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REVISITING THE JUDGE-MADE RULE OF NON-INTERFERENCE IN INTERNAL COMPANY MATTERS

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I INTRODUCTION

When one looks at several of the judge-made rules applied to the internal governance arrangements of companies, at first glance they seem very logical and indispensible to company law. Examples of these rules are: the rule of non-interference in internal company matters by the courts; the rule that courts will not take over the responsibility to manage the business of companies; the rule that courts will not second-guess the business decisions taken by the board of directors; the rule that the courts should respect the outcome of decisions taken by the majority of shareholders (the so-called majority rule); and that the company, as a separate legal entity, is the proper plaintiff when it comes to wrongs committed against the company (the so-called rule in *Foss v Harbottle*).

Superficially, some of these rules seem unrelated, and they seem to exist harmoniously, but a closer analysis reveals considerable overlaps between the rules, and even tensions between them. These overlaps and tensions only become apparent when the question is asked why the courts developed these rules. It is, however, a daunting task to identify trends and patterns as the courts, over a period of almost 200 years, have provided different explanations for the existence of some of these judge-made rules or, in some instances, have not provided clear explanations for developing them at all.

In this article the focus will be primarily on the judge-made rule of non-interference in internal company matters, but reference to other related judge-made company law rules is unavoidable. In section 2 of this article an in-depth analysis of some older, primarily English, cases will be undertaken. In section 3 the focus will be on some qualifications required of the rule that courts will not interfere with internal company matters.

In the discussion it will be seen that some of the judge-made rules still applied today were developed almost 200 years ago. However, these rules, and the cases in which they were laid down, retain their importance, even with a new South African Companies Act (the Companies Act 71 of 2008)

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having been promulgated. As the courts are required to exercise a value judgement on whether or not to interfere in internal company matters, the courts will have to revisit the origin of the judge-made rule of non-interference in internal company matters. There is also no indication in the new Companies Act 71 of 2008 that any of these judge-made rules have been abolished or codified to any extent that would make them irrelevant or inapplicable in the modern company law context in South Africa. Thus, it remains important to discuss and analyse these rules.

II TENSION AMONG JUDGE-MADE RULES OF INTERNAL COMPANY GOVERNANCE

(a) General rules

Two judge-made rules that have been commented on by a few commentators are, first, that courts are reluctant to interfere with the internal affairs of companies and, secondly, that courts will not second-guess the decisions properly taken by directors as part of powers conferred upon the directors by the articles of association.

1 It is, however, far more difficult to draw an exact distinction between the two rules, or even to pinpoint the exact reasons for the existence of each of the two rules. This is difficult because the courts have neither been consistent in the way in which they have expressed these two rules, nor in giving their reasons why the rules were fundamental to company law.

(b) Case studies

(i) One of the earliest reported cases: Carlen v Drury (1812)

One of the earliest cases where the issue for consideration was whether or not a court of law should interfere in the internal managerial affairs of businessmen (the exact business form — a partnership or joint stock company — is somewhat uncertain) was the 1812 case of Carlen v Drury. The case was brought by six committee members on behalf of themselves and the other members of the business enterprise, against three managers, six of whom were also committee members. The bill alleged ‘Circumstances of gross Mismanagement, and Neglect on the Part of the Managers; and praying an Account; a Dissolution of the Partnership; that a Receiver might be appointed...’

1 Jean J du Plessis ‘Directors’ duty to use their powers for proper or permissible purposes’ (2004) 16 SA Merc LJ 308 at 312; Elizabeth Klein & Jean J du Plessis ‘Corporate donations, the best interest of the company and the proper purpose doctrine’ (2005) 28 University of New South Wales LR 69 at 74; and C G Killian and J J du Plessis ‘Possible remedies for shareholders when a company refuses to declare dividends or declare inadequate dividends’ 2005 TSAR 48 at 56.

2 See Carlen v Drury 35 ER 61 at 63.

3 Ibid.

4 Ibid.
The Lord Chancellor [Eldon] pointed out that the business was conducted under internal rules ('Terms of the Articles') agreed upon by the parties who formed the business. The court made it clear that if these rules were not effectual, the court would interfere. However, in this case there were specific arrangements made for resolving internal disputes. It was pointed out that the court would only be prepared to interfere with internal managerial matters entrusted to the managers if a 'case of Breach of Engagement, or Abuse of Trust' is established 'to the perfect Satisfaction of the Court'. It will then have to be established 'that Persons will not according to their Duty attend to the Interest of the Concern'. After all, as the court pointed out, it 'is not to be required of [the court] on every occasion to take the Management of every Playhouse and Brewhouse in the Kingdom'.

The Lord Chancellor then made it clear that parties should first rely on their own internal mechanisms to resolve their difference before approaching the court. The strongest indication of when the court would be prepared to interfere with the internal affairs of a business enterprise appears from the following words:

‘If, however, a Case of Delinquency [of the managers] should be clearly made out, I do not hesitate to declare, the Court would act : but there must be a positive Necessity for the Interference of the Court, arising from the Refusal or Neglect of the Committee to act. That may raise a case for prompt and immediate Interference; which I cannot say exists at present.’

Thus, Carlen v Drury is probably the earliest case where the court did not only state that a court will not interfere in the internal affairs of a company, but where a court specifically focused on the exceptions to this rule. It is probably also the first case where a court accentuated so prominently that it is impossible for a court to manage the internal affairs of companies.

(ii) Foss v Harbottle (1843) and Mozley v Alston (1847)

The two cases most often quoted in the context of the importance of majority rule in company law, and the reluctance of courts to judge the merits of internal company disputes unless internal dispute resolution mechanisms have first been exhausted, are two cases decided in 1843 and 1847 respectively. They are the cases of Foss v Harbottle and Mozley v Alston.

In Foss v Harbottle the plaintiff instituted action on behalf of himself and other shareholders against, inter alia, the five directors of the company, three of whom were bankrupt. It was alleged that the defendants were involved in several fraudulent and illegal transactions. The plaintiffs approached the court, rather than relying on internal remedies and procedures available under the company constitution, because they alleged there was not a sufficient number of qualified directors to constitute a board and that the

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5 Ibid at 62.
6 Ibid at 63.
7 67 ER 189.
8 41 ER 833.
9 Supra note 7.
company had no clerk. The plaintiffs requested the court to decree the defendants to make good to the company the losses and expenses caused by several alleged fraudulent and illegal acts of the defendants. The court held that the plaintiffs had no standing because, under these circumstances, there was nothing to prevent the company itself from instituting the action based on the complaints raised by the plaintiffs.

It is interesting to note that the defendants, specifically to avoid ‘the responsibilities of an ordinary partnership’, applied for a private Act of Parliament — to be granted the privilege to trade as a company. This Act had been granted on 5 May 1837 (7 Will 4) and, under this Act, ‘The Victoria Park Company’, a typical property development company, was founded.\(^{10}\)

In terms of this Act, the company was granted all the important virtues of a body corporate, namely: ‘perpetual succession’; to hold a ‘common seal’; to ‘sue and be sued, plead or be impleaded, at law and in equity’ in the name of the company; to ‘prosecute any bill or bills of indictment or information against any person or persons who should commit any felony, misdemeanour, or other offence indictable or punishable by laws of this realm’; and ‘have full power and authority to purchase and hold lands, tenements and hereditaments to them’.\(^{11}\)

The defendants’ response to the plaintiffs’ claims was a rather narrow one. It was contended that it was the corporation that was injured and that as the corporation was not party to the claim, the court did not have the proper plaintiff appearing before the court. The correct procedure, so it was argued, was to use the name of the corporation and, in that case,

‘it would have been open for the Defendants, or the body of directors or proprietors assuming the government of the company, to have applied to the Court for the stay of proceedings, or to prevent the use of the corporate name; and, upon that application, the Court would have inquired into the alleged usurpation or abuse of authority, and determined whether the Plaintiff should be permitted to proceed’.\(^{12}\)

In short, there was a serious procedural obstacle preventing the case being heard by the court. As mentioned above, the court held in favour of the defendants, but it is important to look at the court’s reasoning. The Vice-Chancellor (Sir James Wigram) explained the underlying procedural dilemma very clearly:

‘The Victoria Park Company is an incorporated body, and the conduct with which the Defendants are charged in this suit is an injury not to the Plaintiffs exclusively; it is an injury to the whole corporation by individuals whom the corporation entrusted with powers to be exercised only for the good of the corporation.’\(^{13}\)

\(^{10}\) Ibid at 191.

\(^{11}\) Ibid.

\(^{12}\) Ibid at 200.

\(^{13}\) Ibid at 202.
Referring to the case *The Attorney-General v Wilson*,14 The Vice-Chancellor then confirmed the principle that the proper plaintiff to bring the suit against alleged wrongdoings by the directors of the corporation is the corporation. He then explained what the procedural problem for Foss and the other plaintiffs was:

‘[I]nstead of the corporation being formally represented as Plaintiffs, the bill in this case is brought by two individual corporators, professedly on behalf of themselves and all other members of the corporation, except those who committed the injuries complained of — the Plaintiffs assuming to themselves the right and power in that manner to sue on behalf of and represent the corporation itself.’15

Thus, under the guise of the proper plaintiff rule, the court refused to judge the merits of the case. The Vice-Chancellor rejected the defendants’ argument that it was totally impossible for individuals to institute an action on behalf of the company. It was pointed out that there might be instances where ‘difficulties arising out of technical rules respecting the mode in which corporations are required to sue’ will have to bow to the principles of justice and equity.16 It was simply a matter of considering whether the case at hand was one where, in the interests of justice, an exception should be allowed, based on justice and equity, to allow the plaintiffs to sue although the company was the proper plaintiff. The Vice-Chancellor referred to the allegation of the plaintiffs that the directors were in breach of their fiduciary duties towards the company by having approved that the company buy their own personal properties from them at a profit to allow the corporation to develop these properties. The general principle here is that such transactions are voidable to the option of the corporation. However, there is a very important qualification, namely that the corporation may decide to hold the directors to the contracts so concluded. This will be the case if the company, by convening a general meeting, would decide so by way of a majority vote by the general meeting. In this case, it was pointed out that no such a meeting at which this issue could have been decided had ever been convened. Thus, it was pointed out that even if an order is made that the directors were in breach of their fiduciary duties, such an order would be without any practical effect if the general meeting were to decide to hold the directors to the contract and continue with the development of the property on behalf of the company.

In short, the way in which the bill was framed was totally flawed as there was no indication that an attempt was made to convene such a general meeting to consider whether or not the contracts with the directors should be avoided, or whether the corporation would effectively ratify or condone the breach of the directors’ duties and continue developing the property obtained from the directors. There was also no indication in the bill that it

14 Cr & Ph 1.
15 *Foss v Harbottle* supra note 7 at 202.
16 Ibid at 203.
was impossible to convene a general meeting, or that the plaintiffs had resorted to all means and found it ineffectual to convene a general meeting for the very purpose of confirming or cancelling the property contracts the corporations had concluded with the directors. As it was explained:

‘[T]here is no suggestion [in the bill] that an attempt has been made by any proprietor to set the body of proprietors in motion, or to procure a meeting to be convened for the purpose of revoking the acts complained of.’

Nowhere in Foss v Harbottle is it clearly stated that courts are reluctant to interfere in the internal affairs of a company; nowhere is it stated that a court will not second-guess directors’ decisions, or that directors’ business judgments would not be challenged by courts of law. There is not even any direct reference to the importance of the application of the principle of majority rule in company law. Also, the Vice-Chancellor seems not to be concerned with opening the floodgates of litigation if courts are prepared to consider internal company matters. So, what does Foss v Harbottle stand for?

It has correctly been referred to as establishing the proper-plaintiff rule in the sense that, in principle, it is the company who should sue for any wrong committed against, and affecting, the company as a separate legal entity. It is also safe to conclude that the court did not want to make an order that would have no practical effect in the sense of a company being able to convene a general meeting after the court order has been made and confirming a transaction in breach of directors’ duties. Thirdly, it most certainly stands for the proposition that a court will only be prepared to interfere with internal company matters if plaintiffs have first exhausted all their internal remedies, and if it is clear to the court that an unjustifiable wrong has been committed. It is, therefore, indisputable that the rule in Foss v Harbottle provided a formidable obstacle for minority shareholders to get their concerns regarding internal wrongdoings heard by the courts. Thus Foss v Harbottle established a strong precedent for non-interference in internal company matters, as will become clearer later.

A second prominent older English case, Mozley v Alston, is often quoted in conjunction with Foss v Harbottle. In this case two shareholders sought an injunction against twelve directors, restraining them from acting as directors of the Birmingham and Oxford Junction Railway Company. It was argued that because these twelve directors did not re-elect four directors as prescribed by legislation, the whole body was constituted illegally and that in actual fact only six directors, later elected, should have the powers to act as directors. The Lord Chancellor (Cottenham) made the point that there are cases where a court will allow individuals to bring a case on behalf of others involved in bodies with a large number of persons, but then the interests of all those who are represented should be identical — in this case it was not clear at all whether that was the case. However, the actual reason for demurring

17 Ibid at 204.
18 Supra note 8.
the bill was based on a specific part of the reasoning in *Foss v Harbottle*, namely, that ‘there existed in the company the means of rectifying what was complained of, by a suit in the name of the company’.\(^{19}\)

It was argued that the same considerations would apply in this case (*Mozley v Alston*), as it was alleged in the bill that ‘a large majority of the shareholders are of the same opinion’ as the plaintiffs. Thus, the court basically encouraged the shareholders to convene a general meeting and then approach the court on behalf of the corporation to restrain the twelve directors to act as directors of the Birmingham and Oxford Junction Railway Company.

It is submitted that the most prominent proposition that could be extracted from *Mozley v Alston* is that the company is the proper plaintiff for wrongs committed against the company as a separate legal entity. Although less prominently, it also stands for the proposition that a court will not be prepared to interfere with internal company matters until the plaintiffs have first exhausted all their internal remedies. It is not certain at all that, as in *Foss v Harbottle*, the court had in its contemplation the fact that it would not make the order sought because such an order would have no practical effect if the company would convene a meeting and ratify the wrong of which the plaintiffs had complained.

Before we move chronologically to the next cases, it is worthwhile to point out that in 1867, in the case of *Hoole v Great Western Railroad Co*,\(^{20}\) it was held that a court will *not hesitate* to interfere with a decision taken, even on application of one shareholder only, by any company organ (board of directors or general meeting of shareholders) if the decision taken by that company organ was ultra vires or ‘altogether beyond [that organ’s] power’.\(^{21}\)

It is, however, the cases that dealt with less extreme instances where it becomes less clear what the real reasons were why the courts *were prepared* to interfere with internal company matters or *were prepared* to second-guess the decisions of company organs. Or, to put it in the negative, why the courts were reluctant to interfere with the internal affairs of a company or why the courts were reluctant to second-guess the decisions of company organs.

(iii) Cases decided between 1848 and 1889

Lord v The Governor and Company of Copper Miners\(^{22}\) is one of the first cases (1848) where *Foss v Harbottle* was quoted as having established the rule that courts will not interfere with the internal affairs of a company. It will be recalled from the discussion above that that particular paraphrasing did not appear in *Foss v Harbottle*. In *Lord’s* case, the majority shareholders, consisting primarily of the board members or governing body as it was called, approved of certain transactions, including a plan to vest all the property of the company in trustees for the purpose of liquidating the company’s affairs. The

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\(^{19}\) Ibid at 837.

\(^{20}\) (1867) 3 Ch App 262.

\(^{21}\) Ibid at 268 (Lord Cairns LJ) and 274–5 (Sir John Rolt LJ).

\(^{22}\) (1848) 41 ER 1129 at 1134.
plaintiff then brought an action, on behalf of himself and all the other shareholders, apart from the members of the governing body, to challenge the validity of the transactions approved by the general meeting. The court, in holding that the sanctioning of the transactions by the general meeting could not be challenged, relied on the rule against interference with internal company affairs. The headnote to the case traced the origins of the rule back to two prominent cases and summarises the ratio of the court’s decision: ‘The doctrine of Foss v Harbottle (2 Hare, 492) and Mozley v Alston (1 Phill, 700), as to the interference of this Court in the internal administration of incorporated companies, confirmed’.

The Lord Chancellor (Cottenham) was very clear in explaining the difficulties that faced the court. It had become more frequent for litigants to challenge transactions of joint stock companies through litigation. On the one hand there was the duty the court had to provide remedies for litigants who were affected by the conduct of joint stock companies; on the other hand, the Lord Chancellor observed that he was ‘not insensible to the danger of carrying this principle too far’ as that could lead to the courts being inundated with litigation, ‘which this Court may not have the means of so exercising’. The Lord Chancellor admitted that there was ‘great difficulty in drawing the line’ between the two competing considerations he mentioned and also admitted that ‘[c]ases of this kind are . . . attended with great difficulty’.

It is worth quoting from the judgment as it reveals a lot about the practical reasons why the court was so reluctant to consider the merits of internal managerial decisions taken by company organs:

‘I find all the complaints made by the individual shareholders to consist of acts within the powers of the corporation, and all sanctioned by general meetings of shareholders and no allegation raising any case for the interference of a Court of Equity with the exercise of such rights. A Court of Equity could not assume jurisdiction in such a case, without opening its doors to all parties interested in corporations, or joint stock companies, or private partnerships, who, although a small minority of the body to which they belong, may wish to interfere in the conduct of the majority. This cannot be done, and the attempt to introduce such a remedy ought to be checked for the benefit of the community.’

The Lord Chancellor then expressed his ‘strong approbation’ of the rule laid down by Sir James Wigram in Foss v Harbottle. It is not at all clear whether it was in actual fact the strong support for the proper-purpose rule, the support of the application of majority rule in companies, or whether it was the daunting consequences of even slightly opening the door in this regard for minority shareholders that moved The Lord Chancellor to support the rule in Foss v Harbottle so strongly. In my view it was the last-mentioned reason.

23 Ibid at 1129.
24 Ibid at 1133.
25 Ibid at 1134.
The importance of the joint stock company as a separate legal entity was already well-appreciated when cases like *Foss v Harbottle*, *Mozley v Alston* and *Lord v The Governor and Company of Copper Miners* were decided. It had become clear that separate legal entities could only act through the medium of human beings, and that such human beings assemble as company organs to take decisions on behalf of these entities. These organs take decisions based on the fundamental principle of majority rule. That simply means it is either the board of directors that takes decisions on behalf of the company, or the general meeting of shareholders. Any individual shareholder who was not satisfied with the way a company was governed internally should first exhaust all his or her internal remedies. One very important such internal remedy was to convene a general meeting and to put the matter complained about to the vote. At this forum the will of the majority must prevail, so it was held by several very prominent older English cases.

Thus, it is the company as separate entity that is in actual fact the proper plaintiff to address all wrongs committed against the company, and it is the company as separate legal entity and only the company as separate entity (almost at all costs!) that should be allowed standing in such cases. The minority has no such standing, unless the wrong complained about falls within the exceptions to the rule in *Foss v Harbottle*. Then, the minority shareholders will either have standing to bring a derivative action — an action derived from what the company would have had if it was not for the fact that the majority who committed the wrong was in control — or a personal action when a shareholder’s personal rights were affected by the conduct of any company organ. Approaches differ, but it is generally said that a wrong committed by the majority (a company organ) cannot be ratified if it constituted, for instance: a ‘fraud on the minority’; was an ultra vires act in breach of the rights of the company as set out in the constitution; or was unlawful conduct and conduct in breach of the common law of the type which is not ratifiable by an ordinary resolution, and which amounts to a wrong to the company.

Another classic case quoted for the proposition that the court will not interfere with a company’s internal affairs is the 1875 case of *MacDougall v*

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26 As long ago as 1860, these principles were explained with great clarity by Nathaniel Lindley (N Lindley *Treatise on the Law of Partnership, including its Application to Joint-Stock and other Companies: Volume I* (1860) 465): ‘One of the great peculiarities, as distinguished from partnerships, is that the management of a company’s business is entrusted to a few chosen individuals, and that the shareholders are deprived of that right of personal interference which is enjoyed by the members of ordinary firms. The members of companies form two bodies, whose interests are or should be the same, but whose powers and functions are different; the one body consists of the directors, in whom the general powers of management are vested, and the other body consists of the great bulk of shareholders, to whom the directors are accountable, and by whom they are generally appointed. Each of the bodies has its own sphere of action, and its own rights and duties. . . .’

Gardiner.\textsuperscript{28} Similar to Lindley LJ, James LJ in MacDougall’s case used the proper plaintiff rule as the reason why a court will not hear internal disputes between shareholders brought by the minority shareholders only, ‘unless there be something illegal, oppressive, or fraudulent — unless there is something \textit{ultra vires} on the part the company \textit{qua} company, or on the part of the majority of the company . . .’.\textsuperscript{29} James LJ was very clear about what type of conduct would be considered to be typically internal matters:

‘The truth is, that is only part of the machinery and means by which the internal management is carried on. The whole question comes back to a question of internal management: that is to say, whether the meeting ought or ought not to be held in a particular way, whether the directors ought or ought not to have sanctioned certain proceedings which they are about to sanction, whether one director ought or ought not to be removed, and whether another director ought or ought not to have been appointed.’\textsuperscript{30}

Earlier on the same page, James LJ illustrated the dire consequences if the courts were to entertain in these types of internal managerial matters — not only would an individual shareholder then be able to make the court order a general meeting to be held, but also to make an order that the other ‘shareholders must stay there to listen to him and be convinced by him’.\textsuperscript{31} Another reason for the reluctance to rule on matters of internal company management was that it may lead to a court expressing ‘an opinion on something which may lead to no practical result’.\textsuperscript{32} It was exactly this dilemma that faced Sargant J in \textit{British Murac Syndicate Ltd v Alperton Rubber Co Ltd}.\textsuperscript{33} Having held that the company was precluded from amending its articles in breach of a separate contract that conferred the right on another company to appoint two directors to the board of the defendant company, it was suggested by the defendant company that it would simply remove the directors under another article. Sargant J then had to rely on the moral argument that ‘having regard to the respect which is ordinarily shown to the decision of a court of justice, the company would \textit{hopefully} not proceed with such removal’ (emphasis supplied). In a rather unconvincing way, he also pointed out that the purpose of the provision on the removal of directors could never have been intended to achieve such a result,\textsuperscript{34} nor in other words, to make a value judgement as to the actual purpose of a rule of internal company management! In sharp contrast stands the case of Bainbridge \textit{v Smith}.\textsuperscript{35} Here the court granted an injunction or restraining order, but then dissolved such order after the company took a resolution at a general meeting that they did not want a particular person to act as managing director any

\textsuperscript{28} (1875) 1 ChD 13 (CA).
\textsuperscript{29} Ibid at 21–2.
\textsuperscript{30} Ibid at 23.
\textsuperscript{31} Ibid at 23.
\textsuperscript{32} Ibid at 24.
\textsuperscript{33} [1915] 2 Ch 186.
\textsuperscript{34} Ibid at 197.
\textsuperscript{35} (1889) 41 ChD 462.
longer, irrespective of whether or not he held the required number of shares in his own right.\(^{36}\)

To get back to *MacDougall v Gardiner*,\(^{37}\) Mellish LJ in that case was clearly more concerned about the practical consequences of opening the door for frivolous or vexatious claims by individual shareholders if courts were prepared to rule on internal managerial matters:

‘Now, if that gives a right to every member of the company to file a bill to have the question decided, then if there happens to be one cantankerous member, or one member who loves litigation, everything of this kind will be litigated; whereas, if the bill must be filed in the name of the company, then, unless there is a majority who really wish for litigation, the litigation will not go ahead. Therefore, holding that such suits must be brought in the name of the company does certainly greatly tend to stop litigation.’\(^{38}\)

In short, Mellish LJ also used the rule in *Foss v Harbottle*, and the practical consequences that would result if that rule were not followed, as a basis for the reasoning why courts should be reluctant to interfere with the internal affairs of companies — the courts were reluctant to hear the cases of minority shareholders, as that would open the floodgates of litigation.

In 1883, in the case of *Isle of Wight Railway Company v Tahourdin*,\(^{39}\) the court had to decide whether directors could ignore the request of shareholders to convene a general meeting at which the intention was to appoint a committee and for that committee, inter alia, to consider the removal of directors. The directors ignored this request, but convened a meeting only to consider the appointment of ‘a committee to inquire into the working and general management of the company and the means of reducing the working expenses’. Realising that they would not be able to remove the directors at such a meeting, the shareholders convened a meeting themselves with all the stated objects for that meeting. The directors then brought an action in the name of the company to restrain the shareholders from holding that meeting.

It is unnecessary to go into detail about why the Court of Appeal agreed that the restraining order should fail. It is, however, important to focus on what the court had to say about the powers of directors, and when a court would be prepared to consider whether an organ like the general meeting would have powers to override the discretionary powers of directors. There were three separate judgments, all agreeing that the restraining order should not be granted, but with different approaches regarding the powers of the board and the shareholders. Fry LJ did not deal with any specific legal principle in this regard. However, Cotton LJ and Lindley LJ both made prominent statements, although different reasons were given for non-

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\(^{36}\) Ibid at p 475: see the reference to an extraordinary shareholders’ meeting held on 15 April 1889 at the end of the judgment. See also *Cooper v Garratt* 1945 WLD 137 at 151–2.

\(^{37}\) Supra note 28.

\(^{38}\) Ibid at 25.

\(^{39}\) (1883) 25 ChD 320 (CA).
interference with internal decisions by company organs. Cotton LJ focused on the powers of directors and when shareholders would be able to give additional instructions to them:

‘Directors have great powers, and the Court refuses to interfere with their management of the company’s affairs if they keep within their powers, and if a shareholder complains of the conduct of directors while they keep within their powers, the Court says to him: “If you want to alter the management of the affairs of the company go to a general meeting, and if they agree with you they will pass a resolution obliging the directors to alter their course of proceedings.”’

Lindley LJ, on the other hand, approached the matter from the point of view of standing and the rule in *Foss v Harbottle*:

‘We must bear in mind the decision in *Foss v Harbottle* 2 Hare, 461 and the line of cases following it, on which the Court has constantly and consistently refused to interfere on behalf of shareholders, until they have done the best they can to set aside the matters which they complain, by calling a general meeting.’

It seems that Cotton LJ’s argument and Lindley LJ’s argument are based on two different considerations. Cotton LJ recognised the wide managerial powers of directors and the courts’ reluctance to interfere with managerial decisions of directors, but with the important qualification — only if ‘they keep within their powers’ — repeated twice in the same sentence. Lindley LJ, on the other hand, seems to be of the opinion that a court will only interfere on behalf of shareholders (clearly minority shareholders) if they have exhausted all their internal remedies by leaving the ultimate decision to a vote by the general meeting. We all know that such an approach made minority shareholders enter into a roundabout, with the ultimate route out of the roundabout being to rely on the highly complex and often irreconcilable exceptions to the rule in *Foss v Harbottle*. Remarkably, it seems as if Cotton LJ’s observations added a new dimension to the rule of non-interference in internal company matters. His observations now shifted the debate to the powers of the directors as a company organ. This, as will be seen later, became a very prominent focus which led eventually to the proper purpose doctrine.

It is very interesting that Len Sealy, many years later, reflected on the tensions created by several of the rules and doctrines of internal governance developed by the courts. He defended the fact that courts should not waste their time on reviewing matters of internal procedure or ‘to listen to people who want to re-open questions of company strategy and business judgement’.42 He also points out that ‘the last thing business litigants want is to have a court review a transaction or a decision and impose with the advantage of hindsight some discretionary solution in the name of “fair-
However, he points out that because of ‘a distaste’ or even ‘fear’ of judges not to interfere with internal company affairs, they kept on finding justifications for also not assisting minority shareholders with legitimate claims. There are clearly some serious tensions here.

(iv) Cases decided in the 1900s
The case of *John Shaw & Sons (Salford) Ltd v Shaw*, decided in 1935, did not deal directly with the reluctance of courts to interfere with the internal affairs of a company, but the principle established in the case provides a good example of when a court will be prepared to rule on an internal company matter. In this case the articles of association were amended to give wide powers to three permanent directors. These permanent directors convened a meeting and, at that meeting, a resolution was passed that the company’s solicitors should institute action against some of the ordinary directors, who were also shareholders of the company. These shareholders then convened a general meeting at which a resolution was passed to instruct the chairman of the general meeting to instruct the solicitors to discontinue the action against the ordinary directors and shareholders. Thus, the question for the court was to decide whether the general meeting had the power to overrule the decision taken by the majority of the permanent directors. Greer LJ pointed out that it was a case of determining whether the majority of the permanent directors had the power to pass the resolution at a board meeting. He held that they indeed had such powers in terms of the company’s articles of association as amended. Under these circumstances, the general meeting could not usurp the powers of the board. Greer LJ then made the following oft-quoted statement:

‘A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles of association, be exercised by the directors, certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles, or if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove. [The general body of shareholders] cannot themselves usurp the powers which, by the articles, are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders.’

The principle that functions conferred on an organ in terms of the articles should be exercised by that organ only has been confirmed in *Scott v Scott*. In that case, a resolution of the general meeting that a weekly amount be paid to preference shareholders up to the date when the annual dividend was

43 Ibid at 47.
44 Ibid at 53–4.
45 [1935] 2 KB 113.
46 Ibid at 134.
47 [1943] 1 All ER 582 (Ch).
declared, and that those interim payments then be debited against the ultimate dividend, was found to be invalid. The reason for declaring the resolution invalid was that the general meeting of members by its resolution sought to do something which in terms of the articles fell within the exclusive jurisdiction of the board of directors.\textsuperscript{48}

The principle enunciated in \textit{Scott v Scott} and \textit{John Shaw & Sons (Salford) Ltd v Shaw} has led to what has later been called ‘the doctrine of the supremacy of the articles of association’. In the South African case of \textit{LSA (UK) Ltd v Impala Platinum Holdings (Ltd)},\textsuperscript{49} Schutz JA explained the principle of supremacy of the articles of association as follows:

‘What it amounts to is that the founding members, and also a later body of members by special resolution, may order the internal affairs of their company in the way that suits them best, subject to such prohibitions as may exist in the Act or any other law, statutory or common. This dispensation is unsurprising when one statute governs many diverse forms of company.’\textsuperscript{50}

In short, it seems a well-established rule and a sound consideration for a court not to interfere with duly exercised powers conferred upon company organs by the articles of association. In other words, now it was clear that the focus shifted more and more towards what the particular powers of company organs were. This in turn motivated the courts not only to consider what the purposes of certain internal powers conferred on company organs were, but also to consider whether these powers were exercised for a proper or permissible purpose.

The 1923 Australian case of \textit{The Australian Metropolitan Life Assurance Co Ltd v Ure}\textsuperscript{51} is a particularly interesting one for at least two reasons. First, it provides good authority that a court will respect the powers given to directors in terms of the articles of association. Secondly, the court will not readily interfere with an internal managerial decision taken by the directors based on a power conferred upon the directors by the articles of association. The power that directors had in terms of article 21 of the company’s articles of association was the power that ‘directors may refuse to register any transfer whatsoever of any shares without assigning any reason therefore’. The directors refused to register the transfer of Mr Ure’s shares. Their underlying reason, which was not disclosed to Ure, was simply that a majority of the board did not want Mr Ure to become a director of the company. This decision was challenged, but the court refused to interfere with the directors’ decision. The reason why the court refused to interfere was because it was concluded that the power of refusal to register Mr Ure’s shares was exercised bona fide for a proper purpose:

\textsuperscript{48} Cilliers et al op cit note 27 at p 87 para 7.08.
\textsuperscript{49} (222/98) [2000] ZASCA 178 (28 March 2000).
\textsuperscript{50} See further J J du Plessis ‘Beskikkingsvryheid oor interne bestuursorganisasie, interne bevoegdheidsverdeling en die prominensie van die statute in die maatskappye-ereg’ 1992 \textit{TSAR} 94 at 99, referred to by Schutz JA in his judgment.
\textsuperscript{51} (1923) 33 CLR 199.
Although it is a power [power to refuse registration of shares] which necessarily involves some discretion, it must be exercised, as all such powers must be, bona fide — that is, for the purpose for which it was conferred, not arbitrarily or at the absolute will of the directors, but honestly in the interest of the shareholders as a whole.\footnote{The Australian Metropolitan Life Assurance Co Ltd v Ure (1923) 33 CLR 199 at 217 (emphasis in original case). Several of the leading English cases are cited as authority for this proposition, including: Allen v Gold Reefs of West Africa Ltd [1900] 1 Ch 656 at 671; Automatic Self-cleansing Filter Syndicate Co v Cunningham [1906] 2 Ch 34 at 45; British Equitable Co v Baily [1906] AC 35 at 42. Cf Nicolette Rogers ‘When can target directors legitimately frustrate a takeover bid?’ (1994) 12 C&S LJ 207 at 210–1. See also In re a Company (no 00370 of 1987), Ex parte Glossop [1988] 1 WLR 1068 (Ch) at 1076H–1077A.}

The court recognised that the circumstances of each particular case may vary, but spent considerable time in explaining what type of factors a court will consider in determining whether a particular power was exercised bona fide for the purpose for which it was conferred.\footnote{The Australian Metropolitan Life Assurance Co Ltd v Ure supra note 52 at 217–20.}

In 1974 it was pointed out that a court cannot, in actual fact, interfere with internal decisions arrived at bona fide and honestly, as Lord Wilberforce explained in \textit{Howard Smith Ltd v Ampol Petroleum Ltd}:

‘Their Lordships accept that such a matter as the raising of finance is one of management, within the responsibility of the directors: they accept that it would be wrong for the court to substitute its opinion for that of management, or indeed to question the correctness of management’s decision, on such a question, if bona fide arrived at. There is no appeal on merits from management decisions to courts of law: nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at.’\footnote{Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821 (CA) at 832E–F. See also Wayde v NSW Rugby League Ltd (1985) 10 ACLR 87 (HC of A) at 93–4; Harlow’s Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL (1968) 121 CLR 483 at 493.}

The reason why a court will not interfere with duly exercised internal decisions of directors has been explained differently in other cases. In \textit{Shuttleworth v Cox Brothers and Company (Maidenhead) Limited} it was said that ‘[i]t was not the business of the court to manage the affairs of the company’.\footnote{Shuttleworth v Cox Brothers and Company (Maidenhead) Limited [1927] 2 KB 9 at 23–4.}

In \textit{Darwall v North Sydney Brick} Kirby P (in 1989) explained as follows:

‘Courts properly refrain from assuming the management of corporations and substituting their decisions and assessments for those of directors. They do so, \textit{inter alia}, because directors can be expected to have much greater knowledge...'}
and more time and expertise at their disposal to evaluate the best interests of the corporation than judges.’

Several South African cases are quoted in *Makhuwa v Lukoto Bus Service (Pty) Ltd*\(^{57}\) to confirm that the principle of non-interference in internal company affairs is well-embedded in the South African law (although it is only a case of the former Venda Supreme Court, and primarily dealing with the concept of winding-up of a company based on the ground ‘just and equitable’). The specific circumstances in which a South African court will be prepared to interfere are, however, far from clear. It is therefore submitted that the principles developed in Australia and in English cases will also be good authority in South Africa.

(v) Extracting the reasons for the non-interference rules from the cases discussed

At this stage, it is important to extract, from the cases discussed, the possible reasons why the courts were reluctant to interfere in the internal governance matters of companies. Already in 1812 it was established in *Carlen v Drury* that a court will not take over the role of managing the business of companies, and that dissatisfied members should first rely on the company’s own internal mechanisms to resolve their differences before approaching the court. These rules were applied in several later cases. Also, at a very early stage, it was realised that if courts are prepared to interfere too readily with internal company matters, they would be inundated by cases, which would make it impossible for them to handle the sheer volume of litigation — the fear of opening the floodgates of litigation. Although never stated so explicitly, the rule in *Foss v Harbottle* establishing the proper plaintiff rule, provided one of the most convenient excuses for later courts not even to consider the merits of internal company disputes. Thus, in actual fact, *Foss v Harbottle* established a strong precedent for non-interference in internal company matters.

Another reason why the courts were reluctant to decide on internal matters was the realisation that it could lead to the court having to make orders with no practical results. For instance, if a court order could subsequently be circumvented by rectifying the wrong following proper internal procedures — for instance, by convening a meeting to ratify a breach of duty or altering a company’s articles of association to validate the wrong complained about — understandably, the courts would see its order as an exercise in futility.

Finally, it was argued that judges will not second-guess directors’ decisions, as the directors have much greater knowledge and more time and expertise at their disposal than judges to make business judgments and consider the best interests of the company.

It is however important to note that the courts were prepared to point to circumstances where they would be prepared to consider the merits of internal company disputes and be prepared to interfere.

\(^{57}\) 1987 (3) SA 376 (V).
Again, as early as 1812, it was established in *Carlen v Drury* that a court will interfere if a company’s ‘internal rules’ were not effectual.\(^{58}\) Additionally, the court in *Carlen v Drury* held that it will interfere ‘promptly and immediately’, but only if a ‘case of Breach of Engagement, or Abuse of Trust’ is established ‘to the perfect Satisfaction of the Court’ and it was required that ‘a Case of Delinquency [of the managers] should be clearly made out . . . [and] there must be a positive Necessity for the Interference of the Court, arising from the Refusal or Neglect of the [Management] Committee to act’.\(^{59}\) Also, several highly complex and often unjustifiable exceptions to the rule in *Foss v Harbottle* developed over time: ‘fraud on the minority’; *ultra vires* acts in breach of the rights of the company as set out in the constitution; or unlawful conduct and conduct in breach of the common law of the type which is not ratifiable by an ordinary resolution, and which amounts to a wrong to the company.

It is interesting to note that by 1883, in the case of *Isle of Wight Railway Company v Tahourdin*, Cotton LJ’s observations added a new dimension to the rule of non-interference in internal company matters. His observations shifted the focus of the issue of interference or non-interference in internal company matters towards the powers of the directors as a company organ. This, as will be seen in the next part, became a very prominent focus leading eventually to the proper purpose doctrine. These developments were, however, slow, and took place over more than 100 years.

### III QUALIFICATIONS REQUIRED OF RULE AGAINST INTERFERENCE WITH INTERNAL COMPANY MATTERS

(a) **Overview**

In the same year that *Isle of Wight Railway Company v Tahourdin* was decided, it was more prominently stated that more than one test is required when the conduct of internal company organs is challenged. This occurred in the case of *Hutton v West Cork Railway Co*,\(^{60}\) where Bowen LJ, dealing with a decision taken by the general meeting, pointed out as follows:

‘[The shareholders in general meeting] can only spend money which is not theirs but the company’s, if they are spending it for the purpose which are

\(^{58}\) It should be remembered that articles of association and internal governance arrangements were in a primitive stage of development in 1812. It is in fact only roughly from 1844, with the passing of the Joint Stock Companies Act of 1844 (7 & 8 Vict. c 110) and, more particularly, the Joint Stock Companies Act of 1856 (19 & 20 Vic c 47) that internal company law arrangements started to be refined by way of model sets of articles of association. See generally Jean J du Plessis ‘Corporate law and corporate governance lessons from the past: Ebbs and flows, but far from “The end of history . . .” part 1’ (2009) 30 *The Company Lawyer* 43 at 49 et seq and ‘Corporate law and corporate governance lessons from the past: Ebbs and flows, but far from “The end of history . . .” part 2’ (2009) 30 *The Company Lawyer* 71 at 73.

\(^{59}\) *Carlen v Drury* supra note 2 at 63.

\(^{60}\) (1883) 23 Ch D 654.
reasonably incidental to the carrying on of the business of the company. That is a general doctrine. *Bona fides* cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly *bonâ fide* yet perfectly irrational. The test must be what is reasonably incidental to, and within the reasonable scope of carrying on, the business of the company.61

As far as exercising powers conferred upon directors is concerned, it has been established over time that they must exercise those powers in good faith (bona fide), honestly and ‘in the best interests of the company as a whole’.62 However, it was also realised that qualifications were required of each and every one of these requirements. These qualifications started to emerge because it seemed somewhat preposterous only to set directors’ decisions aside if the directors did *not* act with good faith — that is, only when they acted in *bad faith* (mala fide) — or when the directors did *not* act honestly — that is, only when they acted *dishonestly*. Furthermore, in cases not involving a conflict of interest (self-interest), it was never really difficult for directors to find one or other reason why they had in actual fact acted in the best interests of the company as a whole. Because of the realisation that there should be some middle-ground between the two extremes of, on the one hand, virtually no possibility for the courts to interfere with internal matters of companies and, on the other hand, an unnecessarily wide discretion for courts to interfere with internal company affairs, a few developments took place over time.

(b) *The ‘bona fide in the best interests of the company as a whole’ and the ‘proper purpose’ doctrines differentiated*

Gradually it became clear that apart from the requirements of ‘good faith (bona fides)’; ‘honesty’; and ‘best interests of the company as a whole’, it should also be asked whether the directors acted ‘for a proper purpose’ (leading to what is nowadays described as the proper-purpose doctrine).63 So, it started to emerge that in cases where the courts had to consider whether a particular power had been exercised for its proper purpose, the court would not simply hear the directors say that in exercising the particular power they had acted in the best interests of the company as a whole. The courts have

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61 Ibid at 671.

62 As to the meaning of the phrase ‘best interests of the company as a whole’ see J T Pretorius, P A Delport, Michelle Havenga & Maria Vermaas Hahlo’s *South African Company Law through the Cases — A Source Book 6 ed* (1999) at 293, but as Ross W Parsons ‘The director’s duty of good faith’ (1967) 5 *Melbourne University LR* 395 at 396 points out ‘the concept remains miserably indeterminate’. It is submitted that it is still the case: see *Kirwan v Cresvale Far East Ltd (In Liq)* (2002) 44 ACSR 21 (CA, NSW) para 127 (per Giles JA). I would respectfully agree with Young CJ’s observation in *Kirwan’s* case that ‘[i]t is of no real use to regurgitate the numerous utterances of past courts on this topic’ (para 292). See also *Ex parte Glossop* [1988] 1 *WLR* 1068 (Ch) at 1076G; L S Sealy ‘“Bona fides” and “proper purposes” in corporate decisions’ (1989) 15 *Monash University LR* 265 at 269–71.

63 See generally J J du Plessis op cit note 1.
invariably rejected such defences in cases where the self-interest of directors was involved.\textsuperscript{64} In cases of this type, the fact that directors had acted in the best interests of the company as a whole has been held to serve no other purpose than restating the general law.\textsuperscript{65} It has also been held that there are definite instances where the test, ‘the benefit of the company as a whole’, is in actual fact ‘largely meaningless’;\textsuperscript{66} Another reason why the courts were simply not prepared to accept directors’ defences that they have acted in the best interests of the company as a whole was that in cases where a misuse of powers is alleged, the crucial issue is often not ‘the interests of the company’, but the interests of shareholders and what is fair between different classes of shareholders.\textsuperscript{67} For all these reasons it had been argued forcefully that directors’ duty ‘to act 	extit{bona fide} and in the best interests of the company’ should be treated as conceptually independent of the duty ‘to act for proper purposes’.\textsuperscript{68}

This distinction is now also clearly recognised in modern legislation.

\textsuperscript{64} Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821 (CA) at 834G; Hogg v Cramphorn Ltd [1967] Ch 254 at 267Aff; Whitehouse v Carlton Hotel Pty Ltd (1987) 5 ACLR 713 (HC of A) at 718; Southern Resources Ltd v Residues Treatment & Training Co Ltd (1990) 8 ACLC 1151 ((SC (SA)) at 1164; Lee Panavision Ltd v Lee Lighting Ltd [1992] BCLC 22 (CA) at 29d–30h. See also B Galgut (consulting editor) and J A Kunst, P Delport and Q Vorster (eds) \textit{Henochsberg on the Companies Act: Volume 2} (Service Issue 27) 5 ed (2008) 467–8; Tony Steel ‘Defensive tactics in corporate takeovers’ (1986) 4 \textit{Company and Securities LJ} 30 at 31. See also M S Blackman ‘Companies’ in W A Joubert (founding ed) \textit{The Law of South Africa} vol 4\textit{(2)} (1996) at 7 states the principle too widely when he argues that directors will ‘still be guilty of acting for an improper purpose’ (emphasis supplied). At least a ‘self-interest’ is required and where there is no such self-interest the improper or impermissible purpose must be primary or substantial — see the discussion below.

\textsuperscript{65} Howard Smith Ltd v Ampol Petroleum Ltd supra note 64 at 835D. In \textit{Re Halt Garage} (1964) Ltd [1982] 3 All ER 1016 at 1039f (read with 1038b–c) Oliver J observed that under certain circumstances ‘a test of benefit to the company’ (also understood as ‘the benefit of the shareholders as a whole’) ‘would be largely meaningless’.

\textsuperscript{66} \textit{Re Halt Garage} (1964) Ltd supra note 65.

\textsuperscript{67} Mills v Mills (1938) 60 CLR 150 at 164 as quoted with approval in \textit{Howard Smith Ltd v Ampol Petroleum} supra note 64 at 835E; and McGuire v Ralph McKay Ltd (1987) 5 ACLC 891 at 894. See also \textit{Whitehouse v Carlton Hotel Pty Ltd} supra note 64 at 718. See generally \textit{Henochsberg} op cit note 64 at 466: ‘Where directors act in breach of [the duty to act only under available powers] it is irrelevant whether they believe they do so in the interests of the company’. The ‘bona fide for the benefit of the company as a whole’ test was also pertinently rejected in \textit{Gambotto v WCP Ltd} (1995) 13 ACLC 342 (HC of A) at 348 as inappropriate ‘[i]n the context of a special resolution altering the articles and giving rise to a conflict of interests and advantages, whether or not it involves an expropriation of shares’.

Section 181(1)(a) and (b) of the Australian Corporations Act, 2001, provide that ‘[a] director or other officer of a corporation must exercise their powers and discharge their duties . . . in good faith in the best interests of the corporation; and . . . for a proper purpose’. In a similar vein, s 76(3)(a) and (b) of the new South African Companies Act 71 of 2008 provide that ‘a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director . . . in good faith and for a proper purpose (and) in the best interests of the company’.

(c) The concept of ‘good faith (bona fides)’

With the development of the proper purpose doctrine, it also became apparent that the role concepts like ‘good faith (bona fides)’ and ‘honesty’ played in the past could not maintain their prominence. As a general rule, it was said that the courts will not second-guess the decisions taken by directors as part of powers conferred upon them by the articles, as long as, prima facie, the powers have been exercised within the limits of the powers conferred upon the organs and bona fide, as well as honestly. When one looks at this statement, it seems as if the only way in which shareholders can challenge the decisions of directors taken under powers conferred upon them by the articles is on the basis that the power was exercised outside the limits of the power conferred upon them, mala fide or dishonestly.\(^69\)

It is however submitted that there is just one consideration; namely, whether the power was exercised for a proper or permissible purpose. Mala fides and dishonesty only serve to indicate that the power was not exercised for a proper or permissible purpose. In this sense bona fide conduct is defined in terms of the purpose for which the power was conferred, but the term bona fide could, of course, be defined in many other ways.\(^70\) However, none of these closer descriptions of bona fides brings us any nearer to a workable

\(^69\) S J Naudé *Die Regposisie van die Maatskappydirekteur met besondere verwysing na die Interne Maatskappyverband* (1970) at 111, under the main heading that directors must exercise their powers bona fide, observes as follows on the concept of ‘honesty’: ‘Sy vertrouensposisie bring mee dat elke direkteur eerlik moet wees in sy optrede as direkteur. Dit is ’n subjektiewe verpligting wat in ’n dikwels ingewikkelde praktiese regverkeer nagekom moet word. Hoewel die basiese vraag is of die direkteur inderdaad eerlik was, word eerlikheid gewoonlik aanvaar indien hul optrede dié was van eerlike sakelui.’ (Naudé’s emphasis.) See generally R. C Nolan ‘The proper purpose doctrine and company directors’ in Barry A K Rider (ed) *The Realm of Company Law: A Collection of Papers in Honour of Professor Leonard Sealy* — S J Berwin Professor of Corporate Law at the University of Cambridge (1998) at 8. See also Ross W Parsons ‘The director’s duty of good faith’ (1967) 5 Melbourne University LR 395 at 417; and Sealy op cit note 62 at 269 regarding the fact that directors must act ‘honestly’.

\(^70\) See Rogers op cit note 52 at 209 and 210. Rogers is faced with the classic dilemma — just when it is thought that the meaning of bona fide is captured (see at 210), its illusory nature would become apparent and then further qualifications become inevitable (see 210 where she must qualify that ‘[a]cting bona fide also requires that . . .’). In actual fact, any type of consideration that could reflect negatively on directors’ intentions, the way in which they have exercised their powers, the result that was achieved by their actions etc could possibly indicate that they have not acted
way of determining when the acts of directors should be set aside because they have not acted bona fide. Developments in this area of company law have led to the recognition that there was a shift from a requirement that directors must exercise their powers bona fide, to a requirement that they must exercise their powers for proper or permissible purposes.\footnote{See \textit{R. P. Austin and I. M. Ramsay, Ford’s Principles of Corporations Law} 13 ed (2007) p 369 para 8.200n1, but note the incorrect reference to Sealy’s article (the reference should have been to \textit{Mon ULR}, not \textit{MULR}). Cf Sealy \textit{op cit} note 62 at 267–8. For earlier views on this issue see J R Birds ‘Proper purposes as a head of directors’ duties’ (1974) 37 \textit{MLR} 580 at 583. At 580–1 Birds gives an excellent summary of the different doctrines at play in this area.}

\subsection{Concept of ‘honesty’}

The prominence given to the concept of ‘honesty’ expected of directors in the past is very well illustrated by a classic contribution of The Honourable Sir Douglas Menzies in the 1959 \textit{Australian Law Journal}.\footnote{The Honourable Sir Douglas Menzies ‘Company directors’ (1959) 33 \textit{The Australian LJ} 156 at 157–9. For a later analysis of the duty of honesty, see M J Whincop ‘Directors’ statutory duties of honesty and propriety’ in Ian M Ramsay (ed) \textit{Corporate Governance and the Duties of Company Directors} (1997) 125 at 127–9 and Michael J Whincop ‘An economic analysis of the criminalisation and content of directors’ duties’ (1996) 24 \textit{Australian Business LR} 273 at 282–4.} Australia was the first common law jurisdiction that included the word ‘honesty’ as part of the general statutory civil law duties of directors. This was done in 1958 when the standards of care and diligence expected of directors were taken up in company law legislation for the first time.\footnote{\textit{Company Directors’ Duties — Report on the Social and Fiduciary Duties and Obligations of Company Directors} (Cooney Report) (1989) p 24 para 3.15.} Section 107 of the Victoria Companies Act, 1958 provided as follows: \textquote{107(1) A director shall at all times act \textit{honestly} and use reasonable diligence in the discharge of the duties of his office’ (emphasis supplied).}

The words, \textquote{[a] director shall at all times act honestly’}, remained part of several later sections in Australian company law legislation setting out the civil law standards of care and diligence expected of directors.\footnote{Section 124 of the Australian Uniform Companies Acts, 1961; s 229 of the Australian Companies Act, 1981 (Cth); s 232(2)–(4) of the Australian Corporations Act, 1989 (Cth). See J Cassidy \textit{Corporations Law: Text and Essential Cases} 2 ed (2008) 4 for an explanation how the Australian Companies Act 1981 (Cth) applied and how it was adopted by each state. See \url{http://www.austlii.edu.au/au/legis/cth/nuw_act/ca1981107/s1.html} for the Australian Companies Act 89 of 1981 (ACT), which applied in the Australian Capital Territory.} However, in 1992 the civil standards of care and diligence were amended, and the word ‘honesty’ was removed as a civil standard of care and diligence expected of directors.\footnote{\textit{s 11 of the Australian Corporate Law Reform Act, 1992 (Cth), amending s 232(4) to read as follows: ‘In the exercise of his or her powers and the discharge of his or her duties, an officer of a corporation must exercise the degree of care and}}
Corporations Act, 2001 provides 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 South Africa, there is also no statutory civil obligation on directors to act ‘honestly’. The reason is probably that the statutory civil obligation provision in the South African Companies Act 71 of 2008 has been influenced by the Australian approach, as will become apparent when s 180(1) of the Australian Corporations Act, 2001 is compared with s 76(3)(c) of the new South African Companies Act 71 of 2008. Section 76(3)(c) of the new South African Companies Act only provides that: ‘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 those carried out by that director; and (ii) having the general knowledge, skill and experience of that director.’

The reason for dealing with these developments is to illustrate how things have changed over time. The concept of ‘honesty’ was often used in close proximity to the requirement that directors must act ‘in good faith (bona fide) and in the best interests of the company as a whole’, while in a jurisdiction like Australia it is nowadays used as a yardstick to determine whether directors committed a criminal offence by acting dishonestly.76

diligence that a reasonable person in a like position in a corporation would exercise in the corporation’s circumstances.’ See also Explanatory Memorandum to the Corporate Law Reform Act, 1992.

76 See s 184(2) and (3) of the Australian Corporations Act, 2001, reading as follows: ‘Use of position — directors, other officers and employees
(2) A director, other officer or employee of a corporation commits an offence if they use their position dishonestly:
(a) with the intention of directly or indirectly gaining an advantage for themselves, or someone else, or causing detriment to the corporation; or
(b) recklessly as to whether the use may result in themselves or someone else directly or indirectly gaining an advantage, or in causing detriment to the corporation.
Use of information — directors, other officers and employees
(3) A person who obtains information because they are, or have been, a director or other officer or employee of a corporation commits an offence if they use the information dishonestly:
(a) with the intention of directly or indirectly gaining an advantage for themselves, or someone else, or causing detriment to the corporation; or
(b) recklessly as to whether the use may result in themselves or someone else directly or indirectly gaining an advantage, or in causing detriment to the corporation.’

There is no similar provision in the new South African Companies Act 71 as it has been decriminalised, which means that the common law approach to 'honesty' as civil standard may still apply in South Africa. It goes without saying that 'honesty' is expected of directors, but the Australian experience did show that it created challenging problems to prove when directors breached a statutory civil standard of 'honesty' without showing that the directors acted dishonestly.

IV PERSPECTIVES AND CONCLUSIONS

Having worked through several of the older English cases, one is struck by how the courts laid down basic and practically-oriented rules which seem to have served company law well. However, things have moved on and company law has become more complex. Professor Len Sealy puts things in perspective:

'Few things in company law are as simple as they used to be. . . . We have inherited from our fathers some well-worn and fairly simplistic rules and concepts, largely laid down a hundred years or so ago in the English courts of chancery; and with these we have been able to make do, aided by a little adaptation and fudging, for much of the present century. But it is becoming apparent that we cannot rely on yesterday's law for much longer; and some major shifts are already perceptively under way, both in the rules and concepts being used, and in judicial attitudes and techniques.'

These words of Sealy provide some explanation for the fact that it has been a really challenging process to identify trends and extract rules from cases decided over a period of almost 200 years, and to understand the true reasons why the courts developed those rules. Part of the complexity is because the same rules were expressed differently and were adopted for reasons that are not necessarily reconcilable.

One consolation for the difficulties experienced in reconciling the different reasons provided by the courts to justify the application of some apparently fundamental rules of internal company governance is found in a striking observation made by Professor L A Zadeh of Berkley, which Professor John Farrar uses to explain what is meant by the 'principle of incompatibility':

'Stated informally, the essence of this principle ("principle of incompatibility") is that as the complexity of a system increases, our ability to make precise and yet significant statements about its behaviour diminishes until a threshold is reached, beyond which precision and significance (or relevance) become almost mutually exclusive characteristics.'

This appears to be completely true of the complex area of judge-made internal company law rules developed over approximately 200 years.

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77 See the cases referred to in notes 52 and 54 above.
78 Sealy op cit note 62 at 265.
Fortunately, there were some admirable attempts made by legislatures to simplify and demystify some of the rules by providing guidance in company and corporation legislation. However, the fascinating thing is that we can hardly escape the past: when the courts are required to interpret comparable provisions in modern company law legislation, the courts will of necessity have to go back to where the current statutory rules originated. It is therefore even in the modern context of considerable importance for us to discuss and analyse these older cases.