's equity. He also found that the issue was contrary to the board's past policy. [96] *Ibid.* 878.
[97] *Ibid.* 856. Street C.J. does comment on the capacity of the directors but not in reference to their decision to issue shares to Howard Smith Ltd.
[98] [1927] 2 K.B. 9. [99] *Ibid.* 18, *per* Bankes L.J.
[1] *Ibid.* 23, *per* Scrutton L.J., 27 *per* Atkin L.J.
[2] *Ibid.* 27 Atkin L.J. thought the question solely determined by the shareholders acting in good faith.
[3] *Ibid.* 18. [4] *Ibid.* 23.
[5] *Ibid.*
[6] *Hirsche v. Sims* (1894) A.C. 654, 660-1.
[7] *Cf.* Lord Greene M.R. in *Re Smith and Fawcett Limited* [1942] Ch. 304, 306 where he considered that directors when refusing to register a share transfer needed to be '*bona fide* in what they consider — not what the court may consider — is in the interests of the company, and not for any collateral purpose . . .'. This is contrary to the High Court decision of *Australian Metropolitan Life Assurance Co. Ltd v. Ure*

different approaches of Bankes L.J.'s reasonable decision, and Scrutton L.J.'s reasonable grounds have persisted, with later cases citing one or the other.[8] The Australian High Court on the other hand, has consistently thought that the decision must be a reasonable one.[9] This and the remoteness of the possibility of the different phrases being applied differently makes concern almost insignificant. If, however, the law's policy is to maintain an objective standard to protect the shareholders' interests, it is submitted that the better test is reasonable decision, as the reasonable grounds approach is orientated more towards the basis of the decision than the result of the decision, and thus places less emphasis on the shareholders' interests.[10]

The scope of judicial review to decide what is a reasonable exercise takes account of the nature of the corporation,[11] the nature of the power,[12] possible alternative actions,[13] and the possible effect of the exercise,[14]

(1923) 33 C.L.R. 199. Sealy L. S., 'Company Directors' Power — Proper Motive But Improper Purpose' [1967] *Cambridge Law Journal* 33, 35 considers that 'there should be no other test than the genuineness of the directors' own motive, provided of course that their view is one that could reasonably be held — the line is drawn short of there being "amiable lunatics" '. *Cf.* other academic commentators, Lindgren K. E., 'Company Power to Issue Shares' (1971) 10 *University of Western Australia Law Review* 364, 372 and Bird J. R., 'Proper Purposes as a Head of Directors Duties' (1974) 37 *Modern Law Review* 580, 584, who take a stronger objective approach.

[8] For reasonable grounds see *Provident International Corporation v. International Leasing Corporation Ltd* (1969) 89 W.N. (N.S.W.) 370, 378 and *Tech Corporation Ltd v. Millar* (1973) 33 D.L.R. (3d) 288, 315. For reasonable decision see *Savoy Corporation Limited v. Development Underwriting Limited* [1963] N.S.W.R. 138, 148.

[9] *Australian Metropolitan Life Assurance Co. Ltd v. Ure* (1923) 33 C.L.R. 199, 481, 491; *Richard Brady Franks Ltd v. Price* (1937) 58 C.L.R. 112, 136, 138; *Mills v. Mills* (1938) 60 C.L.R. 150, 163, 164, 170; *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457, 481, 491; *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 487, 491.

[10] Helsham J. used reasonable grounds in *Provident International Corporation v. International Leasing Corporation Ltd* (1969) 87 W.N. (N.S.W.) 370, 378 and the learned judge also considered directors' 'failure to consider the interest of the general body of shareholders at all is in my view an abuse of the fiduciary powers vested in the directors . . .'. However Jacobs J. in *Savoy Corporation Limited v. Development Underwriting Limited* [1963] N.S.W.R. 138, 146, thought that if the directors considered the interest 'of the shareholders as shareholders insofar as it concerns the interests of the company as a corporate structure . . .' that would suffice. This was approved and applied by Berger J. in *Tech Corporation Ltd v. Millar* (1973) 33 D.L.R. (3d) 288, 314. For comment on Berger J.'s lack of reference to the majority shareholders' interests see Ziegal J. S., 'Directors' Powers and the Proper Purpose' [1974] *The Journal of Business Law* 85, 86.

[11] Isaacs J. in *Australian Metropolitan Life Assurance Co. Ltd v. Ure* (1923) 33 C.L.R. 199, 217; Lord Greene M.R. in *Re Smith and Fawcett Limited* [1942] Ch. 304, 306; the Privy Council in *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 697.

[12] See counsel for the appellants in *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 486; Street C.J. in *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 881; *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 697.

[13] In *Mills v. Mills* (1938) 60 C.L.R. 150, 157 counsel for the respondents argued that 'what Mills wanted to do was to distribute the reserve, this was what he set out to do, and it could not be done without the bonus shares . . .'. In *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 877 Street C.J. considers the benefits of loan against a share issue.

[14] See counsel for the appellants in *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 486; Street C.J. in *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 877; *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689.

weighted against the directors' and court's view of the corporate need.[15] The standard to which the directors must conform is that a reasonable man could also think the exercise beneficial for the company interests as a whole;[16] or, where the exercise affects the rights of shareholders *inter se*, then it is a question of 'what is fair as between different classes of shareholders'.[17]

The Privy Council in *Howard Smith Ltd v. Ampol Petroleum Ltd*[18] rejected[19] the use of Lord Lindley's test of '*bona fide* for the benefit of the company as a whole',[20] but their Lordships did not reject the use of an objective test since the share issue before the court was found invalid because it contravened the company's constitutional checks and balances, which maintained the corporate power structure protecting both the directors'[21] and shareholders' rights.[22] Their Lordships did consider a share issue could be made for a variety of different reasons, some not related to the company's need for capital,[23] but all related to a purpose for which the power over the share capital was conferred.[24] The importance of *Howard Smith Ltd v. Ampol Petroleum Ltd*[25] is not the confirmation that a share issue made solely to create or destroy an existing majority is invalid,[26] but the explanation why such an issue 'must be unconstitutional'.[27] Their Lordships did not provide, however, any guidance as to when a share issue

[15] *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 491; Street C.J. in *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 872. Where a company is a target for a takeover bid, Harper J. B. and Browne A. A., 'The Duties and Liabilities of a Director in 1973' (1973) 47 *Australian Law Journal* 447, 449 regard the corporate need under the 'general law' which the directors should act on, is only to inform the shareholders of all facts regarding true share value and not to fight a takeover bid. The modern trend however seems to regard a takeover bid as one factor by which to view the reasonableness of the directors' actions.

[16] Lord Evershed M.R. defines this in *Greenhalgh v. Arderne Cinemas Ltd* [1951] Ch. 286, 291. Whether this expression includes future shareholders' interests is a moot point. Authority that it does is the Savoy Hotel dispute, England, *Savoy Hotel Ltd and Berkeley Hotel Ltd, Report by E. Mulner Holland Q.C.* (1954), and Helsham J.'s *dictum* in *Provident International Corporation v. International Leasing Corporation Ltd* (1969) 89 W.N. (N.S.W.) 370, 378. On the other hand there is no doubt that an exercise solely in favour of employees or the public in general is not in the interests of the company. *Parke v. Daily News Ltd* [1962] Ch. 927; *Dodge v. Ford Motor Company* 20 Mich. 459, 170 N.W. 668 (1919).

[17] *Mills v. Mills* (1938) 60 C.L.R. 150, 164.

[18] [1974] 2 W.L.R. 689.

[19] The use of this phrase had not escaped previous judicial comment. See Aitkin L.J. in *Shuttleworth v. Cox Brothers & Co. (Maidenhaid) Ltd* [1927] 2 K.B. 9, 26; Rich J. in *Richard Brady Franks Ltd v. Price* (1937) 58 C.L.R. 112, 138 and in *Mills v. Mills* (1938) 60 C.L.R. 150, 169; Dixon J. in *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457, 509.

[20] Formulated in *Allen v. Gold Reefs of West Africa, Ltd* [1900] 1 Ch. 656.

[21] *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 699. Their Lordships cited *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cuninghame* [1906] 2 Ch. 34 as authority for this proposition.

[22] *Ibid.*

[23] *Ibid.* 697. Also see Helsham J.'s remark in *Provident International Corporation v. International Leasing Corporation Ltd* (1968) 89 W.N. (N.S.W.) 370, 378 that 'there must be some nexus between the issue and a desirable capital structure of the company . . .'.

[24] *Ibid.* 689.

[25] *Ibid.*

[26] This was established in *Fraser v. Whalley* (1864) 2 Hem. and M. 10; 71 E.R. 361 and confirmed in a multiplicity of cases.

[27] *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 699.

destroying or creating a new majority would be valid — indeed they found that all the 'different situations cannot be anticipated'[28] — nor as to when a share issue made proportionally to existing shareholders would be invalid. Their Lordships did recognize 'the main stream of authority'[29] which holds that where the corporate contract[30] does not resolve the matter, then the power must be exercised as a reasonable director could think would be in the company's interests.

The Privy Council also thought that, in determining if the purpose was proper or not, credit ought to be given 'to the *bona fide* opinion of the directors if such is found to exist. . .'.[31] The directors may not possess a *bona fide* opinion because they have acted dishonestly or have assumed the purpose proper. If this is what their Lordships mean, they have made the proper purpose test more objective by departing from the traditional requirements that directors act honestly[32] in applying[33] their minds to the purpose of the exercise. Their Lordships, however, did consider the proper purpose test founded on the directors' substantial purpose[34] with objective guides to ascertaining the directors' substantial purpose.

In summary, the proper purpose test currently demands that directors assess their managerial data honestly and reasonably, have regard to implied constitutional limitations, and exercise their powers honestly and for purposes a reasonable director in the same circumstances could think beneficial for the company as a whole.

4. THE SIGNIFICANCE OF DIRECTORS' INTENTIONS WHEN THE SHARE ISSUE CAN BE OBJECTIVELY JUSTIFIED

The early proper purpose cases concerned share issues made solely to enable directors to retain their position on the board[35] or their control of management.[36] Because these share issues were motivated by self-interest,

[28] *Ibid.* 697.

[29] *Ibid.*

[30] See *Australian Metropolitan Life Assurance Co. Ltd v. Ure* (1923) 33 C.L.R. 199, 217; *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457, 495; *Re Smith and Fawcett Limited* [1942] Ch. 304, 306; *Woods v. Cann* (1963) 80 W.N. (N.S.W.) 1583, 1596 for authority that the starting point of the proper purpose test is the company's constitution.

[31] *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 697.

[32] *Australian Metropolitan Life Assurance Co. Ltd v. Ure* (1923) 33 C.L.R. 199, 217; *Mills v. Mills* (1938) 60 C.L.R. 150, 163; *Grant v. John Grant & Sons Pty Ltd* (1950) 82 C.L.R. 1, 31; *Savoy Corporation Limited v. Development Underwriting Limited* [1963] N.S.W.R. 138, 145; *Provident International Corporation v. International Leasing Corporation Ltd* (1969) 89 W.N. (N.S.W.) 370, 377; *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 493; *Tech Corporation Ltd v. Millar* (1973) 33 D.L.R. (3d) 288, 316.

[33] *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 499; *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 861.

[34] *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 697.

[35] *Fraser v. Whalley* 2 Hem. and M. 10; 71 E.R. 361; *Punt v. Symons & Co.* [1903] 2 Ch. 506.

[36] *Piercy v. S. Mills and Company Limited* [1920] 1 Ch. 77.

the court would not permit any argument that the issues were in the interests of the company.[37] Another common thread was the courts' concern to regulate exercises of power which were expressed to be subject only to the directors' discretion.[38]

The legacy of these cases was to focus on the need that directors must act honestly[39] and not for ulterior purposes.[40] The corollary of this approach is to disregard whether the action did or did not actually benefit the company.[41] In later cases, where the directors were motivated by what they thought was in the best interests of the company, the courts, with the benefit of cases which had decided that some purposes were improper, began to review exercises objectively, so that the directors' honesty alone was not enough to make the issue valid.[42] Of course, as long as there continues to be no recognized objective standards for managerial decisions, the directors' honesty at that level remains the 'ultimate question'.[43]

Honesty at the managerial level requires the directors to investigate and weigh the available data in what they consider is in the best interests of the company.[44] Honesty and good faith at the level of the decision to exercise a discretionary power is defined more widely and means that the power must be exercised 'for the purpose for which it was conferred'.[45] It is submitted that good faith, in the sense of the directors' actuating purposes, is irrelevant and anachronistic, as the exercise should and can only be reviewed objectively. If power exercise is objectively supported, notwithstanding that the directors were actuated by an improper purpose, the exercise should not be open to challenge.[46]

While there are considerable judicial *dicta* demanding that directors act positively for the right purposes, the right action for the wrong purposes has never put this to the test, as plaintiffs have not been able to discharge the onus of proving the directors were substantially motivated by an improper purpose in face of contrary objective evidence. Indeed, the directors could, where there is no *prima facie* case to answer, prefer silence and no adverse inference would be drawn against them. A case in point in

[37] *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 696.

[38] *Fraser v. Whalley* 2 Hem. and M. 10, 29; 71 E.R. 361.

[39] *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 499; *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 861.

[40] For an excellent discussion of the early policy considerations see Dixon J. in *Peters' American Delicacy Co. Ltd v. Heath* (1939) 61 C.L.R. 457, 511.

[41] *Ashburton Oil N.L. v. Alpha Mineral N.L.* (1971) 45 A.L.J.R. 162, 166.

[42] The leading cases here are *Hogg v. Cramphorn Ltd* [1967] Ch. 254 and *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689.

[43] *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.* (1968) 121 C.L.R. 483, 493.

[44] To the writer's knowledge there are no decided cases on this point.

[45] *Australian Metropolitan Life Assurance Co. Ltd v. Ure* (1923) 33 C.L.R. 199, 217; *Provident International Corporation v. International Leasing Corporation Ltd* (1969) 89 W.N. (N.S.W.) 370, 377.

[46] *Cf. Ashburton Oil N.L. v. Alpha Minerals N.L.* (1971) 45 A.L.J.R. 162, 166.

Australia is *Australian Metropolitan Life Assurance Co. Ltd v. Ure*[47] where the directors refused and were not called to give evidence. The High Court judged the circumstances and formed its conclusions on reasonable probabilities, finding that the directors' refusal to register the share transfer could well have been based on business considerations.

In the *Ampol* case it must be doubted whether Street C.J., and the Privy Council on appeal, would have found the directors' evidence unacceptable, despite the Howard Smith letter,[48] if the evidence had indicated an urgent need for capital and if the directors had fully considered the effect of raising capital by a share issue rather than a loan.[49]

Given that it is difficult, if not usually impossible, to establish *mala fides* where an exercise is objectively supported, and also recognising this difficulty is aggravated by the courts' acceptance of incidental improper intentions as long as the substantial intent is proper, could a court find the directors' actuating purpose irrelevant, or only one factor to consider when deciding on which 'side of a fairly broad line'[50] the exercise falls?

Today section 124 of the Companies Act 1961,[51] as interpreted by Gowans J. in *Marchesi v. Barnes and Keogh*,[52] can be used by the court to regulate the directors' conduct. Gowans J. had to consider if the defendants, Barnes and Keogh,[53] in making a share issue for the purpose of altering control of a particular class or group of shareholders, were in breach of the requirement set out in section 124 that the directors must act honestly. The learned judge thought since the directors were aware

[47] (1923) 33 C.L.R. 199.

[48] A letter dated 6 July 1972 from W. Howard Smith, chairman of directors of Howard Smith Limited, spelling out the 'improper' reasons for the issue as reported in *Ampol Petroleum Ltd v. R.W. Miller (Holdings) Ltd* [1972] 2 N.S.W.L.R. 850, 859-61.

[49] A powerful objective consideration must be whether the company is experiencing a takeover bid. If a share issue is made as a defence the directors' *bona fides* will be more difficult to establish.

[50] *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 689, 697.

[51] S. 124 of the *Companies Act* 1961 provides:

(1) A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office.

(2) An officer of a corporation shall not make improper use of information acquired by virtue of his position as such an officer to gain directly or indirectly an advantage for himself or for any other person or to cause detriment to the corporation.

(3) An officer of a corporation who commits a breach of a provision of this section is —

(a) liable to the corporation for —

(i) profit made by him; and

(ii) damage suffered by the corporation — as a result of the breach; and

(b) guilty of an offence against this Act.

Penalty: $2,000.

(4) This section has effect in addition to and not in derogation from any other enactment or rule of law relating to the duty or liability of a director or officer of a corporation.

Officer is defined in s. 5(1) and includes director.

[52] [1970] V.R. 434.

[53] *Ibid.* 435. Informations were laid with the general consent of the Minister by Leo Valentine Marchesi, who was an officer of the Registrar of Companies.

> that the allotment was not being made in the interest of the company, it is sufficiently alleged that there was conscious and deliberate conduct in disregard of those interests, and, . . . that is sufficient to satisfy the charge of not acting honestly in the discharge of the duties of the office of director. . . .[54]

Section 124 of the Companies Act successfully regulates the directors' positive conduct but does not protect the company's corporate interests, since the allotment stands.

However, in previous proper purpose cases where the court has found a share issue an improper exercise, the issue has been held voidable and not void.[55] The allotment could be set aside only if the allottee possessed the knowledge that the share issue was made for an improper purpose. In *Harlowe's Nominees Pty Ltd v. Woodside (Lakes Entrance) Oil Co. N.L.*,[56] although the High Court did not have to decide if the share issue was voidable or void, the court remarked:

> we must make it clear that we are not to be taken as denying that Burmah's legal title to the shares would have provided an effective answer to a claim for the relief that Harlowe seeks, in the absence of a finding that at the time of the allotment Burmah had notice of the breach of duty. . . .[57]

The court must be taken to have been giving a warning that today it is too easy to allot shares for an improper purpose to an innocent purchaser.[58] Yet commercial certainty requires that an allotment cannot merely be set aside because of the hidden motives of directors, particularly when the allotment, viewed objectively, is sound business practice. This dilemma could be resolved by imputing knowledge to the purchaser when the objective evidence does not support the allotment.

This approach is also consistent with commercial reality because, if an objectively viable issue made for an improper purpose were challenged, there would appear to be no reason why the directors could not make an identical or similar issue.[59] The directors could argue that they have seen their former error, but proper considerations now demand the issue to meet an existing need, or a need which will revive if the challenged issue is put aside.

There may, however, be a practical advantage for the issue to go before the shareholders at a general meeting, because they may vote to avoid the allotment and vote the directors from office at the same meeting. Questions of timing and procedure can be endless in their ramifications, but, it is

[54] *Ibid.* 438.

[55] *Richard Brady Franks Ltd v. Price* (1937) 58 C.L.R. 112, 142-3; *Bamford v. Bamford* [1969] 2 W.L.R. 1107, 1111-2; *Ashburton Oil N.L. v. Alpha Minerals N.L.* (1971) 55 A.L.J.R. 162, 173 (*per* Windeyer J.), but *cf.* 166 (*per* Menzies J.).

[56] (1968) 121 C.L.R. 483.

[57] *Ibid.* 500.

[58] The merger and acquisition boom is a post World War II phenomenon. See generally Hayes S. L. and Taussig R. A., 'Tactics of Cash Take Over Bids' [1967] 2 *Harvard Business Review* 135.

[59] Shareholders would probably only be advised to challenge an issue which objectively appears proper, where they have the support of extrinsic evidence such as the minutes of the board meeting, or meetings, or correspondence which indicate the directors' *mala fides*.

submitted, to put all proposed share issues before shareholders so that they may vote directors from office is contrary to the accepted findings of *Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cuninghame.*[60]

Finally, shareholders could not stop the directors making another issue for the High Court in *Ashburton Oil N.L. v. Alpha Mineral N.L.*[61] held that shareholders did not have any equitable interest[62] to apply for an injunction restraining directors from making further allotments despite a former allotment having been challenged in the court, and accordingly that

> a blanket prohibition against the issue or allotment of shares or the making of an agreement to issue or allot shares, which would prevent an entirely proper issue of shares, ought never to be made. . . .[63]

5. CONCLUSION

It is respectfully submitted that the directors' decisions to issue shares should only be reviewed objectively. The directors' beliefs and actuating purpose in making a share allotment should be disregarded and the allotment considered objectively, because to do otherwise is to ignore the evidentiary impossibilities of establishing *mala fides* in the face of contrary objective evidence and the practicalities of the directors making an additional issue for another purpose yet achieving the same effect. A predominant objective assessment also has the advantage of resolving the void or voidable share issue dilemma by a commercially realistic mechanism. In conclusion, it is respectfully submitted that an improper share allotment which objectively falls on the side of a proper share issue should not be set aside as it could be 'affirmatively shown that in the events that had happened no useful result could possibly ensue . . .'.[64]

[60] [1906] 2 Ch. 34. This decision was approved and applied by the Privy Council in *Howard Smith Ltd v. Ampol Petroleum Ltd* [1974] 2 W.L.R. 687, 699.
[61] (1971) 45 A.L.J.R. 162.
[62] *Ibid.* 167.
[63] *Ibid.*
[64] *Per* Dixon J. in *Richard Brady Franks Ltd v. Price* (1937) 58 C.L.R. 112, 143.