

**Bills Committee on
Companies (Amendment) Bill 2003**

**Follow-up actions arising from the discussion
at the meeting on 29 January 2004**

Introduction

This paper sets out the following information as requested by Members at the last meeting on 29 January 2004 -

- (a) further clarification on the wording of the proposed section 152FA(2); and
- (b) information about cases in Australia regarding the interpretation of “proper purpose” in section 247A(1) of the Australian Corporations Act 2001.

Proposed section 152FA(2)

2. In the context of the Phase I of the Corporate Governance Review, the Standing Committee on Company Law Reform recommends that a statutory method by which shareholders can obtain access to company records should be provided subject to certain safeguards e.g. the applicant must satisfy the court that he is acting in good faith and the inspection is for a proper purpose. To implement this recommendation, we propose to add a new section i.e. the proposed section 152FA(2) to provide that the court may only make an inspection order (whereby a member or a person on behalf of the member is authorized to inspect the records of his company) if it is satisfied that -

- (a) the application for the inspection order is made in good faith; and
- (b) the inspection applied for is for a proper purpose having regard to the interests of both the company and the applicant.

3. The wording of this proposed section is modelled on the section 247A(1) of the Australian Corporations Act 2001 (reproduced as follows) save that we have proposed to add after the term “proper purpose” the phrase “having regard to the interests of both the relevant specified corporation and the applicant”-

“247A(1) On application by a member of a company or registered managed investment scheme, the court may make an order:

- (a) authorizing the applicant to inspect books of the company or scheme;
- (b) authorizing another person (whether a member or not) to inspect books of the company or scheme on the applicant’s behalf.

The Court may only make the order if it is satisfied that the applicant is acting in good faith and that the inspection is to be made for a proper purpose.”

4. The rationale for the addition in the proposed section 152FA(2) is to ensure that the court would have regard to relevant facts and circumstances of an application for an inspection order, including the interests of a company and an applicant when deciding whether the inspection is for a proper purpose. It is worth noting that the court’s power under the proposed section is discretionary. It may refuse to make an inspection order if it considers that a third party’s interests may be adversely affected.

Interpretation of “proper purpose” in section 247A(1) of the Australian Corporations Act 2001

5. In Australia, most of the cases under section 247A(1) of the Australian Corporations Act 2001 have involved the meaning of “proper purpose”. While there are no firm limits on what constitutes a proper

purpose, it is accepted that the purpose of the inspection must be to assist the applicant in his capacity as a member, rather than in some other capacity¹. Some of the court cases relating to the interpretation of “proper purpose” are summarized in the ensuing paragraphs for Members’ reference.

(A) Proper purpose

(a) To determine the value of shares

(i) Tinois v. French Calendonia Travel Service Pty. Ltd. [1989] 13 ACSR 658

6. The applicant was one of the only two members of the defendant company and he wished to sell his shares. The articles of the company required that he must either make an agreement with the other member for transfer at an agreed price or serve on the company a notice in writing stating that he would like to transfer the shares at the price fixed as the fair value of the shares.

7. The court held that it was a proper purpose for a member to inspect the books if the member wished to ascertain the value of his shareholding.

8. The draft order proposed by the applicant however included a prohibition of use of the information obtained for any purpose other than that of obtaining expert advice on the value of the shares and in any consequent legal proceedings. As there was no specific contemplated legal proceedings indicated by the applicant, the court refused to make an order to allow the use of the information in any consequent legal proceedings until it was known what kind of consequent legal proceedings were to be undertaken.

¹ Corporations Law in Australia, Second Edition, Roman Tomasic, Stephen Bottomley & Rob McQueen, pages 433 - 434

(ii) *United Rural Enterprises v Lopmand* [2003] NSWSC 404 (20 March 2003)

9. The applicant had put forward three different purposes as the purpose for which it sought inspection -

- (a) valuation of its shares or equities of redemption;
- (b) investigation of the rights as between the applicant as a mortgagor and the company as a mortgagee; and
- (c) investigation of the conduct of the company's directors in relation to -

- (i) the existence and implementation of a dividend policy; and

- (ii) the use, whereabouts and commercial benefit to the company of the profit and cash flow obtained by the company in a certain period.

10. Purpose (a) was held to be a proper purpose within the meaning of section 247A(1). In coming to that conclusion, the court took into account the fact that there was a substantial debt owed by the applicant and that the debt was secured on the shares. The court considered that it would be quite impossible for the applicant to make any informed judgment about how to deal with its rights in the company if it did not have a view about the value of the shares.

11. Purpose (b) was held not to be a proper purpose on the ground that section 247A was concerned with a proper purpose connected with matters relating to the proper administration of the company or the rights the applicant had as a member of the company. Even though there would be interaction between the proper administration of the affairs of the company and the exercise of rights as between a mortgagor and a mortgagee, but when the focus of an enquiry was to enquire whether the mortgagee had acted in a way it was entitled to, that was something which was probably beyond the type of investigation the court should allow under section 247A.

12. Purpose (c)(i) was not accepted as a proper purpose on the ground that there was no evidence before the court that there was anything to investigate concerning the existence and implementation of a dividend policy.

13. Purpose (c)(ii) was also not accepted as a proper purpose on the ground that there was no evidence to justify any conclusion that there was a subject to enquire into concerning whether the directors had engaged in a breach of duty.

(b) To investigate whether legal proceedings might be appropriate to challenge certain transactions which adversely affect shareholders' investment in the company

(i) Caveat Pty Ltd. v Baillie & Others [2002] WASC 83 (17 April 2002)

14. The applicant was a shareholder of the defendant company holding just over four million shares. The defendant company was a mining company initially for alluvial diamonds, but subsequently changed its strategic direction to sourcing diamonds from kimberlite deposits. The defendant company was also involved in an abortive share buy-back arrangement of shares in another company.

15. The court held that investigation to see whether legal proceedings might be appropriate in respect of certain transactions which adversely affected an applicant's investment in the company was a proper purpose within section 247A.

(ii) Knightswood Nominees Pty Ltd. v Sherwin Pastoral Co. Ltd. [1989] 15 ACLR 151

16. The applicant was a shareholder in the defendant company after it had been floated by means of a prospectus. The company was subject to takeover interest, including interest from interests which controlled the applicant. The applicant expressed concern about the number of cattle

owned by the defendant company suspecting that the size of the herd at the time the prospectus was issued, was grossly overstated.

17. The court held that an inspection for the purpose of investigation of rights of action which the company might have against warrantors in relation to the size of the herd as warranted; investigation of the present value of the principal assets of the company and through this, the value of the applicant's shares; and investigation of whether the controllers of the company had acted honestly and diligently in relation to its affairs and whether an attempt should be made to have them sued or removed, was an inspection for a proper purpose.

18. In the judgment, the court quoted the following as examples of improper purpose -

“a member seeking inspection motivated by idle curiosity, or has in mind harassment, or even blackmail, or wishes to obtain confidential information for the benefit of one of the company's competitors.”

(c) To decide whether or not a shareholder's rights in respect of a company might or ought to be exercised

(i) Lucy v Prescribing Biochemists Pty Ltd. [2000] NSWSC 1137 (28 November 2000)

19. The applicant was the administrator of the estate of his late father who owned, in his lifetime, shares in the defendant company. The deceased used to be also a director of the defendant company but was subsequently removed.

20. The purpose for which access to the books was sought was to permit the applicant as an administrator to consider whether any action could or ought to be brought by the holder of the deceased's shares in respect of the deceased's exclusion from directorship and management of the company. The court held the purpose to be a proper purpose.

21. Other authorities referred to in the case for the proposition that the gaining of information for the purposes of deciding whether or not a shareholder's rights in respect of a company might or ought to be exercised was potentially a proper purpose for seeking and grant of an inspection order under section 247A include *Biala Pty Ltd v Mallina Holdings Ltd. [1989] 15 ACLR 208*; and *Cescastle Pty Ltd. v Renak Holdings Ltd. [1991] 6 ACSR 115*.

(ii) *Acehill Investments Pty Ltd. v Incitec Ltd No. SCCIV-02-1419 [2002] SASC 344 (18 October 2002)*

22. The applicant had a very substantial interest in the defendant company which had made a proposal for a scheme of arrangement. The court held that the applicant was entitled to the information which would enable it to determine whether or not its substantial financial interests as a shareholder were being adversely affected and to make an informed decision when voting at the meeting called by the court. The applicant was also entitled to ascertain whether the price for its shares was fair and reasonable, and was entitled to ensure that other aspects of the proposed restructuring did not adversely affect its interests.

(iii) *Humes Ltd. v Unity APA Ltd. [1987] 11 ACLR 641*

23. The applicant wanted to inspect the books of the defendant company in order to determine whether the company's directors had breached their duties. It was also apparent that access to the information in the books would assist the applicant in a take over bid it was making for the company.

24. The court held that the dominant purpose was to ascertain whether the directors had breached their duties, and that this was a proper purpose. The fact that there was also a secondary purpose was irrelevant.

(B) Improper Purposes

(a) To ascertain whether a company is solvent

(i) Keenfern Pty Ltd v Thorlock International Ltd. [2002] WASC 142 (8 May 2002)

25. The avowed purpose of the application was to ascertain whether or not the defendant company was solvent. The court held that an attempt to use that section to establish the solvency or otherwise of a company and therefore to use, potentially at least, section 459P to wind up the company was for an improper purpose. If an application by a member was to be made to wind up a company under section 459P, the member must establish a prima facie case that the company was insolvent.

***(b) To assist in the preparation of a take-over bid for a company
To assist in challenging the directors in their daily management of a company***

(i) Re Augold NL [1987] 11 ACLR 362

26. The court held that it was not a proper purpose to seek inspection in order to improve the applicant's prospect of making a successful take-over bid for the defendant company. The court also said in the judgment that the creation of a statutory right to inspect company documents with the leave of the court should not be regarded as affecting the basic rule of company law which had stood for many years that a shareholder would not ordinarily have recourse to the courts to challenge a management decision made by or with the approval of directors.

(c) To overcome obstacles of legal professional privilege claimed in another proceedings

(i) Czerwinski v Syrena Royal Pty Ltd. [2000] VSC 125 (7 April 2000)

27. An attempt to use section 247A as a form of or substitute for

inspection of documents to overcome the obstacle of legal professional privilege claimed in another proceedings was held by the court as not being a proper purpose within the meaning of that section.

(d) To investigate the rights between a mortgagor and a mortgagee

28. Please see *United Rural Enterprises v Lopmand* [2003] NSWSC 404 (20 March 2003) in paragraphs 9 – 13 above.

Financial Services Branch
Financial Services and the Treasury Bureau
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