

Obligations of company directors

A recent case demonstrates that even where the board of directors is acting within its power, it is still subject to the 'proper purpose' rule, writes **Jonathan Silverman**



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Eclairs Group and Glengary Overseas v JKX Oil & Gas [2015] UKSC 71 concerned the board of JKX calling for two shareholders in the publicly quoted company to disclose the beneficial owners behind their shareholdings, as it was entitled to do under section 793 of the Companies Act 2006.

It was apparent to the directors that, in the run-up to an annual general meeting (AGM), both Eclairs and Glengary were likely to vote against the re-election of certain directors and against special resolutions permitting the company to raise capital by share issues.

Since between them they held more than 25 per cent of the shares, they could effectively block a special resolution. The directors recognised that if they could contend that the shareholders had either failed to provide the information in a timely fashion or the responses were not truthful, they could utilise powers under the articles of association to prohibit these

two shareholders from voting at the AGM.

The board did not believe the response by Eclair and Glengary and consequently suspended their rights.

One might well expect a court to accept that where a board was acting within its power, this would suffice, without looking into its motives to deeply.

Yet both the court of first instance and the Supreme Court found that the directors' motives were tainted and so they had improperly utilised their powers, thereby negating the attempt to block the disenfranchised shareholders from voting at the AGM.

The court was concerned that the directors had gone against the 'proper purpose rule' by acting as they did. Although it accepted that the board had acted with integrity, genuinely believing it was in the best interests of the company, the court contended the directors had acted for an improper and underlying purpose (i.e. to stop the shareholders voting against the resolutions recommended by the board).

The Supreme Court remarked that directors are 'fiduciaries' and as such the exercise of their powers must always be subject to the proper purpose rule, commenting that directors acting with any improper purpose, such as to try to stop a takeover, usually come unstuck.

The Supreme Court's decision might have been expected, but there was some consideration given to the circumstances

surrounding the examination of the directors' intents (some of which were proper and some of which were not). The members of the Supreme Court held different views, which makes a detailed review of the judgment worthwhile, raising as it does the possibility that were the matter to come before the court again, issues of 'causation' over 'proper purchase' might become relevant (i.e. looking afresh at the reasons why directors reach a particular decision).

With the intention to broaden the right to call for this information from public to private companies during 2016, this becomes even more significant, as articles in private companies in many cases give powers to directors to disenfranchise shareholders in certain circumstances.

Advising directors

This creates issues both for directors and those advising them, and a need to be extraordinarily careful when recording any board discussions surrounding decisions of this nature. So, how should practitioners advise directors who suspect the registered shareowners are not the beneficial owners or that one or more are likely to act in concert?

It is certainly prudent for directors to seek legal advice if there is any question of why they are serving notices under section 793. They have a fiduciary obligation to the company as a whole and need to act even-handedly and objectively in

exercising their powers.

Directors need to keep a watchful eye on the share register, calling for information as and when they first become aware of any suspicions about the underlying ownership or potential for concert party activity, rather than waiting until just before a general meeting to debate a prospective takeover.

Certainly they should be wary about convening a general meeting if a request for information remains outstanding, especially where the 'suspect shareholdings' might be critical in a vote or if there is any suggestion that they may be taking the side of one group of shareholders against another.

As shares may be changing hand fast and furiously once the company is identified as a target, it would be more than unfortunate if directors felt that their hands were tied from seeking such critical information about the underlying ownership of the shares in the company.

The key issue is that the power must be used only for a proper purpose and no other (i.e. in this case to ascertain honest replies to the notices seeking information and no more).

The practitioner needs to provide clear legal advice about 'proper purpose' to ensure that all the directors understand that their respective views have to be clearly expressed and recorded, demonstrating that their reasons are adequately stated and that none of them could be challenged in any way for being inappropriate. **SJ**