

Director's Duty to Act for a Proper Purpose in the Context of Distribution under the *Companies Act* 71 of 2008

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Abstract

This paper seeks to critically analyse the requirements of the duty imposed on directors to act for a proper purpose as provided in section 76(3)(a) of the 2008 Act (*Companies Act* 71 of 2008) whenever they distribute company money and/or property. This analysis is conducted with the obligations imposed under sections 4 and 46 of the 2008 Act in mind. The purpose is not to question the inclusion of this duty in the 2008 Act. It is simply to question whether the common law interpretation of the duty still suffices in the face of section 76(3) of the 2008 Act, which seems to suggest that a different standard of judgment must be used. The argument that is made here is that the use of common law principles in interpreting proper purpose is well and good when the actions of directors are challenged based on the common law, but, where this duty has been incorporated into statutory law the interpretation of the duty in the context of the wording of the statute should be paramount. In addition, when interpreting any provision of the Act, consideration of the objects of the statute becomes inevitable. The interpretation of the duty cannot, in the face of the changes brought about by the statute, remain stagnant as a result of reliance on common law standards of judgment. The wording of the provision in question and the purpose of the statute cannot and must not be ignored; they must be given effect. A comparative approach will be adopted, using legislation and case law from Australia and Canada. The selection of these particular jurisdictions is based solely on the fact that like South Africa, their legal heritage is based on English common law, and a comparison of the three jurisdictions therefore makes sense.

Keywords

Companies Act 2008; proper purpose; duties of directors; distribution; primary purpose test; dominant test; subjective test; objective test

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1 Introduction

In its endeavours to change the long-standing common law position on company law, the *Companies Act 71 of 2008* (hereinafter "the 2008 Act")¹ has partially codified the duty to act for a proper purpose. Looked at through the lens of the provisions regulating the distribution of company money and/or property, its purpose, as described in the overall objects of the Act in section 7 is to preserve the existence of companies as vehicles to do business but also to reaffirm the concept of a company as a means to achieving economic and social benefits. These were the policy directives issued by the South African government in its 2004 policy paper, which have been transfused into the 2008 Act.² Section 5(1) of the 2008 Act enjoins our courts to interpret and apply the provisions of the Act in a manner which gives effect to the purposes set out in section 7.³ The latter statement suggests that whenever disputes pertaining to the distribution of company

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¹ The *Companies Act 71 of 2008* (the 2008 Act) was assented to by the President on 9 April 2009. The Act came into operation on 1 May 2011 (Proc 32 in GG 34239 of 26 April 2011). The 2008 Act amended the *Companies Act 61 of 1973*. S 224 provides for the partial repeal of the 1973 Act.

² See s 7(d) and (e) of the 2008 Act. Furthermore, and as far as is relevant, this section states that the purposes of the Act are to: "(a) promote compliance with the Bill of Rights; (b)(i) and (iii) encourage enterprise efficiency and high standards of corporate governance, given the significant role of enterprises within the social and economic life of the nation respectively; (e) use of companies in a manner that enhances the economic welfare of South Africa; (i) balance the rights and obligations of shareholders and directors within companies; (j) encourage efficient and responsible management of companies; and (l) to provide a predictable and efficient and effective environment for the efficient regulation of companies". These objectives cannot be ignored in interpreting any provision. *Nedbank Ltd v The National Credit Regulator 2011 3 SA 581 (SCA)* para 2. According to the 2004 South African government-issued policy paper entitled "South African Company Law for the 21st Century: Guidelines for Corporate Law Reform" (hereinafter referred to as "Guidelines for Corporate Law Reform") "Old concepts have been modified or abandoned or new ones have come to the fore informed by the globalised environment within which companies operate, increased innovation in electronic interaction, as well as greater sensitivity to societal and ethical concerns, and greater competition for capital, goods and services." See Gen N 1183 in GG 26493 of 23 June 2004. Also see Henning 2010 *Acta Juridica* 456, Knight 2010 *Acta Juridica* 2.

³ Quite apart from the South African position, in the UK s170(4) of the *Companies Act, 2006* provides that the general duties are to be interpreted and applied in the same way as common law rules or equitable principles, and regard should be had to the corresponding rules and equitable principles in interpreting and applying the general rules. *Eclairs Group Ltd and Glengary Overseas v JKX Oil & Gas plc 2015 WLR (D) 497* para 14 (hereinafter "*Eclairs Group Ltd*").

money or property or related to how directors perform their duties in relation to the company in question are brought before our courts, the courts have the responsibility to ensure that the performance of those duties is interpreted in the context of fulfilling the purposes/objects of the Act as set out in section 7.

Rules pertaining to the distribution of company money or property serve an important role as one of the mechanisms used by the 2008 Act to achieve that which it envisages under section 7 of the Act, that is, to preserve the existence of companies, but also to reaffirm the concept of a company as a means to achieving economic and social benefits. Thus, one of the cardinal purposes of the distribution rules is to ensure that the company is managed judiciously.⁴ These rules impose obligations on directors and as such must be observed, based on the duties of directors as provided under section 76(3) of the 2008 Act. One of the duties under section 76(3) which directors must perform when acting in that capacity is to exercise their powers and perform their functions for a proper purpose.⁵

Previously, prohibitions against directors' actions in the realm of improper purpose were to the effect that directors may not distribute assets of the company among its redundant employees for the sole purpose of treating employees generously, other than the members,⁶ or to issue shares or refuse to do so for an improper purpose, or contravene common law rules by paying dividends out of capital,⁷ for example, unless they honestly

⁴ To ensure that this is achieved, the 2008 Act sought to strengthen the rules relating to the distribution of company money or property. Changes to the distribution rules were first brought about by the *Companies Amendment Act 37 of 1999*. The *Companies Amendment Act 37 of 1999* was signed into law on 14 April 1999 and was published as GN 515 in GG 19983 of 30 April 1999. Currently these rules are regulated under the 2008 Act. As the main controlling measure against the demise of a company, both pieces of legislation introduced the solvency and liquidity test and a number of procedures which must be followed before a distribution is made. These were first introduced under ss 85(4) and 90(2) of the 1973 Act, and are now set out under s 4 of the 2008 Act. Currently this test operates in conjunction with the procedural requirements under s 46.

⁵ See s 76(3)(a) of the 2008 Act.

⁶ Other factors would include cases where the director causes the company to guarantee his or her indebtedness or to discount a bill of exchange in favour of the company for the directors' private use; and where the director pays a cheque drawn in favour of the company into his personal banking account and misappropriates the proceeds of the cheque. *Delpont et al Henochsberg on the Companies Act* 298(2). Also see *Parke v Daily News Ltd* 1962 Ch 927; and *Hutton v West Cork Railway Co* 1883 23 Ch D 654 CA 671.

⁷ *Meskin Henochsberg on the Companies Act* 389; *In Re Exchange Banking Co; Flitcroft's Case* 1882 21 Ch 519 (CA) 533-534, 535; *In re Sharpe* 1892 1 Ch 154 (CA) 165-166; *In re Kingston Cotton Mill Co (2)* 1896 1 Ch 331 347-348; *In re Duomatic Ltd* 1969 2 Ch 365 374-375; *Jacobson v Liquidator M Bulkin & Co Ltd* 1976 3 SA 781 (T) 790-791.

believed that there were profits for distribution at the time.⁸ In interpreting the rules pertaining to improper purpose practically the challenge was that divergent views persisted as to which standard of judgment should be used to determine whether an improper purpose existed in the circumstances of a particular case.⁹ The standards of judgment applied by courts varied from a "causative test" to a "subjective test", a "primary purpose test" and an "objective test".¹⁰ Judging from case law, in the process to determine whether directors acted for a proper purpose, courts in the different jurisdictions considered in this paper seem to be in tune with one another in the application of the "primary purpose test", the "dominant test" and the "causative test" to ascertain whether indeed the power conferred was exercised for a proper purpose. However, on further perusal of the contemporary jurisprudence and/or commentaries on the subject of proper purpose, one senses that the approach differs markedly on which standard to apply, whether subjective or objective or both. The difference seems to arise from the fact that the existing statutes do not attempt to define what proper purpose entails. As a result, for the purpose of decision making on the subject, the absence of a definition has suggested to commentators and the courts alike that the common law jurisprudence which over the years has informed its interpretation is still relevant, especially as some jurisdictions have more or less absorbed the common law position into their statutory frameworks. Some countries, such as South Africa, have codified directors' duties into their company law legislation, and have also statutorily provided that common law rules still apply to determine director liability.¹¹ Looking at case law in the South African context, the courts seem not to be of one mind as to which standard of judgment is contemplated under the 2008 Act. Some courts still favour an interpretation of the statutorily expressed duty of proper purpose by using only the common law objective standard of judgment. This may be justified because the duties in the 2008 Act are those applied at common law. However, the problem with approaching the interpretation of this duty in terms of common law principles only is that it stands to dilute the policy direction adopted by the Act currently in operation, especially if the Act in question contemplates charting a different course by imposing a higher standard of judgement than was the case at common law. The interpretative possibility is an adoption of a standard completely unintended by the express provisions of the Act.

⁸ Meskin *Henochsberg on the Companies Act* 389.

⁹ See Fridman 1980 *Bond LR* 165.

¹⁰ See a discussion of the operation of different tests in Langford and Ramsay 2015 *JBL* 173-182.

¹¹ See s 77(2)(a) and (b) of the 2008 Act.

This paper seeks to critically analyse the requirements of the duty imposed on directors¹² to act for a proper purpose as provided in section 76(3)(a) of the 2008 Act whenever they distribute company money and/or property.¹³ This analysis is conducted with the obligations imposed under sections 4 and 46 of the 2008 Act in mind. The purpose is not to question the inclusion of this duty in the 2008 Act. It is simply to question whether common law interpretation of the duty still suffice in the face of section 76(3) of the 2008 Act, which seems to suggest that a different standard of judgment must be used. The argument that is sought to be made here is that the use of common law principles in interpreting proper purpose is well and good when the actions of directors are challenged based on the common law, but, where this duty has been incorporated into statutory law the interpretation of the duty in the context of the wording of the statute should be paramount. In addition, when interpreting any provision of the statute, consideration of its objects becomes inevitable. The interpretation of the duty cannot, in the face of the changes brought about by the statute, remain stagnant by continued reliance on common law standards of judgment. Therefore, the wording of the provision in question and the purpose of the statute cannot and must not be ignored; they must be given effect. A comparative approach is adopted, using legislation and case law from Australia and Canada as poles of comparison. These two jurisdictions are selected solely because like South Africa their legal heritage is based on English common law, and a comparison of the three jurisdictions therefore makes sense.

2 Duty to act for a proper purpose

The duty to act for a proper purpose attaches to the exercise of powers conferred on directors, be they acting collectively or individually. The duty is

¹² Section 76(1) defines a director to include an alternate director and a prescribed officer, or a person who is a member of a committee of a board of a company, or of the audit committee of a company, irrespective of whether or not the person is also a member of the company's board. In section 1 a director means a member of the board of a company, as contemplated in s 66, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated. An alternate director is defined as a person elected or appointed to serve, as the occasion requires, as a member of the board of a company in substitution for a particular elected or appointed director of that company.

¹³ See s 66(1) of the 2008 Act and s 102 of the *Canada Business Corporations Act*, 1985 (the CBCA), which gives directors the power to make decisions. Where a director is appointed with authority to manage the affairs of the company, the director becomes the agent of the company, hence he/she stands in a fiduciary relationship. Visser *et al South African Mercantile and Company Law* 350; *Regal (Hastings) Ltd v Gulliver* 1942 1 All ER 378 (HL); and *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 217, 218.

fiduciary in nature.¹⁴ Previously the duties of directors were regulated by common law¹⁵ informed by principles from equity.¹⁶ The UK Supreme Court in *Eclairs Group Ltd*¹⁷ expressed the fundamental nature of the responsibilities of directors to act for a proper purpose as follows:

The rule that the fiduciary powers of directors may be exercised only for the purpose for which they were conferred is one of the main means by which equity enforces the proper conduct of directors. It is also fundamental to the constitutional distinction between the respective domains of the board and the shareholders.

From this narrow statement it can be gleaned that at common law it was important for directors not to overstep the bounds of the power which was conferred on them by the shareholders of the company through the company's constitution. In South African company law, directors' duties were not codified under the 1973 Act.¹⁸ The policy direction under the 2008 Act has changed, resulting in the duties being codified at a fairly high level.¹⁹ Under the 2008 Act the duty to act for a proper purpose is fused together with the duty of good faith and is regulated in terms of section 76(3)(a).²⁰ Additional to the duty to act for a proper purpose is the duty to "act in the best interests of the company" as well as with "care, skill and diligence" as regulated in sections 76(3)(b) and 76(3)(c) of the 2008 Act. As will be argued below, under the 2008 Act these duties are meant to operate cumulatively as the operation of one seems embedded in the operation of the other. Furthermore, one's intuition is raised where the duty to act for a proper purpose is not expressly required to be complied with in order for a director to earn protection under the business judgment rule as provided under section 76(4) of the 2008 Act. But, the duties regulated under sections

¹⁴ According to Nolan, proper purpose is the least discussed and least understood of the directors' fiduciary duties. See Nolan "Proper Purpose Doctrine and Company Directors" 1; and Tjio 2016 *LMCLQ* 176-185.

¹⁵ Delpont *et al Henochsberg on the Companies Act* 290(4).

¹⁶ *Eclairs Group Ltd* para 14; and *Balls v Strutt* 1841 Hare 146.

¹⁷ *Eclairs Group Ltd* para 37. Also see the discussion of the case in Langford and Ramsay 2017 *MLR* 110-120.

¹⁸ However, common law is not excluded and may still apply in some instances. Delpont *et al Henochsberg on the Companies Act* 290(4); and *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited* 2015 6 SA 338 (WCC) (hereinafter "*Mthimunye-Bakoro*"); Coetzee and Van Tonder 2016 *JJS* 1-13; Havenga 2013 *TSAR* 257-268.

¹⁹ *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty)* 2014 5 SA 179 (WCC) para 58 (hereinafter "*Visser*").

²⁰ In the UK this duty is contained in s 171(b) of the *Companies Act, 2006*; *Madoff Securities International Ltd v Raven* 2013 EWHC 3147 (Comm), before Popplewell J para 194 (hereinafter "*Madoff*"). The heading to s 171 is: "duty to act within powers". S171(b) states that: "a director of a company must only exercise powers for the purposes for which they are conferred".

76(3)(b) and (76(3)(c) are provided.²¹ Nevertheless, on proper analysis one may safely submit that taken together these duties seem to be inseparable, as it is inconceivable that the 2008 Act may require a director to act for a proper purpose without doing so in the best interest of the company and with care, skill and diligence.

Under the Australian *Corporations Act 2001* the duty to act for a proper purpose is contained in sections 181(1)(b) and 180(2)(a). Under section 180(2)(a) the duty forms part of the satisfaction of the business judgment rule. It states that "a director or officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and equity, in respect of the business judgment rule, if they make the judgment in good faith for a proper purpose".²² Under section 181(1)(b) "a director or other officer of a corporation must exercise their powers and discharge their duties for a proper purpose."

Under the *Canada Business Corporations Act, 1985* (hereinafter "the CBCA") the duty to act for a proper purpose is not included. Rather the Act emphasis the phrase "to the best interests of the company" in sections 122(1)(a),²³ fusing it with the duty to act honestly and in good faith. Under the *Corporations Act* the phrase "in the best interests of the company" is regulated in section 181(1)(a) together with the duty of good faith. The section reads "a director or other officer of a corporation must exercise their

²¹ Section 76(4)(a) of the 2008 Act states that: "in respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director of a company will have satisfied the obligations of subsection (3)(b) and (c) if...".

²² Subsection (1) basically refers to s 180(1), which states that "a director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they: (a) were a director or officer of a corporation in the corporation's circumstances, and (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer". In the United Kingdom the duty is contained in s 172(1) of the *Companies Act, 2006*. It requires directors to act in a way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.

²³ The section provides that every director and officer of a corporation in exercising their powers and discharging their duties shall, act honestly and in good faith with a view to the best interests of the corporation, and shall exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. *Peoples Department Stores Inc (Trustee of) v Wise* 2004 3 SCR 461 para 32 (hereinafter "*Peoples*"); and *BCE Inc v 1976 Debentureholders* 2008 3 SCR 560 para 36.

powers and discharge their duties in good faith in the best interests of the corporation".²⁴

3 Assessment of legal principles on the duty of proper purpose

As will appear, the Australian, Canadian and UK courts have over the years applied the same principles as the South African courts when determining whether directors acted for a proper purpose. The difference, however, has been in the preferred standard of judgment to be used in determining whether a director acted for a proper purpose. Commentators agree that the presence of the duty to act for a proper purpose under section 76(3)(a) of the 2008 Act confirms the position under common law, but in addition removes any doubts as to the existence of the duty and makes it distinct from that of good faith.²⁵ According to Cassim *et al* the setting out of this duty distinctly confirms the foundations of its legal principles, that in effect it has been used by the courts as an attempt to restrain the exercise by directors of the discretionary powers that they possess.²⁶ This was so because the nature of the application of the power is that its exercise often leads to prejudice to another party.²⁷

The words "for a proper purpose" are not defined under any of the statutes considered here. It is submitted that literally construed the duty to exercise one's powers for a proper purpose provides two connotations: (i) that, in addition to acting honestly and in good faith, a director must also exercise his/her power for the purpose for which it was conferred and not for ulterior motives; and (ii) it also could assert that directors must not act beyond their powers, which is a principle used to control power conferred on public officials under administrative law. The understanding here is that when directors conduct the affairs of the company they are expected to do so within the confines of the conferred powers and for a rational purpose.²⁸ Cassim *et al* confirms that the first connotation constitutes what the duty has always been taken to mean at common law.²⁹ This duty is distinct from the

²⁴ See the discussion of the business judgment rule in Kilian 2007 http://www.cita.edu.au/professional/papers/conference2007/2007CK_ODPPNPSA_CA.pdf. Also see Jones 2007 *SA Merc LJ* 326-336.

²⁵ Cassim *et al Contemporary Company Law* 526.

²⁶ Cassim *et al Contemporary Company Law* 526.

²⁷ Visser para 81.

²⁸ In the absence of rationality, courts are permitted to invalidate any decision which directors have taken where their motivational purpose seems to the court as one beyond the powers which should have legitimately been exercised. Also see Kilian 2007 http://www.cita.edu.au/professional/papers/conference2007/2007CK_ODPPNPSA_CA.pdf.

²⁹ Cassim *et al Contemporary Company Law* 526.

duty of good faith, but they operate cumulatively such that a director who may have acted in good faith can be found to have not exercised his powers for a proper purpose.³⁰ In *Visser* the Western Cape High Court stated that:

The position in South African law has always been that directors occupy a fiduciary position and as a result must exercise powers conferred on them in what they *bona fide* consider to be the best interests of the company, for the purpose for which the power was conferred, and within any limits which may be imposed for the exercise of the power.³¹

In *Visser* the test for a proper purpose was said to be purely objective.³² In law it has been accepted as a useful starting point to determine whether the conferred power was used for a proper purpose. This was so because once it had been ascertained what the actual purpose for which the power was exercised, then that would assist to determine whether the actual purpose falls within the confines for which the power was conferred.³³

It is implied, as has been realised by the High Court in *Visser*, that the provision conferring the power calls for an interpretation which takes into account the instrument as a whole³⁴ and other relevant factors. In giving effect to the approach, the court in *Visser* applied what seemed to be the "dominant purpose test". In its ruling the court inferred that in the context of decisions by directors, there is often a close relationship between the requirement that the power should be exercised for a proper purpose and the requirement that directors should act in what they consider to be the best interests of the company. To the court, the overarching purpose for which directors must exercise the powers conferred on them is the purpose of promoting the best interests of the company.³⁵

Approaching the interpretation of the duty for proper purpose from the context of the early Courts of Chancery on how the principle to act for a proper purpose was considered at the time, the court in *Eclairs Group Ltd* stated that:

The early Court of Chancery attached the consequences of fraud to acts which were honest and unexceptionable at common law but unconscionable according to equitable principles. In particular, it set aside dispositions under

³⁰ Cassim *et al Contemporary Company Law* 526.

³¹ *Visser* para 58.

³² *Visser* para 80; Cassim *et al Contemporary Company Law* 526; and Kilian 2007 http://www.cita.edu.au/professional/papers/conference2007/2007CK_ODPPNPSA_CA.pdf 16. Also see a brief, but useful depiction the case in le Roux and Mardon 2014 *De Rebus* 40. Also see Jones 2007 *SA Merc LJ* 326-336.

³³ *Visser* para 80.

³⁴ *Visser* para 80.

³⁵ *Visser* para 80.

powers conferred by trust deeds if, although within the language conferring the power, they were outside the purpose for which they were conferred.³⁶

Referring to earlier cases on the subject heard much earlier, the court further stated that:

... that the donee, the operator under the power, shall, at the time of the exercise of that power, and for any purpose for which it is used, act with good faith and sincerity, and with an entire and single view to the real purpose and object of the power, and not for the purpose of accommodating or carrying into effect any bye or sinister object (I mean sinister in the sense of its being beyond the purpose and intent of the power) which he may desire to effect in the exercise of the power.³⁷

Viewed in the context of the ruling of the court, one may deduce that the principle of proper purpose had nothing to do with fraud in the common law meaning of the term or any conduct which could be properly termed dishonest or immoral. What it meant was merely that the power had been exercised for a purpose, or with an intention, beyond the scope of or in a manner not justified by the instrument creating the power.³⁸ Therefore, the principle was concerned with the abuse of power. What was being done by a director was in fact within the scope of the power conferred, but was being done for an improper purpose.³⁹ Therefore, what the court suggests is that the director's *bona fide* belief that he/she is acting in the best interests of the company would not in itself mean that the director would not ordinarily be exercising a power for an improper purpose.⁴⁰ To ascertain the true state of affairs it was equally important to determine the motivational aspects which influenced the director in question to act improperly. An inquiry into the state of mind of the director at the time would be indispensable. The court in *Eclairs Group Ltd* seems to have recognised this critical aspect,

³⁶ *Eclairs Group Ltd* para 15.

³⁷ *Eclairs Group Ltd* para 15, citing previous cases as early as *Aleyn v Belchier* 1758 1 Eden 132 138; and *Lane v Page* 1754 Amb 233. Also see Langford and Ramsay 2017 *MLR* 117. In their article the writers were of the view that a subjective test provides more autonomy to directors than an objective test. They were of the opinion that the judgment of Lord Sumption created uncertainty around the test to be adopted. This submission was based on previous commentaries on whether the test is subjective or objective. Ultimately, they submitted that in their opinion Lord Sumption meant that the test should be both subjective and objective, contrary to *Howard Smith Ltd v Ampol Petroleum Ltd* 1974 AC 821 832 (hereinafter "*Howard*"), wherein Lord Wilberforce said that a court must view a situation objectively where there is a dispute as to a decision for one purpose or another. Their reasons for agreeing with Lord Sumption will be ventilated below.

³⁸ *Eclairs Group Ltd* para 15.

³⁹ *Eclairs Group Ltd* para 15.

⁴⁰ *Madoff* para 194.

because contrary to the position taken by the court under South African law in *Visser*, the court preferred a subjective test.⁴¹ According to the court:

Where the question is one of abuse of powers, said Viscount Finlay in *Hindle v John Cotton Ltd* (1919) 56 Sc LR 625, 630, the state of mind of those who acted, and the motive on which they acted, are all important.⁴²

Accordingly, it is necessary to subjectively scrutinise the reasons which influenced directors to make a particular decision to determine what purpose motivated them and/or ascertain what purpose occupied their mind at the time of their taking a decision. To assist in determining the purpose for which the conferred power was exercised or to ascertain whether a director can be said to have exercised a power for the purpose for which it was conferred, the court stated in *Madoff* that a four-stage test must be employed. The court's approach may be universally applicable.⁴³ Also, looking at the court judgments discussed hereunder, the universality of the application of the four-stage test seems to have been the foundation upon which the various courts have relied. The test involves the identification of: (i) the power whose exercise is in question; (ii) the proper purpose for which the power was conferred; (iii) the substantial purpose for which the power was exercised in the instant case; and (iv) whether that purpose was proper.⁴⁴

It is submitted that when applying this four-stage test in the context of distributing company money and/or property the first leg would refer to the power which the director has. In *Howard*,⁴⁵ ruling in the context of self-interest, the court stated that the determination of the power exercised by directors, including the nature of the power and any limits within which it may be exercised, represents the legal question. In the South African context, quite apart from its counterparts, the powers which a director must use for such purpose are conferred by the 2008 Act. Directors no longer derive their powers from the company's Memorandum of Incorporation (hereinafter "the MOI") as is the case in Australia and Canada. It is submitted that the character of the power is inherent in the duties which directors possess as conferred by the 2008 Act.⁴⁶ Shareholders may vary

⁴¹ *Eclairs Group Ltd* para 15.

⁴² *Eclairs Group Ltd* para 15.

⁴³ *Madoff* para 195; approved in *Howard* 835F-H; *Extrasure Travel Insurances v Scattergood* 2003 1 BCLC 598 para 92. See also Delpont *et al Henochsberg on the Companies Act* 298(1).

⁴⁴ Also see *Visser* para 80.

⁴⁵ *Howard*. The court stated that where self-interest is involved, the directors of the company cannot assert that their actions were *bona fide* in the interest of the company. However, credit must be given to the *bona fide* position of the directors and their judgment in matters of management must be respected.

⁴⁶ *Pretorius v PB Meat (Pty) Ltd* 2013 ZAWCHC 89 (14 June 2013) ("*PB Meat (Pty) Ltd*") para 25.

this power in the company's MOI, but, even the shareholders cannot vary the power in whatever form they think proper. The variation must constitute an additional protective measure to the company by limiting, restricting or qualifying these powers or the activities of the company.⁴⁷ Directors must act within these powers at all times. To act contrary will not always suggest that the power was exercised improperly or for an improper purpose, however.

In terms of the second leg, the proper purpose for which the power was conferred will be paramount. In most statutes the proper purpose for which a power is conferred is not expressly stated. The 2008 Act is no exception. However, one may infer that in the context of distributions, the purpose for which the power is conferred on directors is to facilitate the proper distribution of company money and/or property. When doing so, directors must therefore not act in a manner that will contravene the distribution rules so as to compromise the solvency and liquidity of the company. In *Msimang v Katuliiba*⁴⁸ the court stated that in order to assess whether directors acted in a manner contravening the Act their conduct in relation to their duties as directors must be scrutinised. Where the power has been properly exercised, the courts, taking into account the business judgment rule, may not invalidate the exercise of that power without justification. At all times they must bear in mind that it remains the directors' call whether or not the distribution in question should have been made, having taken into account their statutory and fiduciary duties as imposed on them under sections 4, 46, 76(3) and (4) of the 2008 Act. As long as the director at the time reasonably and rationally believed, having taken into account its reasonably foreseeable financial circumstances, that the company would or would not sustain the distribution, as the case may be, his decision would stand. There must always be a rational basis for his/her belief.

The second leg invites the application of questions of rationality in regard to the decision making process employed by directors. Even under the 2008 Act the rationality principle finds application by virtue of section 76(4)(a)(iii). Much as the use of the requirement of rationality in the context of company law has been articulated in various other cases such as *Charterbridge Corporation Ltd v Lloyds Bank Ltd*⁴⁹ and *The Manning River Cooperative*

⁴⁷ See s 15(2)(a)(iii) of the 2008 Act. S 15 of the 2008 Act allows for the company to limit, restrict or qualify the powers given to a director. A company is entitled to ratify directors' actions, however, by special resolution of shareholders, except for those which contravene the Act. See ss 20(2) and (3) of the 2008 Act.

⁴⁸ *Msimang v Katuliiba* 2013 1 All SA 580 (GSJ) ("*Msimang*") para 51.

⁴⁹ *Charterbridge Corporation Ltd v Lloyds Bank Ltd* 1969 2 All ER 1185 (Ch) 1194E-F.

Dairy Co Ltd v Shoesmith,⁵⁰ the rationality principle has been referred to less frequently.⁵¹ At its core, the principle of rationality relates to the fact that decisions made by those on whom powers have been conferred must be related to the purpose for which the powers were given.⁵² In the context of the exercise of public power, the requirement of rationality has been held in some court judgments to concern the relationship between the decision and purpose for which the power was given.⁵³ The question was asked in this way: "was the decision or the means employed rationally related to the purpose for which the power was given"?⁵⁴ This vital relationship between "the power conferred" and "the purpose of its use" was made clear in *Democratic Alliance v South African Broadcasting Corporation Limited*,⁵⁵ where the Western Cape High Court intimated that:

Rationality is a minimum threshold requirement applicable to the exercise of all public power by members of the executive and other functionaries. It is a requirement of the principle of legality that decisions must be rationally related to the purpose for which the power was given, otherwise they are in effect arbitrary.⁵⁶

⁵⁰ *The Manning River Cooperative Dairy Co Ltd v Shoesmith* 1915 19 CLR 714 (HC) 723; and *Maetra Properties Ltd v Morstead Mansion Ltd* 2008 EWHC 2843 (Ch) para 7.

⁵¹ *Visser* para 75.

⁵² Under the 2008 Act the principle of rationality applies to the business judgment rule. In exercising their powers, the rule requires directors to ensure that they have no personal interests and that they make use of the benefit of other members of the company whom they believe to possess the required competence. Richard Stevens and Philip de Beer make two observations with regard to the principle of rationality. They refer to two salient factors arising from the business judgment rule: that directors must take reasonable steps to ensure that their decision is informed; and that they must believe that the decision was in the best interests of the company. These factors arise from the operation of s 76(4) of the 2008 Act. To that end, the two factors identified represent steps which directors must take to ensure that they comply with their duties in terms of s 76(3)(c) as informed by s 76(4) of the 2008 Act. But the underlying requirement that the directors made their decision on a rational basis. See Stevens and de Beer 2016 *SA Merc LJ* 257.

⁵³ *Visser* para 77.

⁵⁴ *Association of Regional Magistrates of Southern Africa v President of the Republic of South Africa* 2013 7 BCLR 762 (CC) paras 49-50; *Minister of Defence and Military Veterans v Motau* 2014 5 SA 69 (CC) para 69.

⁵⁵ *Democratic Alliance v South African Broadcasting Corporation Limited* 2015 1 SA 551 (WCC), per Schippers J. Also see how rationality in the context of the legality principle was said to operate in *Pharmaceutical Manufacturers Association of SA: In re Ex parte President of the Republic of South Africa* 2000 2 SA 674 (CC) para 90.

⁵⁶ *Democratic Alliance v South African Broadcasting Corporation Limited* 2015 1 SA 551 (WCC) para 71. See also *Pharmaceutical Manufacturers Association of SA: In re Ex parte President of the Republic of South Africa* 2000 2 SA 674 (CC) paras 85 and 90. See also in *Masetlha v President of the Republic of South Africa* 2008 1 SA 566 (CC) para 78, wherein the court amongst others, stated that "the holder of power must act in good faith and not misconstrue his/her power; public power should not be exercised arbitrarily or irrationally; there must be lawfulness in the conduct of the person exercising the public power".

The court in *Visser* stated that the rationality criterion as an aid to section 76 of the 2008 Act is objective.⁵⁷ It is submitted that there is no reason why this administrative law principle should not, with appropriate modification, apply equally to directors, whose power has been conferred on them by statute, like the power conferred on public officials.⁵⁸ Consequently, in order for a decision to be rational the provision of cogent reasons for taking that decision will be one of the criteria justifying the decision.⁵⁹

On the third leg, in *Howard* the court stated that the examination of the substantial/primary purpose for which an action was taken, leading to a conclusion as to whether or not that purpose was proper, is a factual question. In that context, facts will have to be established through the presentation of evidence so as to determine what motivated a director to act in a particular manner as well as to ascertain his/her state of mind at the time, whether indeed the director in question acted with that particular purpose in mind or whether or not his/her decision was informed by the interests of the company.⁶⁰ If the board/director distributes company money

⁵⁷ However, according to *Visser* para 76, its threshold is quite different from, and easily met than a determination as to whether the decision was objectively in the best interests of the company. A court must not allow itself to delve into the arena of decision making conferred on directors by, for example, giving views on how the power should have been exercised. The wisdom to make decisions on behalf of the company is conferred on directors. Rather what the court must do is to review whether the decision made was rationally related to the purpose for which the power was conferred. See also the *Pharmaceutical Manufacturers Association of SA: In re Ex parte President of the Republic of South Africa* 2000 2 SA 674 (CC) para 90. See also *Stevens and De Beer* 2016 SA Merc LJ 259.

⁵⁸ *Visser* para 78.

⁵⁹ *Democratic Alliance v South African Broadcasting Corporation Limited* 2015 1 SA 551 (WCC) para 83. See also *Eclairs Group Ltd* para 17; and *R(FDA) v Secretary of State for Work and Pensions* 2013 1 WLR 444 paras 67-69. In South Africa however, in as far as private companies are concerned, the 2008 Act does not require directors to furnish reasons for their decisions as is the case under s 771(b) of the UK *Companies Act*, 2006. There is no general duty on a fiduciary to give reasons for his/her actions to those to whom their duties are owed: "the duty of a fiduciary to render an account is a duty to disclose what he has done in the course of his administration, not why he has done it". As a result, an MOI may allow a Board not to give reasons on a decision which it has taken on a particular matter. The administration of corporations would become unwieldy if directors were bound on request to provide reasons for their decisions. In relation to share transfers, there might be sound business reasons not to provide reasons. To do so might jeopardise the company's relations with third parties. The directors might be reluctant publicly to state reservations they have concerning the character of the proposed transferee. The furnishing of reasons might require the company to disclose matters of strategy. *Visser* paras 46-49.

⁶⁰ It is submitted that the substantial purpose for which the power was exercised in the particular case will invite questions such as: what was the "primary purpose" for which the power was exercised; was it to give effect to the interests of the company or was it for personal purposes; did the board refuse to register the transfer of shares informed by personal interests or by those of the company; did the director act fraudulently or with a fraudulent purpose; did the director act intentionally to deny

and/or property based on ulterior motives, such conduct would be unlawful. It is submitted that it is at this stage that an objective test is called for to establish whether the directors acted objectively, even though subjectively they might have intended to act for the benefit of the company. Hence a sanction must not be applied until it is proven that the exercise of the power was not for a proper purpose, as the fourth leg requires.

4 Juridical determinations of the appropriate standard of judgment

The operation of the above principles and the divergence in the standards of judgment applied to them can be gleaned/observed in the following cases. The case law discussion which follows relates to three jurisdictions, being South Africa, Australia and Canada. UK case law will be discussed in conjunction with South African case law. The consideration of UK case law is informed by the fact that one of the UK provisions regulating the duties of directors is similar to one of the provisions under the 2008 Act which will be referred to hereunder. For that reason, UK company law may serve as a comparator for the purpose of interpreting and applying the principle of proper purpose in the South African context.

4.1 South Africa

The first among these is the South African case of *Visser*.⁶¹ From the outset it is worth noting that in this case the court used both the objective and subjective tests at different stages of its judgment to determine whether or not the refusal to transfer shares was lawful.⁶² What seems apparent, however, is that of these two tests only the objective standard of judgment was used to interpret and analyse/apply the duty to act for a proper purpose. The case concerned an application for refusal by the board of the first respondent, Goede Hoop Sitrus (Pty) Ltd (hereinafter "GHS"), to approve a transfer by the applicant, Visser Sitrus (Pty) Ltd (hereinafter "VC"), to the second respondent, Mouton Sitrus (hereinafter "MC"), of the shares held by VC in GHS. The shares were not necessarily to be transferred from the company to the shareholder in question, but from one shareholder to another. VC sought to compel

dividend payments unjustifiably or did the director act without care as to the interests of the company, for example by not caring whether the company became insolvent as a result of his/her actions? For other situations in the context of good faith in the interests of the company, see Langford and Ramsay 2015 *JBL* 174.

⁶¹ *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty)* 2014 5 SA 179 (WCC).

⁶² See for example *Visser* para 76, referring to the test applicable to rationality under s 76 as objective. Also see para 80 referring to proper purpose as provided in s 76(3)(a) as objective. Also see paras 73-74 referring to the test under s 76(4)(a) as subjective.

GHS to register the transfer by way of relief in terms of section 163 of the 2008 Act, stating that any refusal by GHS to register the transfer of shares without rational or cogent reasons would constitute oppressive and unfair prejudicial conduct.⁶³ VC also sought the amendment of a clause in GHS' MOI restricting the transferability of its shares.⁶⁴

In invoking the provisions of section 163, the claim by the applicants related to the question whether GHS' directors breached their fiduciary duties in refusing to register the transfer.⁶⁵ In response, the court ruled that if a director acts and/or exercises the power conferred on it by the company's MOI, and in so doing meets the standard set under section 76 of the 2008 Act, the director would be acting lawfully.⁶⁶ The question posed by the court was: "Can a shareholder who is prejudiced by the decision then complain that the decision is 'unfairly' prejudicial to him?" In other words, where directors act lawfully and in accordance with the standard imposed on them without any malice, their decision cannot be reversed by a court simply because the decision adversely affects another person's interests. The director's' decision will stand. In fact, the counsel for the applicants conceded that circumstances where directors would be found to have acted unlawfully could be rare, especially where directors exercised their powers in good faith, for a proper purpose, in the best interests of the company.⁶⁷ Applying the dominant purpose test, the court emphasised that the test for proper purpose is objective, the overarching purpose for which directors must exercise their powers being the purpose of promoting the interests of the company.⁶⁸

The power to refuse to register a transfer of shares must thus be exercised in what the directors consider to be the best interests of the company. More specifically, the clause conferring the power has in mind that there may be circumstances in which a company's best interests would be served by not having the proposed transferee as the holder of the shares in question. The board might consider that it would be preferable, in the best interests of the company, that the proposed transferee should not become a shareholder at all or that he should not acquire a greater stake than he already has. The exercise of the power

⁶³ Visser para 29.

⁶⁴ Visser paras 1 and 10-13.

⁶⁵ Visser para 52.

⁶⁶ Visser para 59.

⁶⁷ Visser para 59. This, however, does not mean that such cases may not exist, as in *Catalano v Managing Australia Destinations Pty Ltd (No 2)* 2013 FCA 672.

⁶⁸ Visser paras 45, 80. Also see *Village Cay Marina Ltd v Acland* 1998 UKPC 11 (BVI); *Mactra Properties Ltd v Morshead Mansions Ltd* 2008 EWHC 2843 (Ch) para 7; *Banfi Ltd v Moran* 2006 IEHC 257; *Smolaret v Liwyszyc* 2006 WASCA 50 paras 67-68.

will often, by its very nature, result in prejudice to the parties to the proposed transfer.⁶⁹

Summing up what was in its mind in this regard, the court ruled that, in its opinion having had the benefit of hearing a description of the process followed by the directors and the various board meetings in which the decisions were taken,⁷⁰ at the time of decision making the directors of GHS were *bona fide* of the opinion that the best interests of the company would be served by not allowing MC to increase its shareholding in GHS. In the court's view, the actual purpose for which GHS' board exercised the power to refuse the proposed transfer fell within one of the intended purposes of the empowering provision, that is, to enable the board to prevent a person from acquiring an increased shareholding in the company where the obtaining of the increased shareholding was regarded as being contrary to the best interests of the company.⁷¹

Further, VC alleged that the board had exercised the power for an improper purpose because the directors were using the power as leverage to force MC to conclude a long-term contract, even though the MOI permitted short-term contracts. Again the court ruled in favour of the board. Referring to the adequacy of the information which the directors made reference to before making the decision in question so as to enable themselves to make a proper decision, the court noted that even if the argument raised was the board's purpose, the court was not convinced that it was an improper purpose. This was so because the board of a company is entitled to encourage long-term contracts if this would best serve the interests of the company.⁷² Besides, MC did not allege that the directors had failed to take reasonable diligent steps to inform themselves of the facts relevant to their decision, and even if they had made that argument, the court ruled that it had no reason to doubt that, as business people, the directors had sufficient information at their disposal to make a proper assessment.⁷³

As to whether the decision of the directors had a rational basis, the court stated that simply because the applicants had a different view from that of the board, that in itself did not mean that the applicants had a better way forward for GHS than the course which the board of GHS was charting. Therefore, this would not mean that the board was acting irrationally by preferring its view to that of MC.⁷⁴ It would be fallacious to take the view that a proposed transferee always acquires shares with a view to better

⁶⁹ Visser para 81.

⁷⁰ Visser paras 14-30.

⁷¹ Visser para 84.

⁷² Visser para 85.

⁷³ Visser para 86.

⁷⁴ Visser para 88.

advancing what he regards as the best interests of the company. The transferee may have other business interests which would be enhanced if the affairs of the target company were curtailed or conducted differently.⁷⁵ Therefore, the court concluded that in refusing to approve the transfer the board had met the standard set by section 76 of the 2008 Act and that the refusal was lawful.⁷⁶ The court dismissed the application.⁷⁷

In *Pretorius v PB Meat (Pty) Ltd*⁷⁸ the ultimate decision of the court suggests that the court preferred the dominant purpose test as well as the objective test, as in the *Visser* case, to determine whether or not the directors of the company were acting for their own interests or in the interests of the company. The court did not refer to the subjective test. Essentially, the allegations levelled against the applicants were that they had not acted *bona fide* and in the best interests of the company in making an application requesting further company records. Their argument was that in making the application for access to the records, they were doing so in order to be able to perform their duties as directors of the company. In its ruling the court stated that the applicant's access to company records must be fettered by the purpose for which such access was sought. The court held that the request for documentation by the applicants was not for the purpose of exercising their powers and performing their duties in the best interests of the company. In fact, the purpose was so that they could defend the allegations levelled against them, which went to the root of the performance of their duties in terms of section 76 of the 2008 Act. Having assessed the reasons informing their application, the court found that the applicants did not request the information to protect the company, but to protect themselves as individual directors. Therefore, the court denied the applicants access to the information they required.

If the approach in the above two cases is compared to one of the most important cases on proper purpose in UK case law, a different picture appears. The UK case in question was decided by the Supreme Court,

⁷⁵ *Visser* para 89.

⁷⁶ *Visser* para 95.

⁷⁷ *Visser* para 98. *PB Meat (Pty) Ltd* paras 27, 44 and 49. The duty to act for a proper purpose has also been deliberated upon in pension fund cases. See for example the case of *Hoffman v Pension Funds Adjudicator* 2012 2 All SA 198 (WCC). In the case the court found the administrators of the fund to have acted for an improper purpose based on para (a) of s 1 of the definition of "complaint" in the *Pension Funds Act* 24 of 1956. They were also found not to have acted in accordance with their duties as required in paragraph (d) of the definition of "complaint" in the same Act. This was so because the Fund failed to investigate or apply its own mind to the instruction given by the applicant's employer for the employee to be classified as a Class 2 Executive instead of being a Class 1 Executive, thus affecting his retirement pension adversely. See paras 29, 32, 45 and 46. Also see *Berge v Alexander Forbes Retirement Fund (Pension Section)* 2006 ZAGPHC 241 (18 April 2006).

⁷⁸ *PB Meat (Pty) Ltd*.

based on the *Companies Act* 2006. The case is that of *Eclairs Group Ltd.*⁷⁹ In the case the Supreme Court of Appeal seemed to apply both the subjective and the objective tests, informed by the dominant purpose for which the power was used, which influenced the directors to make the decision they did, rather than only the objective test preferred in *Visser* and the Australian case of *Howard* discussed hereunder. This "subjective and objective dominant purpose test" is qualified by the "causation test" due to the possible existence of multiple causes, some proper and some improper. The latter test places emphasis on the existence of a link between the improper use of the conferred power and the end result, as in where, for example, "but for" the improper purpose the power would not have been exercised or the result in question would not have materialised.

Importantly, in the *Eclairs Group Ltd* decision Lord Sumption set out a number of principles applicable in cases related to proper purpose. According to Lord Sumption, in determining purpose it was not necessary that the purpose of an instrument should be expressly stated. Rather,

⁷⁹ *Eclairs Group Ltd.* See a summary of the facts of the case in ICLR 2015 <http://www.iclr.co.uk/case-summaries/2015/wlrd/497>; and Langford and Ramsay 2017 *MLR* 117. The case was about two directors who were alleged to be attempting to obtain voting control by entering into an arrangement to combine their shareholding. The purpose of the control was to orchestrate a "raid" on the company by using their voting power to purchase the company's shares for a value below their market value. In response, the company issued disclosures in terms of s 793 of the *Companies Act*, 2006. The section provides that a public company may issue a disclosure notice on any person that it knows, or reasonably believes, to be interested in its shares, requesting information including the number of shares held, the beneficial ownership of such shares, and any agreements or arrangements between the persons interested in them. In terms of s 794, if a person to whom such notice was issued fails to comply, the company may apply for a court order imposing restrictions on the shares, including their transfer, the exercise of voting rights, and the right to receive the payment of capital or income. This provision was incorporated into the company's articles of association, thus authorising the directors to invoke the clause without a court order. The directors in question submitted the information required, but the directors remained unconvinced that there were no arrangements. Consequently, the directors issued restrictions in terms of the section preventing the two directors from voting at the upcoming company's AGM, including voting in the re-appointment of the company's Chief Executive Officer. The two directors opposed the restrictions, alleging that they were invoked for an improper purpose contrary to s 171(b) of the *Companies Act*, 2006. At the High Court the ruling was in favour of the applicants. The court was of the view that the directors' decision on the effected restrictions in question were not motivated by the lack of accuracy of the information supplied by the applicants. Rather, the directors' decision was unduly influenced by the ulterior motive of preventing the raiders from blocking the resolutions at the ensuing AGM. The court agreed, however, that notwithstanding the fact that the restrictions were genuinely issued in the best interests of the company and its other shareholders, such restrictions were outside the scope of the proper purpose and scope of article 42 of the company's constitution. In the Appeal Court, the High Court decision was overturned, the court stating that proper purpose had no significance to the application of article 42.

purpose would usually be implied from a mixture of the express terms of the instrument, an analysis of their effect and form, and the court's understanding of the business context. Primarily, proper purpose is concerned with the abuse of power by engaging in acts which are within the scope of the power but exercised for an improper reason or motive. An assessment of whether the power has been properly exercised is therefore necessarily subjective and dependent on the state of mind of the persons exercising the power. To determine whether a power has been properly exercised, it is necessary to assess the primary or dominant purpose motivating the use of the power.⁸⁰ However, the assessment must be made having considered the range of a director's functions and the conflicts may be inseparable from the position of a director.⁸¹ A court of equity needed not just to uphold the integrity of the decision-making process. Its purpose was to limit its intervention in the conduct of a company's affairs to cases in which an injustice has resulted from the directors' having taken irrelevant considerations into account.⁸² Put differently, it is the overall determination which directors must make which borders on what motivated them to opt for that particular decision. Leaning on the objective standard of judgment, according to the court one possibility in identifying the dominant purpose is to choose between the "weightiest" purpose about which the directors would feel most strongly and the purpose which caused the decision to be made as it was.⁸³ As there are likely to be multiple causes, some proper some improper, the relevant test should be that of causation, that is, "but for" the relevant motive, the power would not have been exercised.⁸⁴ To the court this approach was correct since it was consistent with the rationale behind the proper purpose rule.⁸⁵

In cases where the director would have made the same decision anyway had he/she acted for a proper purpose, the court stated that the act would remain valid despite the existence of some improper considerations.⁸⁶ Proper purpose is precisely meant to apply and most valuable to apply in situations where there are conflicting factors and where the affairs of a company are contested. In such circumstances, this is a primary tool for ensuring that directors act within their powers and recognise the difference between their powers and those of a company's shareholders. Ultimately, it

⁸⁰ *Eclairs Group Ltd* para 17.

⁸¹ *Eclairs Group Ltd* para 17.

⁸² *Eclairs Group Ltd* para 17.

⁸³ *Eclairs Group Ltd* para 19.

⁸⁴ *Eclairs Group Ltd* para 19. See the Australian case of *Whitehouse v Carlton House Pty* 1987 162 CLR 285 295.

⁸⁵ *Eclairs Group Ltd* para 22; citing decisions based on the equity principle *Birley v Birley* 1858 25 Beav 299 307; *Pryor v Pryor* 1864 2 De G J & S 205, 210; *Roadchef (Employee Benefits Trustees) Ltd v Hill* 2014 EWHC 109 (Ch) para 130.

⁸⁶ *Eclairs Group Ltd* para 21.

is up to the board to decide whether the information provided is sufficient. However, there will always be room for the directors to decide erroneously. In the end, the Supreme Court of Appeal upheld the appeal and dismissed the directors' decision. In the eyes of the court the manner in which the directors in the *Eclairs Group Ltd* case acted proved that they did so for an improper purpose. This was so because they were primarily influenced by seeking to influence the outcome of the proposed shareholder resolutions, rather than to obtain the information sought by the prior disclosure notices. The court came to this conclusion despite the fact that the directors were found to have acted rationally and in a genuine belief that they were acting in the best interests of the company.

RT Langford and IM Ramsay discuss the case in the context of the implications for the autonomy of directors of the different judicial interpretations of the proper purpose rule.⁸⁷ Expressing their views on whether courts should adopt an objective or a subjective test when interpreting the proper purpose rule, as well as on the fact that Lord Sumption seemingly used a subjective test to dispense with *Eclairs Group Ltd*, the authors first acknowledge that Lord Sumption used a subjective test to analyse the proper purpose rule. Further, they acknowledge that the use of the subjective test was contrary to the views of corporate law scholars and of earlier authority.⁸⁸ Nevertheless, in their opinion the use of the test by the Lord was correct. Their support is based on their interpretation of what Lord Sumption said. The UK Supreme Court of Appeal in *Eclairs Group Ltd* referred to the duty of proper purpose under the Act as one determined on subjective standards and the motives which informed the directors' decision at the time. According to Langford and Ramsay what Lord Sumption meant by the latter statement was that the proper purpose rule encapsulates both subjective and objective elements, and his statement that the test is subjective should therefore be interpreted as meaning that.⁸⁹ Their support for the use of the test is based on two grounds. The first is that, following the statement that the test is subjective, Lord Sumption cited *Hindle v John Cotton Ltd* (see under Heading 3 page 11 above). The statement made was that "the state of mind of those who acted, and the

⁸⁷ They discuss three issues relating to the interpretation of the rule that have important consequences for whether directors have broad or narrow autonomy in their decision-making. They discuss: the scope of the proper purpose rule; whether an objective or subjective test is employed in the application of the rule; and the test for causation, where a director is motivated by mixed purposes. See Langford and Ramsay 2017 *MLR* 111.

⁸⁸ Langford and Ramsay 2017 *MLR* 117. They make reference to such writers as Davies and Worthington *Gower and Davies' Principles of Modern Company Law* 16-46, and to the decision in *Howard*.

⁸⁹ Langford and Ramsay 2017 *MLR* 117.

motive on which they acted, are all important". According to Langford and Ramsay this statement means that:

... in order to determine for what purpose directors made the decision under review, it is necessary to understand their subjective motivations.

To that end, they submit that the application of the objective test, in addition to the subjective test, has the purpose of ascertaining as a matter of law the purposes for which the power may or may not be exercised. It is also to determine/test whether the purpose which the directors in question say motivated them to make the decision in question was permissible.⁹⁰

Their second concern is their difficulty in reconciling the decision of Lord Sumption (that the directors had acted for an improper purpose) with the application of a subjective test.⁹¹ The majority of the directors were in fact found to have based their action on a genuine belief that it was proper for them to issue the restriction notices. But the same genuine subjective belief which was required and which the directors were found to have possessed at the time of making their decision was not enough to protect their' decision. According to the authors this suggests that from the point of view of the court, the directors failed to act for a proper purpose as objectively determined by the court.⁹²

It is proposed that what the above submissions suggest is that the fact that a director has acted subjectively will not for all purposes mean that he has ultimately also acted objectively. His/her motives might have influenced him/her not to act objectively even though subjectively he was genuine in carrying out his duties to his principal. If the court finds that a director has passed a subjective test, that in itself shall not be regarded as being enough to satisfy the duty to act for a proper purpose. What must also be satisfied is the requirement that one acted objectively as well. According to Langford and Ramsay the ruling of Lord Sumption means that a test which considers the subjective motivations of directors is ultimately an objective test. In their words:

This test assesses the conduct of directors against what the court determines are the proper purposes for which a particular power can be exercised and thereby places a restraint on directors' conduct and limits their available actions. It is a test that has particular importance in the context of a battle for corporate control.⁹³

⁹⁰ Langford and Ramsay 2017 *MLR* 118.

⁹¹ Langford and Ramsay 2017 *MLR* 118.

⁹² Langford and Ramsay 2017 *MLR* 118.

⁹³ Langford and Ramsay 2017 *MLR* 118.

Having read the case, and as has been noted in the discussion above, the question which comes to the fore is: whether it is possible for a director to act genuinely subjectively and yet act improperly from an objective point of view? It is submitted that in applying both the subjective and objective standards of judgment, the *Eclairs Group Ltd* case confirmed that this is possible. The opinion of Langford and Ramsay is therefore supported. What they suggest is that subjectively speaking a person may have proper motives and as such carry him/herself properly in that regard, but the power itself may be exercised for an improper purpose, hence objectively speaking a court would not sanction any action which to the court bears no relation to proper purpose, even though subjectively speaking the actions of the director in question were proper.

4.2 Canada

From the outset it must be stated that there is no duty to act for a proper purpose under the CBCA in terms of section 122(1)(a) regulating the duty of good faith. Nevertheless, Canadian courts seem to appreciate the application of the subjective standard of judgment when determining the motivational aspects of a director. This standard is applied in conjunction with the objective standard. One deduces from the decisions of the courts that had section 122(1)(a) of the CBCA also contained the duty to act for a proper purpose alongside the duty of good faith, as is the case under the 2008 Act and the *Corporations Act* 2001, the subjective standard of judgment would be the preferred standard where motivational aspects of a director's conduct are under scrutiny. It is in this context that the two cases below are discussed.

To that end, the application of both the subjective and objective standards of judgment were visible in the almost half a century old case of *Teck Corp Ltd v Millar*⁹⁴ on corporate law, relating to directors' fiduciary duties in the context of a take-over bid. The premise from which the court set out and the principles evoked in the case seem to resonate with those in *Visser*. The court seemed to be referring to the application of the subjective standard or to the motivational aspects which tend to inform the decision of directors when it stated that before directors take a decision, they must first have informed themselves. For example, if someone seeks to take control of a company, directors of the company must be allowed to ask who is seeking

⁹⁴ The court discussed the validity of the steps which might be taken by directors to resist a take-over bid. The relevant question related to how wide a latitude directors ought to have. Should directors ignore those who seek to take control of a company, or are they entitled to consider the consequences of the take over? *Teck Corp Ltd v Millar* 1973 33 DLR (3d) 288 BCSC; *Savoy Corp Ltd v Development Underwriting Ltd* 1963 NSWLR 138 147; *Criterion Properties Plc v Stratford UK Properties* 2002 EWHC 496 (Ch).

control and why. If, after they have informed themselves, they believe that there will be substantial damage to the company's interests if the company is taken over, the exercise of their power to defeat the taking of control will not necessarily be categorised as improper. Suggesting the application of an objective test, however, the court later stated that directors must act in good faith and must have reasonable grounds for their belief. According to the court impropriety may lie in the directors' purposes. A finding of impropriety would be based on proof that the directors' decision was actuated by collateral purpose. It does not depend on the nature of any shareholders' rights that may be affected by the exercise of the power concerned. In *Teck Corp Ltd* Berger J eventually ruled that the purpose of the directors was not to keep themselves in control. In fact, the purpose was to prevent the deal from materialising. To the court, this was a proper purpose which the directors were entitled to use their powers to prevent.

The *Peoples* case is not strictly speaking a proper purpose case. However, it is introduced here to illustrate the application of both the subjective and objective test. In its decision the court was emphatic as to which standard of judgement is preferred in Canada when the duties of directors are in question. On route to applying the subjective test, the court first referred to the fiduciary duty in section 122(1)(a). The court stated that section 122(1)(a) requires that directors and officers of a company in their dealings involving the use of the company's resources are to make reasonable business decisions that are to the advantage of the company.⁹⁵ In other words, only the company is expected to benefit from the performance of director's duties. Directors must respect the trust and confidence placed in them to manage the assets and affairs of the business in pursuit of the realisation of the objects of the company.⁹⁶ Referring to whether a subjective or an objective test applied in the circumstances of the case, the court in *Peoples* stated that under section 122(1)(b) of the CBCA the test was objective. From the point of view of the court it was clear that the factual aspects of the circumstances surrounding the actions of directors or officers are important only when the court considers the directors' duty of care.⁹⁷ Where the court also has to consider the motivational aspects of a director's decision then a subjective standard will be the central focus of the statutory fiduciary duty under the duty of good faith in section 122(1)(a), exercised in the best interests of the company.⁹⁸ The understanding here is that under

⁹⁵ *Peoples* para 34.

⁹⁶ They must avoid abusing their position to gain personal benefit. They must also maintain the confidentiality of any information they acquire by virtue of their position. They must serve the company selflessly, honestly and loyally. *Peoples* para 35, citing McGuinness *Law and Practice of Canadian Business Corporations* 715; *KLB v British Columbia* 2003 SCC 51 (CanLII).

⁹⁷ *Peoples* para 63.

⁹⁸ *Peoples* para 63.

section 122(1)(a) and (b) of the CBCA an objective test applies under the latter subsection. A subjective test will apply only were a court has to engage in the motivational aspects of a decision if the duty being determined is the duty of good faith as regulated in terms of the former subsection. As was alluded to earlier, in Canada there is no duty to act for a proper purpose under the CBCA. However, had it been included it is assumed that it probably would have been regulated alongside the duty of good faith in section 122(1)(a), as is the case under the different statutes which are the subject of discussion in this paper. If that were to be the case, then it seems that a subjective standard of judgement would apply.

4.3 *Australia*

In perusing some of the early Australian cases on proper purpose, the principles applied seem to be similar to those applied in the above cases, especially with reference to the dominant purpose test. Where they differ from the above cases is in the application of either the subjective or the objective test. The Australian cases emphasise the objective test rather than the subjective test. In *Howard*⁹⁹ the court agreed with the above cases, when it ruled that in order to judge whether a proposed action is not in pursuit of self-interest, the actions of the board of directors must be used as a guideline to determine their purpose for allotting additional shares owing to the lack of a clear list of different corporate actions that could constitute an improper purpose. Although the court did not classify the actions of the board as the consideration of motivational aspects, looked at in hindsight the court seems to have been referring to such motivational aspects. Nevertheless, according to the court, self-interest would constitute a ground for finding an improper purpose when the true purpose for an allotment of shares is to dilute the majority voting power. However, the court used an objective test rather than a subjective test to determine liability. According to the court, when a dispute arises over whether a company made a decision for one purpose or for another, or where there is more than one purpose and one of them has to be the substantial or primary purpose, the court will be entitled to look at the situation objectively in order to estimate how critical or pressing, or substantial or *per contra* insubstantial an alleged requirement may have been.¹⁰⁰ If the court finds that a particular requirement, though real, was not urgent or critical, at the relevant time, it may have reason to doubt or discount the assertions of individuals that they

⁹⁹ *Howard* 835.

¹⁰⁰ *Howard* 832F-H; *Eclairs Group Ltd* para 24. This case is also discussed in Kilian 2007
http://www.cita.edu.au/professional/papers/conference2007/2007CK_ODPPNPSA_CA.pdf 17.

acted solely in order to deal with it, especially where their actions were unusual or even extreme.¹⁰¹

Another of the earliest of these cases is *Harlowe's Nominees Pty Ltd v Woodside (Lake Entrance) Oil Company NL*.¹⁰² In this case the High Court ruled that the first task of a trial judge was to decide whether it had been established to his satisfaction, even if on a balance of probabilities, that the directors of the company were actuated by an improper purpose.¹⁰³ In establishing this fact the court takes cognizance of the process followed by the directors, their thinking and their actions leading to their decision making.¹⁰⁴ As was submitted in the case of *Howard* above, by looking at the line of thinking of the directors the court seems to have recognised that establishing the motives of the directors is indispensable. The court also stated that in cases where directors must issue shares, there may be occasions when directors may fairly and properly issue shares for various reasons. What is required is that those reasons must relate to the purpose of benefitting the company as a whole. The purpose must not be to maintain control of the company by the directors themselves or their friends.¹⁰⁵ According to the court: "an enquiry as to whether additional capital was presently required is often most relevant to the ultimate question upon which the validity or invalidity of the issue depends; but the ultimate question must always be whether in truth the issue was decided honestly in the interests of the company".¹⁰⁶ The court continued:

Directors in whom are vested the right and the duty of deciding where the company's interests lie and how they are to be served may be concerned with a wide range of practical considerations, and their judgment, if exercised in good faith and not for irrelevant purposes, is not open to review in the courts.¹⁰⁷

¹⁰¹ *Howard* 832F-H; and *Eclairs Group Ltd* para 24.

¹⁰² *Harlowe's Nominees Pty Ltd v Woodside (Lake Entrance) Oil Company NL* 1968 HCA 37 (hereinafter "*Harlowe*"). In the case *Woodside* was engaged in gas and oil exploration. In its explorations it collaborated with other companies. The company had issued share capital. The directors of the company were concerned about a "mystery buyer" acquiring substantial shareholding in the company and allotted shares to B. The mystery buyer challenged the allotment arguing that the allotment was for an improper purpose and was not made in the best interests of the company. According to the buyer the power could not have been exercised *bona fide* in the best interests of the company.

¹⁰³ *Harlowe'* para 7.

¹⁰⁴ *Harlowe'* paras 10-14. See paras 15-18 for comments on each of the director's thinking and the trial court's view on their evidence as whether or not they were reliable witnesses.

¹⁰⁵ *Harlowe'* para 6; *Kirwan v Cresvale Far East Ltd (in liq)* 2002 NSWCA 395 para 123.

¹⁰⁶ *Harlowe'* para 6. Also see *Richard Brady Franks Ltd v Price* 1937 58 CLR 112 142; *Mills v Mills* 1938 60 CLR 150 163, 169; *Ngurli Ltd v McCann* 1953 90 CLR 425 438-441.

¹⁰⁷ *Harlowe'* para 6; *Kirwan v Cresvale Far East Ltd (in liq)* 2002 NSWCA 395 para 123.

Only directors possess the ability to determine the company's best interests and how they may serve these interests.¹⁰⁸ The allotment of shares would be voidable as an abuse of their fiduciary power where the directors create an advantage for themselves otherwise than as members of the general body of shareholders. Where the allotment is for the purposes of giving the company greater freedom to plan for future joint operations to ensure its long-term stability rather than to prevent another person from gaining control, the decision to allot will suffice.¹⁰⁹

¹⁰⁸ *Harlowe'* para 125.

¹⁰⁹ *Harlowe'* para 18. The *Harlowe'* case was preceded by the case of *Ngurli Ltd v McCann* 1953 90 CLR 425. The question in the case was whether the allotment of 4199 shares was valid. According to the plaintiff the allotment was not made in good faith, nor in the best interests of the company, but was made with the sole fraudulent purpose of benefitting one director to the detriment of the plaintiffs. *Ngurli Ltd v McCann* 1953 90 CLR 425-430. The court expressed sentiments similar to those in the decision in *Harlowe'*. The court distinguished between two instances which might lead to an intervention by a court: where it is necessary to prevent an abuse by majority shareholders in a general meeting; and where it is necessary to prevent an abuse by the directors of the powers conferred on them by their articles. In comparing these two, a court may more readily interfere when the latter occurs rather than the former. *Ngurli Ltd v McCann* 1953 90 CLR 425 438-439. However, the court stated that even with shareholders in a general meeting, there is a limit to the extent to which the majority may exercise their votes for their own benefit. For example, the power of shareholders to alter the articles of association must, like all other powers, be exercised subject to the general principles of law and equity which are applicable to all powers conferred on majorities and enable them to bind minorities. The power must be exercised, not only in the manner required by law, but also *bona fide* for the benefit of the company as a whole, and it must not be exceeded. *Ngurli Ltd v McCann* 1953 90 CLR 425 439. Where the exercise of a power by directors is questioned, a higher standard is required from directors as against shareholders. The exercise by shareholders of their powers when voting in general meetings is not fiduciary in nature. When directors exercise their power, that power is fiduciary in nature and as such must be exercised *bona fide* for the purpose for which it was conferred. It must not be used under the cloak of such a purpose for the real purpose of benefitting some shareholder or their friends at the expense of other shareholders or so that some shareholders or their friends can wrest control of the company from other shareholders. *Ngurli Ltd v McCann* 1953 90 CLR 425 439-440. Also see Delpont *et al Henochsberg on the Companies Act* 142 and the cases cited therein. Where it is alleged that, in promoting the interests of the company, the directors in question have promoted their interests as well, the court intimated that: "if the true effect of the whole evidence is, that the defendants truly and reasonably believed at the time that what they did was for the interest of the company, they are not chargeable with *dolus malus* or breach of trust merely because in promoting the interests of the company they were also promoting their own". *Ngurli Ltd v McCann* 1953 90 CLR 425 440; and *Mills v Mills* 1938 60 CLR 150. Fraud occurs when the power has been exercised for a purpose beyond the scope of or not justified by the instrument creating the power. *Ngurli Ltd v McCann* 1953 90 CLR 425-438. The principles set out in *Ngurli v McCann* were later confirmed in *Hogg v Cramphorn Ltd* 1967 Ch 254. The court stated that directors must not use their power to issue shares merely for the purpose of maintaining control of the company or merely for the purpose of defeating the wishes of the existing majority of shareholders. It is only when the directors act oppressively against the minority that a court will interfere with the constitutional

Wayde v New South Wales Rugby League Ltd,¹¹⁰ was a case decided in the context of oppressive and unfair prejudicial conduct. The challenge was based on an honest decision by the board. The articles of the respondent company permitted its board to determine how many teams should be permitted to compete in a rugby competition that year. For that season the company's board determined that only 12 teams would compete. A company called Wests, which was a member of the respondent and owned a team excluded from the 12 selected, complained that the decision of the board had an oppressive effect to the interests of the company. The decision of the Australian High Court, per Mason ACJ, confirmed the principle that the power vested in directors to make decisions inherently involved prejudice to another. It stated that to determine the number of teams to compete inherently involved prejudice to the team excluded. The existence of such prejudice was insufficient to invoke the remedy.¹¹¹ In dismissing the claim, the court acknowledged the fact that it was inescapable for any court not to delve into what motives informed director-made decisions. To that end the court appreciated the special expertise and experience that boards possess and the fine line between the *bona fide* and proper exercise of the given power in pursuit of the purpose for which it was conferred and the caution which courts must exercise in determining its application in order to avoid an unwarranted assumption of responsibility for the management of the company.¹¹²

rights of directors or inquire into the merits of the view held or policies favoured. How the court ruled in the recent case of *Kirwan v Cresvale Far East Ltd (in liq)* 2002 NSWCA 395 seems to be an exception to the general rule as established in *Ngurli v McCann* and *Harlowe* in relation to directors promoting their interests together with those of the company. In *Kirwan* the court stated that: "where a company is in need of capital and there is only one avenue of obtaining that capital, then even though the person who is subscribing the extra capital and has a dominant purpose in obtaining control and even though that person is a director of the company, there would be no improper purpose in making the allotment." *Kirwan v Cresvale Far East Ltd (in liq)* 2002 NSWCA 395 para 2.

¹¹⁰ *Wayde v New South Wales Rugby League Ltd* 1985 HCA 68 para 16 (hereinafter "Wayde").

¹¹¹ According to the court the appellants faced a difficult task in seeking to prove that the decisions in question were unfairly prejudicial to Wests and therefore not in the overall interests of the members as a whole. It had not been shown that those decisions of the Board were such that no Board acting reasonably could have made them. The effect of those decisions on Wests was harsh indeed. It had not, however, been shown that they were oppressive or unfairly prejudicial or discriminatory or that their effect was such as to warrant the conclusion that the affairs of the League were being conducted in a manner that was oppressive or unfairly prejudicial.

¹¹² *Wayde v New South Wales Rugby League Ltd* 1985 HCA 68 para 16. Brenna J, agreeing with the majority, stated the following: "The question here is whether the resolutions which were manifestly prejudicial to and discriminatory against Wests, were also unfair – that is, so unfair that reasonable directors who considered the disability the decision placed on Wests would not have thought it fair to impose it. The decision by the League's directors to reduce the number of competitors to 12

5 Making a case for both a subjective and an objective standard of judgment

What can be deduced from the above discussion is that the fundamental principles upon which the duty of proper purpose rests are the same in all the jurisdictions. The difference lies in the preferred standard of judgment for purposes of interpretation and practical application. Under the Australian *Corporations Act 2001* it seems settled that courts prefer the objective standard of judgment based on the dominant purpose test. Under *Teck Corp Ltd* and the *Peoples* case the Supreme Court of Canada preferred using both an objective and a subjective standard of judgment to judge whether a director acted in good faith at the time of decision making.

In South Africa the position is less clear as to which standard of judgment the courts seem to believe the provisions under the 2008 Act related to proper purpose contemplate. Divergent views appear in the cases considered. Accordingly, it remains arguable whether a subjective or objective standard of judgment is the appropriate test to determine whether

and exclude Wests was in fact taken with full knowledge of the disability that that decision would place on Wests. But the directors also knew that the larger competition was burdensome to, and perhaps dangerous for, players and that a shorter season was conducive to better organisation of the Premiership Competition. The directors had to make a difficult decision in which it was necessary to draw upon the skills, knowledge and understanding of experienced administrators of the game of rugby league. The Court, in determining whether the decision was unfair, is bound to have regard to the fact that the decision was admittedly made by experienced administrators to further the interests of the game. There is nothing to suggest unfairness save the inevitable prejudice to and discrimination against Wests, but that is insufficient by itself to show that reasonable directors with the special qualities possessed by experienced administrators would have decided that it was unfair to exercise their power in the way the League's directors did." *Wayde v New South Wales Rugby League Ltd* 1985 HCA 68 para 7; with approval in *Catalano v Managing Australia Destinations Pty Ltd (No 2)* 2013 FCA 672. One of the most recent cases decided involved a group of companies. See *Equiticorp Finance Ltd (In liq) v Bank of New Zealand* 1993 32 NSWLR 50 147-148. In assessing the validity of the directors applying company funds for the benefit of other companies in the group, the trial Judge used an objective test. The court took the position that liability would depend on whether an intelligent and honest man in the position of a director of those companies could believe that the application of the liquidity reserves towards the repayment of the debt was for the benefit of the companies. The issue would be whether the directors exercised their power for the benefit of the company. Where they had failed to consider the interests of the relevant company, a finding of a breach of duty would suffice. If the transaction was objectively viewed, in the interests of the company, no consequences would flow from the breach. The steps taken must be to protect the interests of the group of companies as a whole. The question would be whether the actions taken for the benefit of the group as a whole could be regarded as benefitting one or more companies in the group. An exception would be where the interests of an individual company was inextricably bound with the welfare of the group. In that case the interests of the group would be the interests of the individual company as well.

a director acted for a proper purpose in the circumstances of a particular case. This is especially so, having regard to the seemingly conflicting directions taken by the courts. It is submitted that the better option between the two approaches would be to use both the objective and the subjective standards of judgment. This is so because, in interpreting proper purpose, it would seem that under the 2008 Act courts are required to bear in mind the statutory context within which that duty must be construed. They should take into account the ordinary meaning as well as the context in which the terms of the statute are used and what they were meant to achieve.¹¹³ In *Visser* the court seemed to have realised this.¹¹⁴ Such context and meaning will be deduced from the text itself as well as from the objects of the Act as a whole.¹¹⁵ Most closely allied to the objects of the 2008 Act is the emphasis on high standards of corporate governance and the management of companies in an efficient and responsible manner.

As has been argued earlier, the provisions of section 76(3) are meant to apply cumulatively and are not meant to be stand-alone provisions, each provision fulfilling its own purpose as against the purpose sought to be achieved by the other. In that context it is submitted that the duty to act for a proper purpose in the distribution of company money or property is related to the duty of exercising care, skill and diligence, which is how directors are expected to carry out their duties in terms of the objectives provided in section 7 of the 2008 Act. In that respect the provisions of section 76(3)(c)(i) and (ii) of the 2008 Act cannot be ignored in interpreting and applying the duty to act for a proper purpose. The section states that, subject to subsection (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director:

... with the degree of care, skill and diligence that may reasonably be expected of a person: (i) carrying out the same functions in relation to the company as

¹¹³ In *City of Cape Town Municipality v SA Local Authorities Pension Fund* 2014 2 SA 365 (SCA) para 25 (hereinafter "*City of Cape Town Municipality*"), the court stated that in looking at the background of the section in question it was important to look at the purpose for which the chapter in question was introduced into the Act; *LA Health Medical Scheme v Horn* 2014 3 All SA 421 (SCA); *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) paras 18, 26.

¹¹⁴ *Visser* para 80.

¹¹⁵ *Asmal v Essa* 2016 1 SA 95 (SCA) para 9. Among the relevant objects of the 2008 Act as provided in s 7 are: to promote compliance with the Bill of Rights; to encourage enterprise efficiency and high standards of corporate governance, given the significant role of enterprises within the social and economic life of the nation; to ensure the use of companies in a manner that enhances the economic welfare of South Africa; to balance the rights and obligations of shareholders and directors within companies; to encourage the efficient and responsible management of companies; and to provide a predictable and efficient and effective environment for the regulation of companies. See ss 7(a), (b), (e), (i), (l) and (j) of the 2008 Act respectively.

those carried out by that director; and (ii) having the general knowledge, skill and experience of that director.

The s 76(3)(c) provisions closely resemble those contained in s 174 of the UK *Companies Act 2006*.¹¹⁶ Effectively, what the section states is that a director will be regarded in law as having exercised his powers for a proper purpose if the director acted with care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director who has the general knowledge, skill and experience of that director in the circumstances of the case. It is clear from the wording of this section¹¹⁷ that the standard to assess whether the directors carried out their duties for a proper purpose cannot only be objective. The section seems to suggest that whenever a director exercises his powers for any purpose, be it to distribute company money or property or for another purpose, the director's motives must be assessed subjectively as well.¹¹⁸ This assessment must be made: "in comparison to other directors carrying out the same functions in relation to the company as those carried out by that director with the same general knowledge, skill and experience as the director in question."¹¹⁹ In other words, courts have a responsibility to make a value judgment in terms of how other directors with similar general knowledge, skill and experience would have conducted themselves. The aim is to ensure that directors with

¹¹⁶ The section states that: (1) a director of a company must exercise reasonable care, skill and diligence; (2) this means the care, skill and diligence that would be exercised by a reasonable person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by a director in relation to the company, and (b) the general knowledge, skill and experience that the director has. This duty is a codification of the common law approach and closely resembles the subjective/objective approach applied by Lord Hoffman in *Norman v Theodore Goddard* 1991 BCLC 1028 and *In re D'Jan of London Ltd* 1993 BCC 646. This approach was followed in South Africa in *Howard v Herrigel* 1991 2 SA 660 (A) and *Philotex (Pty) Ltd v Snyman; Braitech (Pty) Ltd v Snyman* 1998 2 SA 138 (SCA).

¹¹⁷ See *City of Cape Town Municipality* para 24.

¹¹⁸ Du Plessis 2010 *Acta Juridica* 263-289 agrees that s 76(3)(c)(ii) introduces the consideration of subjective elements. Also see Du Plessis "Comparative Analysis of Directors' Duty of Care, Skill and Diligence in South Africa and in Australia" 263. Stevens and De Beer 2016 *SA Merc LJ* 251-253 discuss the duty of care and skill as influenced by English jurisprudence. They express the view that it is generally accepted that the common law duty of care and skill was more subjective than objective because of the element of "men". But there were also objective elements in the inquiry because directors had to act "reasonably" when taking their decisions.

¹¹⁹ See ss 76(3)(c)(i) and (ii) of the 2008 Act; s 180(1)(a) and (b) of the *Corporations Act, 2001*; s 122(1)(a) of the *CBCA*; and s 174(1) and (2) of the *Companies Act, 2006*. Mongalo argues that the objective standard will apply to the skill and diligence only. This is so because the general knowledge, skill and experience requirement as provided for under s 76(3)(c) refers to the standard of skill and diligence, and as such is not a reference to the standard of care. See Mongalo 2016 *JCCL&P* 1. Also see Du Plessis 2010 *Acta Juridica* 263.

the same skill are compared on an equal footing¹²⁰ with directors who do not have similar skills.

Previously, Naudé convincingly canvassed for the application of a subjective standard of judgment as influenced by English company law when reviewing whether directors can be held liable for breach of the duty of care, skill and diligence. His thinking was informed by various factors.¹²¹ While du Plessis acknowledges that section 76(3)(c) brings subjective elements into court reviews, he also submits that, because South African company law has changed since the UK case of *City Equitable Fire Insurance Co Ltd* in 1925 and *Fisheries Development Corporation of SA Ltd v Jorgensen* in 1980, which set the tone for the duty of care and skill in South Africa, and has followed international developments in the area of the duties of directors, South African courts, as was decided in the Australian *Daniels v Anderson* case, must use modern yardsticks to determine whether directors have breached their common law duty of care, skill and diligence that will include the principles of the modern law of delict.¹²² His view is that there is no reason in principle, based on policy or on practical considerations, why our courts should not move away from the subjective standard developed under English courts.¹²³ According to him, the basis of liability for the breach of the duty of care, skill and diligence should be the principles of the law of delict.¹²⁴ Richard Stevens and Phillip de Beer seem to favour an objective standard of judgment. Arguing on the basis of English influence, especially with such cases as *Dorchester Finance Co Ltd v Stebbing* in mind,¹²⁵ the authors are of the view that since section 76(3)(c) appears to have been lifted from the UK *Companies Act* 2006, South African courts should follow the objective standard of judgment adopted by English

¹²⁰ Du Plessis 2010 *Acta Juridica* 263.

¹²¹ Amongst these were the considerable variation in size of companies; the considerable variation of skills which appointed directors possess; the fact that some directors are appointed only for their prestige value and others for their knowledge of the industry; the fact that some directors literally have no technical know-how of the business but are appointed to run the day-to-day business of the company anyway. See Naudé *Regsposisie van die Maatskappydirekteur* 216-217, 230. This article was cited in Du Plessis 2010 *Acta Juridica* 263, whose opinion was that Naudé's sentiments were convincing at the time they were made. According to him this was so because at the time the standards expected of directors were low and the directors' profession was still not well developed and defined as well as the fact that the South African law of delict was still relatively ill-developed as far as negligent misstatements or misrepresentation causing pure economic loss were concerned.

¹²² In making his argument the author quoted extensively from the case. See Du Plessis 2010 *Acta Juridica* 263.

¹²³ Du Plessis 2010 *Acta Juridica* 263-289.

¹²⁴ Du Plessis 2010 *Acta Juridica* 263-289.

¹²⁵ *Dorchester Finance Co Ltd v Stebbing* 1989 BCLC 498.

courts, which has an upward trajectory in interpreting and/or reviewing the duties of directors.¹²⁶

It is submitted that it is clear from the provisions of section 76(3)(c)(i) and (ii) that the 2008 Act has preferred to take a different path. The section is phrased differently from those under the *Corporations Act* 2001. Hence an objective assessment seems the contemplated norm under the 2001 Act.¹²⁷ In fact, the position in Australia was very much influenced by the case of *Daniels v Anderson*.¹²⁸ In that case the court preferred what it termed the use of the modern law of negligence to determine whether a director was in breach of his duty of care, skill and diligence. The court's view was that the modern law of negligence can cope with the potential tension between expecting objective professional standards of all directors in all types of companies.

In *Visser* the court seems to have followed the approach suggested by du Plessis. This was surprising as one would have thought that, after the court had quoted in full the provisions of section 76(3) of the 2008 Act,¹²⁹ it would proceed to analyse these using both the objective and subjective standards of judgment. This is especially so given that the court failed to recognise subjective elements in interpreting the duty to act for proper purpose. Instead the court simply stated that an objective test was applicable to determine the duty of proper purpose without mentioning the subjective standard.¹³⁰ The court did not even attempt to interrogate the possible application of the subjective standard of judgment to the duty of proper purpose by virtue of section 76(3)(c)(i) and (ii) of the 2008 Act. In fact, the court said nothing about the section. It is submitted that the court erred in not reviewing the actions of the directors by inviting subjective elements into its decision by virtue of section 76(3)(c)(i) and (ii) of the 2008 Act. Much as du Plessis argues for an objective test, he in fact does confirm that section 76(3)(c) does not completely objectify directors' duty of care, skill and diligence.¹³¹

¹²⁶ Stevens and De Beer 2016 *SA Merc LJ* 254-255.

¹²⁷ In Australia the duty is differently phrased under the *Corporations Act*, 2001. s 180(1) states that: a director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they (a) were a director or officer of a corporation in the corporation's circumstances; and (b) occupied the office held by, and had the same responsibilities within the corporation as the director or officer.

¹²⁸ *Daniels v Anderson* 16 ACSR 607 (CA (NSW)) 664-665, from which Jean J du Plessis quotes extensively in support of his point: Du Plessis 2010 *Acta Juridica* 263-289.

¹²⁹ *Visser* paras 72-73.

¹³⁰ *Visser* para 80. In fact, the court applied different tests at different stages of its judgment. For example, para 76 refers to the objective test as applicable to determine rationality, while para 74 refers to s 76(4)(a) as subjective.

¹³¹ Du Plessis 2010 *Acta Juridica* 263-289.

The section does not require comparison with a "reasonable person" as is the case in Australia, but instead refers to what is "reasonably expected of a person".¹³² To that end, section 76(3)(c) takes a different path from that taken by section 180(1) of the *Corporations Act 2001*.¹³³

What the court in *Visser* turned its attention to and recognised is the applicability of the subjective standard of judgment under section 76(4)(a)(i) based on the words "in the best interests of the company".¹³⁴ In quoting the provisions of section 76(3)(c)(i) and (ii) of the 2008 Act, the court seemed to have in mind that these provisions were applicable to determine the lawfulness of the directors' decision.¹³⁵ One was convinced that this was the proper course which the court was about to take because, when looking at the provisions of section 76(3)(c)(i) and (ii), the section seems to direct that a subjective test be applied to determine the proper purpose for which a power was exercised.

It is evident that this section is relevant to the performance and exercise of powers for the purpose for which they were conferred under the duty to act for a proper purpose. The proper purpose for which a decision was taken must be determined unambiguously in the context of whether the director exercised the power to distribute company money and property with the care, skill and diligence reasonably expected of a person carrying out the same functions in relation to the company in question as those carried out by that director, who has the same general knowledge, skill and experience as that director. The proper purpose for which the powers were used should therefore not be determined in the abstract.¹³⁶

¹³² See s 43 of the *Close Corporations Act 69 of 1984*, which is similarly phrased.

¹³³ Du Plessis 2010 *Acta Juridica* 263-289.

¹³⁴ It stated that s 76(4) makes it clear that the duty imposed by s 76(3)(b) to act in the best interests of the company is not objective, in the sense of entitling a court, if a board decision is challenged, to determine what is objectively speaking in the best interests of the company: "what is required is that the directors, having taken reasonably diligent steps to become informed, should subjectively have believed that their decision was in the best interests of the company and this belief must have had 'a rational basis'." The subjective test accords with the conventional approach to directors' duties, which (in relation to share transfers) was stated thus by Lord Greene MR in *Re Smith & Fawcett Ltd supra ...*". See *Visser* para 74; Stevens 2016 *TSAR* 709-730; Stevens and De Beer 2016 *SA Merc LJ* 250-284 for how the principle of rationality applies.

¹³⁵ *Visser* para 72.

¹³⁶ In South Africa the fact that a director must observe the duty of care, skill and diligence has since been accepted as part of our law as influenced by cases such as *In re Brazilian Rubber Plantation and Estates Ltd* 1911 1 Ch 425; and *In re City Equitable Fire Insurance Co Ltd* 1925 1 Ch 407. A director was expected to exercise the care which can reasonably be expected of a person of his knowledge and

It is therefore submitted that under the 2008 Act a subjective as well as an objective standard of judgment are unambiguously the standards contemplated to be applied to establish whether or not a director acted for a proper purpose when distributing company money or property. The four-stage test referred to earlier will therefore be an aid in determining whether a director used the power for its conferred proper purpose during the process which led to the distributive decision. The duty to act for a proper purpose is pervasive. The purpose for the directors' decision will be decisive in determining if indeed the decision was proper in the circumstances of the case, given the nature of the power conferred upon them. Proper documentation of the detailed analysis of the reasons for the decision as well as of the legal advice obtained will feature prominently in determining whether the decision was taken for a proper purpose. Where directors are not acquainted with the operations of the company to be protected under the business judgment rule, they are entitled to rely on other persons as provided under section 76(5) of the 2008 Act.¹³⁷

If a director has performed his or her' duties for a proper purpose it could therefore be deduced, first and foremost, that the director did not exceed the limitations of his or her capacity as conferred on him or her by the company's MOI.¹³⁸ More so, it can be said that the director exercised in the best interests of the company the care, skill and diligence expected from a director with the knowledge, skill and experience befitting a reasonable director in the same position and circumstances as the director in question. Ensuring that directors exercise their power properly is a necessary exercise to undertake to protect investors as well as those who might contract with the company.¹³⁹ This is the reason why the legislature had it as a requirement that the objects for which the proposed company was to be established must be in the company's memorandum of association,

experience. See *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 4 SA 156 (W) 166A.

¹³⁷ These are one or more employees of the company whom the directors reasonably believe to be reliable and competent in the functions performed or the information, opinions, reports or statements provided; legal counsel, accountants, or other professional persons retained by the company, the board or a committee as to matters involving skills or expertise that the directors reasonably believe are matters within the particular person's professional or expert competence; or as to which the particular person merits confidence; or a committee of the board of which the directors are not members, unless the directors have reason to believe that the actions of the committee do not merit confidence.

¹³⁸ *Delport et al Henochsberg on the Companies Act* 298(1)-(2), citing Naudé *Regsposisie van die Maatskappyditekteur* 111-115.

¹³⁹ *Delport et al Henochsberg on the Companies Act* 298(2).

which when signed and registered would establish the company.¹⁴⁰ The principle was established such:

...objects and purposes foreign to, or inconsistent with, the memorandum of association are *ultra vires* of the corporation itself.¹⁴¹

Directors commit a breach of trust if they exercise powers which are non-existent or their actions go beyond the powers conferred on them.¹⁴² It is irrelevant whether they believe they do so in the best interests of the company.¹⁴³ The issue under the proper purpose is whether the conduct impugned is inconsistent with the proper discharge of the duties of the office in question.¹⁴⁴ All relevant circumstances must be taken into account, including the extent of the director's awareness and the financial stability of the corporation.¹⁴⁵ Whether the action was proper in the circumstances of the particular case at the time will be for the court to decide. Directors must exercise their powers effectively. For example, when refusing to register shares, directors must at all times act *bona fide* in the best interests of the company.¹⁴⁶ There must be a formal resolution to that effect, as mere inactivity will not suffice.¹⁴⁷

What is telling, though, in the 2008 Act, is that in the definition of a director under the Act and/or common law no distinction is drawn between executive and non-executive directors.¹⁴⁸ This suggests that no distinction shall be drawn in the performance of their duties by executive and non-executive directors. It is not clear from the 2008 Act, however, whether this also means that their level of skills, knowledge, expertise and experience should not be distinguished for the purposes of founding liability. This distinction is especially potent when it is remembered that the 2008 Act contemplates holding directors individually liable for their actions or omissions. The cases

¹⁴⁰ Delpont *et al Henochsberg on the Companies Act* 298(2); *Ashbury Railway Carriage & Iron Co Ltd v Riche* 1875 LR 7 HL 653 678; and *Cotman v Brougham* 1918 AC 514 (HL) 522.

¹⁴¹ *Ashbury Railway Carriage & Iron Co Ltd v Riche* 1875 LR 7 HL 653 694; *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* 1986 Ch 246 (CA) 295-296, 303-307.

¹⁴² *Meskin Henochsberg on the Companies Act* 389; *Cullerne v The London & Suburban General Permanent Building Society* 1890 25 QB 485 (CA) 488, 490; *Sparks & Young Ltd v John Hoatson* 1906 27 NLR 634, 642.

¹⁴³ Delpont *et al Henochsberg on the Companies Act* 298(2).

¹⁴⁴ As the authors of Delpont *et al Henochsberg on the Companies Act* confirm, if a director does not comply with a legal rule, be it in terms of the Act or any other law, the director will be in breach of his/her fiduciary duties. Delpont *et al Henochsberg on the Companies Act* 296, 298(1); *Bester v Wright*; *Bester v Mouton*; *Bester v Van Greunen* 2011 2 All SA 75 (WCC).

¹⁴⁵ Delpont *et al Henochsberg on the Companies Act* 298(1).

¹⁴⁶ *Visser*.

¹⁴⁷ Delpont *et al Henochsberg on the Companies Act* 298(1).

¹⁴⁸ *Howard v Herrigel* 1991 2 SA 660 (A) 678A.

discussed above do not deal with this issue. Courts therefore have the need to clarify and give direction in this regard.

6 Conclusion

It is submitted that the above discussion shows that the duty to act for a proper purpose and its regulation still plays a meaningful role in restraining directors in the exercise of their powers. Quite a number of divergent views have emerged in the above discussion as to which standard of judgment should primarily be used to determine whether a particular decision was made for a proper purpose in the circumstances of a case. The discussion reflects that Australian courts have applied the objective standard of judgment based on common law, with the primary purpose test as the norm and the preferred standard in determining whether a director acted for a proper purpose at a particular time. In Canada, the preferred standards of judgment has been both the objective and subjective tests, accompanied by the "primary purpose test" and the "causative test". And in the UK both the subjective and the objective tests seem to be applied. The different approaches are evident in how the courts of these countries have ruled on the provisions of the CBCA as well as the *Companies Act 2006*.

South African law has also followed the common law approach, preferring an objective test accompanied by the "dominant purpose test" instead of the subjective test. An argument has been made in this paper that the 2008 Act requires the application of both the subjective and objective standards of judgment. Having looked at the wording of sections 4(1)(b) and 76(3)(c)(i) and (ii) of the 2008 Act, this interpretation seems inevitable. But also, the policy direction of the Act as gleaned from its objectives must serve as a valuable guide. Overall, it is submitted that what the 2008 Act requires is a two-pronged approach to the interpretation of the duty to act for a proper purpose. First the duty must be interpreted in terms section 76(3)(a), then the latter section must be considered in the context of section 76(3)(c)(i) and (ii). To proceed otherwise would be not in the spirit and purposes of the 2008 Act.

Ultimately, at all times directors must realise that they are the primary agents of the company. They have a constitutional, fiduciary and statutory obligation to act with integrity and responsibility for the efficient and responsible management of companies. The manner in which they carry out their duties is bound to impact significantly on how companies are governed. If directors are reliable and sincere in the performance of their obligations, they will certainly invigorate and strengthen corporate governance generally. This is the reason why directors are accorded protection under the business

judgment rule whenever they act prudently. However, if they are not prudent, the objectives of corporate governance will not be attained.

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List of Abbreviations

Bond LR	Bond Law Review
CBCA	Canada Business Corporations Act, 1985
ICLR	Incorporated Council of Law Reporting for England and Wales
JBL	Journal of Business Law
JCCL&P	Journal of Corporate and Commercial Law and Practice
JJS	Journal of Juridical Science
LMCLQ	Lloyd's Maritime and Commercial Law Quarterly
MLR	Modern Law Review
SA Merc LJ	South African Mercantile Law Journal
TSAR	Tydskrif vir die Suid-Afrikaanse Reg