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Eclairs Group Ltd, a sticky problem for directors?

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The Supreme Court this week handed down judgment in **Eclairs Group Ltd v JKX Oil & Gas plc** [2015] UKSC 71 concerning directors' powers under sections 793-797 of the Companies Act 2006 which provide that a company can issue a disclosure notice calling for information about persons interested in its shares and can restrict the exercise of rights attaching to shares in the event of non compliance.

The JKX Oil & Gas Articles of Association included the common provision that the directors could treat a response to a disclosure notice as non compliant where there was reasonable cause to believe that the information provided was false or materially incorrect.

The directors of JKX had the reasonable belief that certain shareholders had failed to provide appropriate responses to a disclosure notice. The directors decided to use their powers under the Articles to issue restriction notices in relation to the shares which suspended the right to vote at general meetings. The purposes of the directors' decision included a desire to influence the outcome of on various AGM resolutions concerning the composition of the board.

The shareholders challenged the restriction notices, relying on the proper purpose rule ie that a director may *"only exercise powers for the purposes for which they are conferred"* (see CA 2006 s.171(b). That rule has its origins in the equitable principle known as "*fraud on a power*" which has nothing to do with fraud but simply meant that a fiduciary power is not to be exercised for a purpose, or with an intention, beyond the scope of or not justified by the instrument creating the power.

The Supreme Court held that the proper purpose rule applied to the directors' decision and had been breached. The purpose of the power to restrict rights attaching to shares had three purposes, namely: (i) to induce a shareholder to comply with a disclosure notice; (ii) to protect

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the company against having to make decisions without having relevant information; and (iii) as a punitive sanction for failure to comply with a disclosure notice. However, seeking to influence the outcome of shareholder's resolutions where there was a battle for the control of the company is not a proper purpose.

The previous case law referred to a "*substantial or primary purpose*" test but Lord Sumption and Lord Hodge considered that where directors have multiple concurrent purposes for acting in a particular way then a "*but for*" test should be applied, ie the court needs to consider whether or not the same decision have been reached even if there had not been any improper purpose. Lord Mance said that that *"but for"* causation offers a single, simple test, which it might be possible or even preferable to substittue for references to the principal or primary purpose test but (along with a majority of the Court) expressly left this important question undecided.

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