DIRECTORS' DUTIES AND IMPROPER PURPOSES

IN *Eclairs Group Ltd. v JKX Oil & Gas plc.; Glengary Overseas Ltd. v JKX Oil & Gas plc.* [2015] UKSC 71, the Supreme Court had a rare opportunity to analyse the rules on directors' exercise of power for improper purposes, and to do so in a context which raised more subtleties than earlier authorities.

An English listed oil and gas company, JKX, suspected it was the target of a hostile raid by two of its shareholders, Eclairs and Glengary. These were BVI companies with alleged Ukrainian backers. JKX, through its directors, had the power to require individual shareholders to disclose details of those with interests in the shareholding, and then to disenfranchise shareholders if it considered their response inadequate. This JKX did with both Eclairs and Glengary. It was not disputed that the power to disenfranchise had been exercised so as to disentitle these shareholders from voting at JKX's AGM, thus ensuring the passage of certain resolutions, including resolutions to appoint the next round of directors, rather than for the purpose of enforcing the company's demand for information. Future control of JKX thus hung on the validity of the directors' actions.

For directors, the proper purpose rule is now enshrined in statute: Companies Act 2006, s. 171(b), provides that directors must "only exercise powers for the purposes for which they are conferred", and s. 170(4) adds that the rule is to be interpreted and applied with regard to the corresponding common law rules and equitable principles. This seems terribly simple, but the devil is in the detail.

In any proper purposes case, the court must proceed in steps: first, analysing the particular power in issue to determine as a matter of law the boundary between its proper and improper exercise; secondly, assessing as a matter of fact the reason(s) for the exercise of the power in the case before them, and applying some appropriate legal test if the directors acted for mixed purposes, as typically they do; and, finally, deciding the appropriate consequences. Regrettably for legal certainty, the Supreme Court in *JKX* was only required by the facts to deal with the first step.

That step alone was difficult enough. Until *JKX*, most proper purposes cases concerned the issue of shares, often to defeat hostile takeover bids (the long-standing leading authority was *Howard Smith Ltd. v Ampol Petroleum Ltd.* [1974] A.C. 821). A power to issue shares can clearly be exercised for a variety of reasons, some potentially proper and others improper. By contrast, the *JKX*-style conditional power to disenfranchise shareholders can only be exercised when the conditions are met. Suggesting that it might be improper to exercise the power to disenfranchise in those very circumstances could seem contrary to the very essence of the power. JKX put this fundamental "no proper purpose limitation" argument

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in three different ways, but none persuaded the Supreme Court. The Court denied that the proper purpose rule frustrated the purpose or utility of the disenfranchising provisions in the company's articles. This must be right: the duty is general, applicable to all directors' powers, and will only frustrate illegitimate purposes, not legitimate ones. The Court also denied that proper purpose restrictions are only discovered by seeking technical common law implied terms in the contract. They are, instead, sourced in very much broader equitable constraints applicable to the exercise of powers generally (see e.g. *Assénagon Asset Management S.A. v Irish Bank Resolution Corporation Ltd.* [2012] EWHC 2090). Finally – and this was JKX's primary focus – the Court denied that the jurisdiction depended on whether the power was "unilateral" or conditional, even though the latter might appear to put the consequences of its exercise entirely in the hands of the shareholders. This conclusion too must be right. Even in this context, the company is both the initiator of the request and the final arbiter of the potentially draconian consequences.

But accepting that the power does indeed have to be exercised for proper purposes, the difficult issue is to determine which purposes are proper and which are not. Lord Sumption held that "it is usually obvious from its context and effect why a power has been conferred" (at [31]). But, however "obvious", reasonable minds are very likely to differ, and it is this which makes the proper purposes jurisdiction so fraught. In *JKX*, Lord Sumption determined that there were three proper purposes: to incentivise supply of the required information, to protect the other shareholders from having to make decisions in ignorance of hidden vested interests, and to punish non-compliance. By contrast, it was not proper to prevent shareholders from participating in corporate governance, even though that was equally an incident of a proper exercise of the power.

All this may seem eminently compelling, but it leaves a very difficult issue of fact. Lord Sumption's three purposes surely collapse into one, that being to protect the shareholders from taking decisions in ignorance of vested interests, and doing that by means of incentives and punishments. Moreover, the more crucial the decision, the more crucial the protection. Indeed, it is difficult to see this power being exercised in anything other than such important voting circumstances. The threat of disenfranchisement may be precisely the directors' intention, in order to provide the desired protection—as indeed is contemplated by the express terms of the power. This then seems on all fours with *JKX* so, if the directors had worded their motives in this more appropriate longhand, might all have been well? Instead, Eclairs' appeal was allowed on the basis that the directors had indeed exercised their power for the improper and primary purpose of disenfranchising Eclairs at the AGM.

Although that determined the outcome, Lord Sumption (Lord Hodge agreeing) went on to consider the approach to be adopted if the directors

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had mixed purposes, some proper and some improper, as is very common in corporate decision-making. Although obiter, Lord Sumption's analysis is compelling and likely to prove enormously influential. He noted that, in the public-law arena, an improper purpose of any magnitude is regarded as tainting the decision (although note *R. (FDA) v Secretary of State for Work and Pensions* [2013] 1 W.L.R. 444). The terms of CA 2006, s. 171(b) suggest the same rigid approach, yet with trustees and company directors the law has always been more lenient in allowing mixed purposes (but see [17]). The question then is how to draw the line between acceptable and unacceptable balances of proper and improper purposes.

Lord Sumption put forward a principled preference for the "but for" test. This was on the basis that if equity allowed a decision to stand despite the taint of improper purposes it could only be because no injustice had been done to the interests being protected. That would only be the case if the decision would in any event have been taken with or without the improper purposes. By contrast, if the decision would not have been taken "but for" the improper purposes then it was tainted by the improper purposes (at [21]–[23]). This favours the wording in the Australian cases (*Mills v Mills* (1938) 60 C.L.R. 150, 186; and *Whitehouse v Carlton House Pty* (1987) 162 C.L.R. 285, 294), rather than the "primary" or dominant purpose test in *Howard Smith* (above). But Lord Mance expressed uncertainty with this, Lord Neuberger agreeing (at [51]–[54]); and, in the event, the rest of the Court declined to follow, especially not having heard oral argument on the issues.

Theoretically, that then left the third and final question: what consequences should follow a finding of improper purposes? This was not considered by the Supreme Court. It is uncontroversial that decisions made for improper purposes are voidable (*Hunter v Senate Support Services Ltd.* [2004] EWHC 1085 (Ch), at [173]–[179]). But a difficult hypothetical question was posed by the trial judge, Mann J.: assuming the directors decided one way only because of an improper purpose, but they would have decided precisely the same way had that improper purpose not been present, should their decision then be allowed to stand? Mann J. thought the facts in *JKX* were undoubtedly thus; and perhaps on the principles advanced by Lord Sumption, it might be thought that the directors' decision should be allowed to stand. But the better approach, it is suggested, is to insist that the court does not deal with hypotheticals. The mooted scenario is not the same as a mixed purposes scenario. On the assumed facts, the decision *was* made for improper purposes and so is voidable. If the affected shareholders avoid the decision, then the company is free to remake it, properly. But the court should not speculate. And in the interim, time runs.

Earlier authorities typically deal with shareholder counterparties avoiding the voidable decision (*Howard Smith*, above) or ratifying it (*Hogg v Cramphorn* [1967] Ch. 254), not with the directors having a further stab at the decision itself.

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In short, this case provides a far more revealing exposé of improper purposes than previous authorities, but it also teases those seeking certainty: ultimately none of the three key questions on improper purposes is pinned down by robust ratio.

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IMPLICATION OF JURISDICTION AGREEMENTS

IN *Vizcaya Partners Ltd. v Picard* [2016] UKPC 5, the Privy Council considered an attempt to enforce a New York judgment in Gibraltar. The judgment debtor was not present in New York at the time the New York court assumed jurisdiction, which suggested that enforcement of the US judgment would be refused for want of jurisdiction. However, the argument of the judgment creditor was that an express choice of New York law in the contract, coupled with other factors, was sufficient to imply submission of the parties to the courts of New York (and, accordingly, vest the New York courts with jurisdiction for the purposes of enforcement of the New York judgment). The crux of the case was thus whether the terms of the contract could indicate submission to the jurisdiction of a foreign court, even if that submission was not crystallised in the form of an express contractual provision. The Privy Council held that, while, in principle, it might be possible to imply submission, on the facts, there was no such submission so that the judgment was unenforceable.

The reasoning of Lord Collins, who gave the judgment for the Board, was twofold. The first question for him was whether in principle the English conflict of laws recognised implied jurisdiction agreements as a basis for the enforcement of a foreign judgment. The answer was positive – as a matter of English law, the jurisdiction agreement may be implied, and one can only agree with this proposition.

The second, logically subsequent, question was whether the parties had actually agreed to the jurisdiction of a foreign court, albeit impliedly. And that, Lord Collins stated, is not a question for English law, but is a question for the governing law of the host contract. In the event, the law of New York governed the contract, and thus the court would need to turn to the law of New York to gauge the implication of a jurisdiction agreement. On the facts of the case, Lord Collins was not convinced that New York law permitted the implication of a choice of court agreement on the basis of an express choice of law clause.

The judgment of the Board provides a clear and authoritative account of the manner in which jurisdiction agreements should be implied for the

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