Abuse of Power ?

The Proper Purpose Rule; The Majority Rule; and The Proper Plaintiff Rule:

The concept of "abuse of power" and the nature of the claims which it spawns, recently, have come under close scrutiny by the Judicial Committee of the Privy Council (the **Privy Council**); and, most recently, in *Wong v Grand View Private Trust Co Ltd [2022] UKPC 47 (**Grand View**)* and *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd (12 & 13 March 2024) (**Tianrui**).*

In this Article we consider the concept of abuse of power, constraints on the exercise of powers, and the issue of standing to pursue an abuse of power.

Grand View

In *Grand View,* on a summary judgment application, the issue before the Privy Council was whether the trustee of a settlement, the Global Resource Trust (**GRT)**, exercised for a proper purpose an express power contained in the trust deed to add and exclude discretionary objects, when it simultaneously **(i)** added a purpose trust, the Wang Family Trust (**WFT**), as an object and **(ii)** removed all members of the founders' families who had until then comprised the entire class of objects. The two founders were brothers, YC Wang and YT Wang (the **Founders**), who had built a group of companies, the Formosa Plastics Group (**FPG**), into one of the largest business conglomerates in Taiwan. During the trust period, of 100 years, the GRT trustee had a discretionary power to apply the whole or part of the capital and income of the fund to or for the benefit of the children and remoter issue of the Founders.

The addition of the WFT and the removal of the Founders' families was followed immediately by the trustee's exercise of its discretionary dispositive power to appoint the whole trust fund to the WFT, thus bringing the GRT to an end.

Kawaley J held that the trustee had invalidly exercised its fiduciary powers to add and exclude beneficiaries for an improper purpose, the powers not having been exercised for the purposes for which they were conferred. The trustee's acts were declared to be void. The Court of Appeal (Sir Christopher Clarke P, Smellie JA and Subair Williams JA) allowed the trustee's appeal. On appeal from that decision, the Privy Council concluded that the powers of the trustee had been exercised for an improper purpose, and allowed Grand View's appeal.

In so doing, the Privy Council found **(i)** that the clear purpose of the GRT was to benefit the Founders' issue, **(ii)** that this informed the purpose for which the powers

of addition and exclusion had been conferred and should be used, **(iii)** that the trustees had not used the powers to benefit the Founders' issue, and **(iv)** that the trustees had therefore used them for an improper purposes.

Tianrui

In *Tianrui,* on a strike out application, the issue before the Privy Council was whether an individual (minority) shareholder, Tianrui, had standing to bring and maintain a personal claim in its capacity as a shareholder against the company of which it was a shareholder (**CSCG**), for relief in respect of an alleged improper exercise by the directors of their powers.

The power exercised was the power to issue convertible bonds and to allot shares. The exercise was alleged to have been an abuse of power in that it was said to have been made for the improper purpose of diluting Tianrui's shareholding in CSCG, to enable other shareholders to gain control of CSCG.

The grounds of CSCG's application to strike out Tianrui's claim were that:

(a) the pleaded breaches of fiduciary duty by CGCG's directors, on which the claim was based, were in respect of duties owed to CSCG, and not Tianrui (as a shareholder);

(b) the damage resulting from the alleged breaches of duty was suffered by CSCG, and not Tianrui; and

(c) the issues of convertible bonds and new shares, alleged to have been made for an improper purpose, were ratifiable in general meeting by a majority of CSCG's shareholders.

Segal J, at first instance declined to strike out Tianrui's claim. He found that the reasoning of Hoffman J in *Re A Company (No 5135 of 1986), Re Sherborne Park Residents Co Ltd. [1987] BCLC 82 (**Sherborne Park**),* and that developed by King CJ in *Residues Treatment Company Ltd v Southern Australia [1988] 6 ACLC 1160 (**Residues**)* afforded a sound basis for Tianrui's personal claim. He also drew considerable support from, amongst others, the decision of the Privy Council in *Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821 (**Howard Smith**).* In so doing he expressly declined to follow the decision and reasoning of Kawaley J in the Grand Court of the Cayman Islands in *Gao v China Biologic Products Holdings, Inc (Cause No FSD 157 of 2018) (**China Biologic**).*

The Court of Appeal (Sir John Goldring P, Field JA, and Dennis Morrison JA), in *Tianrui,* allowed CSCG's appeal. Field JA, giving the judgment of the Court of Appeal

appears to have been persuaded by CSCG's submissions that neither Hoffman J, in *Sherborne Park*, nor King CJ, in *Residues,* had provided a principled basis as to why a shareholder should have a personal right in respect of a breach of a fiduciary duty owed to the company and not to the shareholder.

Tianrui's appeal to the Privy Council was heard on 12 and 13 March 2024. At the date of this Article, the decision of the Privy Council has not been delivered.

Abuse of Power and Excess of Power

In each of *Grand View* and *Tianrui*, the courts were concerned with fiduciary powers. Being fiduciary powers, their exercise is subject to duties and restrictions imposed by equity.

As Lord Richards observed in *Grand View* (at *[1]*):

> *"It is a fundamental principle of equity that a fiduciary power may be exercised only for a purpose for which the power has been conferred."*

In *Eclairs Group Ltd v JKX Oil & Gas plc [2015] UKSC 71 (**Eclairs**),* Lord Sumption, at *[15]* drew, and explained, the distinction between acts in excess of power and those in abuse of power. An act which is beyond the scope of the instrument creating a power as a matter of construction or implication is characterised as an excess of power. An act which is within the scope of a power but which is done for an improper reason is characterised as an abuse of power.

In the former case, the issue being one of contractual interpretation, evidence of the parties' subjective intention being inadmissible, the test is objective. In the latter case the state of mind of those who acted and their motive are admissible and of primary importance: *Hindle v John Cotton Ltd (1919) 56 Sc LR 625, Viscount Finlay 630*; *Grand View,* Lord Richards at *[51]* to *[55].*

The Extent of a Power

The donor's purpose (or purposes) in conferring any power, whether contractual or fiduciary in nature, is to be determined objectively as at the date of the instrument in which the power is conferred. The entirety of the instrument will be considered in order to determine the purpose of the power. Contemporaneous documents forming part of the factual matrix in which the instrument is executed are admissible for that purpose. In the case of a trust, a contemporaneous, but not future, letter of wishes (see, *Lewin on Trusts, 20th edn, at 30-080A, Grand View* at *[61-63]),* may be considered as an aid to interpretation, *Grand View* at *[63].*

Specifically, in *Grand View*, the Privy Council observed that, while the trustee of the GRT could legitimately have regard to a letter of wishes expressed by the Founders, as to how the trustee should exercise the dispositive powers, such wishes were not admissible in determining the purpose for which those powers were conferred.

The proper purpose rule as explained by the Privy Council in *Grand View* was followed in *Adams v FS Capital Limited [2023] EWHC 1649 (Ch)* to set aside the sale of trust assets in a manner intended (as it was found) to defeat the interests of the existing beneficiaries.

Fraud on a Power and the Proper Purpose Rule

Historically, an abuse of power or exercise of a power for an improper purpose was characterised as a "fraud on a power". The early Court of Chancery attached the consequences of fraud to acts which were honest and unexceptionable at common law, but which were unconscionable according to equitable principles: *Eclairs,* Lord Sumption at *[15].* The concept of a "fraud on a power", thus, was not confined to reprehensible conduct on the part of the fiduciary. It extended to situations in which the fiduciary used a fiduciary power for a purpose not falling within the scope of the purposes for which the power was conferred. That was the case even though the fiduciary was acting in good faith and genuinely with a view to benefitting the beneficiaries: *Grand View,* Lord Richards at *[56].* Thus, the principle or concept has nothing to do with fraud. For that reason, Lord Richards, in *Great View* said, at *[56],* that the "*Board considers that there is much to be said for discarding the historical language and referring instead to the proper purpose rule.*"

Relevance of the Rule to Directors

It is not in doubt that a director is a fiduciary. In his much-quoted judgment in *Mothew v Bristol & West Building Society [1998] Ch 1 (**Mothew**)*, Millett LJ, at *18A-C,* said:

> *"A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary."*

The circumstances in which, and the reasons why, a person assumes the obligations of a fiduciary were explained by Mason J in *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64, at *68 & 69* (***Hospital Products***):

> *A critical feature of fiduciary relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interest of that other person in either a legal or practical sense.*
>
> *The relationship, therefore, gives the fiduciary a special opportunity to exercise that power or discretion to the detriment of that other person, and that other person is, accordingly, vulnerable to abuse by the fiduciary of his position.*
>
> *It is partly because the fiduciary's exercise of the power or discretion can adversely affect the interests of the person to whom the duty is owed and because the latter is at the mercy of the former that the fiduciary comes under a duty to exercise his power or discretion in the interests of the person to whom it is owed.*

Nor is it in doubt that a director has always been treated as a trustee for the company of his powers: *Eclairs,* Lord Sumption at *[16].*

The proper purpose rule, so far as it relates to directors, is now enshrined in statute. Since the introduction of the Companies Act 2006, in England & Wales the general duties of directors have been codified. Thus, it provides, in s.170(1), that the general duties are owed by the directors to the company. The proper purpose rule is set out in s. 171. That provides:

> *"**171 Duty to act within powers***
> *A director of a company must—*
> *(a) act in accordance with the company's constitution, and*
> *(b) only exercise powers for the purposes for which they are conferred."*

S.172(1) sets out the company law statutory equivalent of a director's duty of loyalty. It provides, in part:

> *"**172 Duty to promote the success of the company***
> *(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, … "*

In Cayman, the duties of directors are not codified; the common law duties continue to apply. Directors must act in a manner which they *bona fide* believe to be the best interests of the company of which they are directors. That is the common law duty of

loyalty. It is owed to the company of which they are directors. Similarly, they may only exercise the powers conferred on them for the purposes for which they were conferred: *Grand View*, Lord Richards at *[1]*.

Constraints on the exercise of Contractual Powers

The primary constraints on the exercise of contractual powers will be those contained in the instrument containing such powers. But where the terms of the governing instrument provide no clear indications as to their existence and extent, those constraints may arise from, and those powers may be circumscribed by, the nature of the relationships between the donor and the donee of the power.

Commercial Relationships

In commercial relationships, the Courts have held that an apparently unfettered discretion conferred on a party under a contract is subject to limitations. As Baroness Hale DPSC explained in *Braganza v BP Shipping Ltd [2015] UKSC 17,* at *[18]* (***Braganza***)*:*

> *"Contractual terms in which one party to the contract is given the power to exercise a discretion, or to form an opinion as to relevant facts, are extremely common. It is not for the courts to rewrite the parties' bargain for them, still less to substitute themselves for the contractually agreed decision-maker. Nevertheless, the party who is charged with making decisions which affect the rights of both parties to the contract has a clear conflict of interest. That conflict is heightened where there is a significant imbalance of power between the contracting parties as there often will be in an employment contract. The courts have therefore sought to ensure that such contractual powers are not abused.* ***They have done so by implying a term as to the manner in which such powers may be exercised, a term which may vary according to the terms of the contract and the context in which the decision-making power is given****." (****emphasis*** added*)*

Relational Contracts

In *Socimer International Bank Ltd. v. Standard Bank London Ltd. [2008] Bus. L.R. 1304 (C.A.),* Rix LJ reviewed the authorities concerning a contractual power to make decisions at *[60]-[65].* At *[60]*, he identified two issues which will arise. He said:

> *"When a contract allocates only to one party a power to make decisions under the contract which may have an effect on both parties, at least two questions arise. One is, what if any are the limitations on the decision-maker's freedom of decision? The other is, what is to happen if the contractual power was not in fact exercised at the time when the relevant party was obliged to make a decision?"*

He continued at *[66]*, in a passage cited with approval by Baroness Hale in *Braganza*:

> *"It is plain from these authorities that a decision-maker's discretion will be limited, as a matter of necessary implication, by concepts of honesty, good faith, and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality. The concern is that the decision should not be abused."*

Such considerations arise in a number of contexts, and situations; for example, between partners, shareholders in limited companies, and within classes of note-holders.

In *Assenagon Asset Management SA v Irish Bank Resolution Corporation Ltd [2012] EWHC 2090 (**Assenagon**)*, Briggs J reviewed, at *[40]-[47], "the general principles which have been established by English law in relation to the construction and exercise of powers conferred upon a majority to bind a minority within a class."* He said that:

(a) the principles could be traced back to Justinian's *Institutes*, and were applied, in *Blisset v Daniel (1853) 10 Hare 493,* to a power given to two-thirds of the members of a partnership to expel a partner by notice. At *523-524*, Page Wood V.C. said that the *"power is inserted, not for the benefit of any particular parties holding two-third of the shares, but for the benefit of the whole society and partnership…".*

(b) that principle was applied to the relationship of shareholders in a limited company, in *Re Westbourne Galleries [1973] AC 360,* at *381* by Lord Wilberforce, and in *O'Neill v Phillips [1999] 1 WLR 1092,* at *1098-1101* by Lord Hoffmann.

(c) the same principle was applied to the power of a majority of debenture holders to modify the terms of a debenture issue so as to bind a minority of such holders in *British America Nickel Corporation Ltd v MJ O'Brien Ltd [1927] AC 369,* at *371* by Viscount Haldane. He said:

> *"There is, however, a restriction on such powers, when conferred on a majority of a special class in order to enable that majority to bind a minority. They must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities of classes enabling them to bind minorities; namely, that the power given must be exercised for the purpose of benefiting the class as a whole, and not merely individual members only. Subject to this, the power may be unrestricted."*
>
> (See also *Redwood Masterfund Ltd v TD Bank Europe Ltd* [2006] 1 BCLC 149, Rimer J at *§§ 91-92(**Redwood**).)*

(d) that in *Allen v Gold Reefs of West Africa [1900] 1 Ch 656*, at *671*, Lindley M.R. said, in relation to a power conferred on the majority of shareholders to alter the articles of association:

> *"Wide, however, as the language of s.50 is, the power conferred by it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded. These conditions are always implied, and are seldom, if ever, expressed."*

Implied Terms?

The question inevitably arises as to by what legal construct or principle are these constraints introduced to, or imposed upon, contractual relationships?

In *Redwood,* at *§ 92,* Rimer J thought that the existence of such constraints fell to be implied on the basis **(i)** of obvious inference that they were intended to apply to the contract (*Shirlaw v Southern Foundries (1926) Ltd [1939] 2 KB 206* at *227* per MacKinnon LJ*)*, or **(ii)** of necessity to give effect to the reasonable expectations of the parties (*Equitable Life Assurance Society v Hyman [2002] 1 AC 408* at *459* per Lord Steyn*)*.

However, in *Assenagon,* at *§ 46*, Briggs J suggested that the basis for:

> *"the implication of this principle into provisions conferring powers on majorities to bind minorities may be that it is a term generally implied by the law in contracts or arrangements of particular types, as reflected in the speech of Lord Wilberforce in Liverpool City Council v Irwin [1977] AC 239, at 253 - 255. If that is as I conceive it to be the true basis for the implication of the principle, then it must still be regulated by any contrary intention demonstrated by the parties' agreement."*

(See also *Mercantile Investment and General Trust Co v International Company of Mexico [1893] 1 Ch 484 (note),* Lindley LJ at *489.)*

Constraints on the exercise of Fiduciary Powers: *Grand View*

In *Grand View*, Lord Richards said, at *[61].*

> *"Ascertaining the purpose of a power where the instrument is silent depends on an inference from the mischief of the provision conferring it, which is itself deduced from its express terms, from an analysis of their effect, and from the court's understanding of the business context."*

As described above, the identification of the purpose will, in addition, be informed by the rest of the instrument in which the power is contained: *Grand View,* at *[62]*. As well as that instrument, contemporaneous documents executed and intended to be read together with it are admissible in interpreting the power and in ascertaining its purpose: *Grand View,* at *[63]*. Whilst a trustee may legitimately have regard to wishes later expressed by a settlor as to how the trustees should exercise its dispositive power, such wishes are not, as in all instances of contractual interpretation, inadmissible in determining the purpose or extent of that power: *Grand View* at *[63].*

In *Grand View,* the Privy Council was concerned, in particular, with the issue as to whether the power to add a beneficiary permitted the addition of the trustees of a purpose trust as objects of the dispositive power in the trust deed.

It was argued by the appellants, at *[69]*, that:

(1) the only point of adding a beneficiary is to permit the trustee to consider exercising its discretionary dispositive powers in favour of that beneficiary;

(2) any such disposition must confer a benefit on the added beneficiary;

(3) a payment to a trustee confers a benefit, not on the trustee, but on the beneficiaries or objects of the trust;

(4) therefore, the powers of addition of beneficiaries could not be exercised in favour of a trustee in its capacity as such nor could a trustee in its capacity as such be added as a beneficiary;

(5) the proper course would be to add the beneficiaries or objects of the other trust as beneficiaries of the trust;

(6) but that of course could not be done in the case of a purpose trust.

The Privy Council rejected that suggested limit on the scope of the power in question, having regard to its express terms. It held that there was no justification for construing the power so narrowly so as to rule out the exercise of the power to add a trustee of another trust. Further, it observed that it was established that a power to appoint in favour of a "person" will generally include a power to benefit a purpose, because it is only through persons that purposes can be benefitted: *Grand View,* at *[70].*

It also rejected a general proposition suggested by the Court of Appeal that "*giving effect to the settlor's wishes in non-commercial trusts in which the beneficiaries have provided no consideration will not usually constitute a fraud on the power*".

On the principles applicable to the exercise of fiduciary powers, the Privy Council found, in *Grand View,* at *[121]:*

> *"The power to add or to exclude beneficiaries is, however, a power of a potentially different character. It has the capacity to effect significant, even fundamental, changes to a trust. The question is whether, in the case of such a power contained in any particular trust deed, it is intended to have that capacity, or indeed to have any purpose that goes wider than simply furthering the interests of the identified beneficiaries.* ***In the view of the Board, the question of the purpose of such a power is not to be answered by applying, as an overriding principle, a rule that all powers must be exercised in the interests of some or all of the beneficiaries, unless express provision to the contrary is made. The task is to discern the intended purpose of the particular power of addition and exclusion in the context of the particular trust.*** *This requires the approach of considering the power in the context of the trust instrument, and of the circumstances surrounding it, which the Board has earlier set out and applied. ….* ***the purpose of a trust must be judged by reference to all the terms of the trust instrument, including any powers of addition and exclusion of beneficiaries, and to the circumstances in which the trust was created****." (****emphasis*** added*)*

That approach is consistent with the judgment of *Mason J* in *Hospital Products,* at *[70]*:

> *"70. That contractual and fiduciary relationships may co-exist between the same parties has never been doubted. Indeed, the existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship. In these situations it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them. The fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction."*

It was not disputed that the GRT trustee's purpose was to exclude all the children and remoter issue of the Founders as the entire existing class of Beneficiary and to substitute a purpose trust, the WFT, as the sole Beneficiary with a view to appointing the entire trust fund to the WFT and bringing the GRT to an end. The reason given for this exercise of power was based on the Founders' decision to retain their own substantial personal FPG shareholdings, from which their children could expect to benefit when the Founders died. In the light of this, the Founders considered that there was no longer any need for a private trust from which their children might benefit.

The GRT trustee considered that there had been a change of circumstances which altered the basis on which the GRT had been formed and that the appropriate course was for the assets of the GRT to be transferred to the WFT (reflecting the Founders' views).

Its argument was heavily based on the broad language of the clause in question, which it argued gave them as trustees the widest discretion to add or exclude beneficiaries as it thought fit, after proper deliberation and taking account of the views of the Founders or what the GRT trustees believed would have been their views.

However, whilst as the Privy Council noted the breadth of the language of the clause was highly relevant to the determination of the purpose, this was only one part of the enquiry, it being common for powers expressed in the widest of language to be restricted as to their permissible exercise by their proper purpose. The Privy Council determined that the natural reading of the trust deed as a whole demonstrated that it was established as a family trust, for the benefit of the direct descendants of the Founders, and that that family character was emphasised by the terms of the trust deed, to a degree which may be unusual in the world of discretionary trusts: *Wong*, at *[80].* Memoranda signed by the Founders when the GRT was constituted indicated that their purpose in creating it had been to benefit family members rather than a non-charitable purpose trust.

Further, the Board stated that there was nothing in the terms of the GRT trust deed, or in the surrounding circumstances at the time that it was made, to suggest that the actual and potential interests of the Founders' children and remoter issue were intended to terminate if, in the view of the GRT trustee, the trust in their favour was no longer needed to provide such alignment and motivation (*Wong*, at [88]).

It further found that it is generally the case that fiduciary powers conferred on a trustee of a trust with identified beneficiaries must be exercised to further the interests of the beneficiaries: *Wong,* at *[120].* That, of course is consistent with the approach adopted by the legislature in CA 2006 to the fiduciary obligations of directors: see *s.172(1) CA 2006.* In the premises, the trustee's decision was declared void.

In addition to the terms of the originating instrument, and consistently with the purpose for which the power is conferred, we suggest that any exercise of a power is constrained by the primary duty of the fiduciary, that is to say, the obligation of loyalty: see *Mothew*; see *Eclairs.*

Constraints on the exercise of Powers: *Tianrui*

The proper purpose rule, and the constraints on the exercise by directors of their fiduciary powers, were comprehensively considered by the Privy Council in *Howard*

Smith. That decision has been cited, continuously, with approval ever since and, for present purposes, in particular, by the Privy Council in *Eclairs* and *Grand View;* and it was not doubted by either the parties, or the Court, in *Tianrui.*

Eclairs

In *Eclairs,* Lord Sumption, at *[18],* cited with approval from "*the seminal judgment in the High Court of Australia in Mills v Mills (1938) 60 CLR 150*" (***Mills***). In *Mills* at *185-186* Dixon J pointed out the difficulties associated with too rigorous an application of any public law test to the decisions of directors. He concluded:

> *"When the law makes the object, view or purpose of a man, or of a body of men, the test of the validity of their acts, it necessarily opens up the possibility of an almost infinite analysis of the fears and desires, proximate and remote, which, in truth, form the compound motives usually animating human conduct. But logically possible as such an analysis may seem, it would be impracticable to adopt it as a means of determining the validity of the resolutions arrived at by a body of directors, resolutions which otherwise are ostensibly within their powers.* ***The application of the general equitable principle to the acts of directors managing the affairs of a company cannot be as nice as it is in the case of a trustee exercising a special power of appointment. It must, as it seems to me, take the substantial object the accomplishment of which formed the real ground of the board's action. If this is within the scope of the power, then the power has been validly exercised.*** *" (****emphasis*** *added)*

Further, at *[23]* in *Eclairs*, Lord Sumption cited with approval from "*the leading modern case*" of *Howard Smith,* at *834:*

> *"… the issue (of shares) was clearly intra vires the directors. But, intra vires though the issue may have been, the directors' power under this article is a fiduciary power: and it remains the case that an exercise of such a power though formally valid, may be attacked on the ground that it was not exercised for the purpose for which it was granted."*

At *[30]* in *Eclairs,* Lord Sumption said:

> *"I do not doubt that a term limiting the exercise of powers conferred on directors to their proper purpose may sometimes be implied on the ordinary principles of the law of contract governing the implication of terms. But that is not the basis of the proper purpose rule.* ***The rule is not a term of the contract and does not necessarily depend on any limitation on the scope of the power as a matter of construction. The proper purpose rule is a principle by which equity controls the exercise of a fiduciary's powers in respects which are not, or not necessarily, determined***

> ***by the instrument***. *Ascertaining the purpose of a power where the instrument is silent depends on an inference from the mischief of the provision conferring it, which is itself deduced from its express terms, from an analysis of their effect, and from the court's understanding of the business context." (**emphasis** added)*

That final sentence was cited with approval by Lord Richards in *Grand View,* at *[61].*

The subject matter of the previous two sentences, emphasised in the quotation, was considered further at the hearing before the Privy Council in *Tianrui.*

As is clear from that quotation, the extent of any constraint on the exercise of a fiduciary power will depend on the mischief of the provision as identified by the originating instrument. Whilst Lord Sumption finds the existence of the rule in equity, correctly in our view, he does not elaborate upon why equity intervenes to constrain the exercise of a power in that way.

Hopefully the Privy Council will deal with this in its judgment in *Tianrui*. However, we suggest that, consistently with the observations of Lord Sumption in *Eclairs,* such constraint is a facet or, perhaps, a consequence of the duty of loyalty owed by a fiduciary to its principal. In terms of company law, the company is the principal. Its interests are synonymous with the interests of the general body of shareholders; that is, the whole of the body of shareholders, and not just some part of them.

Locus Standi: The Basis of the Shareholders' Personal Cause of Action

Locus Standi was, of course, the very issue before the Privy Council in *Tianrui.*

In *China Biologic*, Kawaley J had found that a minority shareholder would have no personal right of action in order to impugn the propriety of the directors' purpose in pursuing a new issue of shares. However, he found that, if the plaintiff had been a majority shareholder prior to the impugned issue of new shares, such a person would have been able to bring a personal claim to challenge the propriety of the issue.

In reaching his decision, Kawaley J appears to have proceeded on the basis that the wrong done by an improper allotment of shares was a wrong done to the company. In so doing he relied on the judgment of Harman LJ in the Court of Appeal in *Bamford v Bamford [1970] Ch 212 (***Bamford***)*:

> *"The only question is whether the allotment, having been made, as one must assume, in bad faith, is voidable and can be avoided at the instance of the company - at their instance only and of no one else, because the wrong**, if wrong it be, is a wrong done to the company.**"*

and of Russell LJ:

> *"It is true that the point before us is not an objection to the proceedings on Foss v Harbottle (1843) 2 Hare 461 grounds. But it seems to me to march in step with the principles that underlie the rule in that case. None of the factors that admit exceptions to that rule appear to exist here. The harm done by the assumed improperly-motivated allotment* ***is a harm done to the company****, of which only the company can complain."*

In *Bamford*, the Court of Appeal concluded that the directors' allotment of shares for an improper motive being simply voidable, the power to remedy the defect was in the hands of the general meeting, which could exercise that power by simple majority (although the votes attaching to any shares issued in the impugned allotment would not be counted in assessing whether the majority was attained).

In reaching his conclusion, Kawaley J dismissed the relevance of *Howard Smith* on the basis that "*the issue of standing was not considered or decided*".

His decision involved little consideration of the discussion of the Supreme Court in *Eclairs* as to the limitation on the powers given to the directors. Whilst the Supreme Court decision in *Eclairs* did not analyse whether the claim was properly brought by way of a personal claim, the issue of standing had been before the first instance judge (*[2013] EWHC 2631 (Ch)* at *§§ 8 - 13; 248 - 255*) and the Court of Appeal *([2014] EWCA Civ 640* at *§§ 33 - 38*). *Eclairs* was successful on the issue of standing in both courts; it was not pursued in the Supreme Court.

Instead, in the Supreme Court, in considering the exercise by directors of their powers for the purpose of influencing the outcome of a general meeting, Lord Sumption said at *[16]:*

> *"This is not only an abuse of power for a collateral purpose. It also offends the constitution and distribution of powers between the different organs of the company."*

Implicit in that statement is the notion that it is open to those affected by the abuse of power to seek to have it remedied: see *Fraser v Whalley*.

It is that analysis which informs the issue of standing.

Derivative Claims

The issue of standing often arises in relation to derivative claims. In *Waddington Ltd v Chan [2008] HKCFA 63 (****Waddington****),* Lord Millett NPJ, said at *[48]:*

> *"The injustice which would result if a derivative action were not available where the company is controlled by the alleged wrongdoers is vividly described by Lord Denning MR in Wallersteiner v. Moir (No.2)(supra) at p.390:*
>
> > *"But suppose [the company] is defrauded by insiders who control its affairs - by directors who hold a majority of the shares - who then can sue for damages? Those directors are themselves the wrongdoers. If a board meeting is held, they will not authorise the proceedings to be taken by the company against themselves. If a general meeting is called, they will vote down any suggestion that the company should sue them themselves. Yet the company is the one person who is damnified. It is the one person who should sue. In one way or another some means must be found for the company to sue. Otherwise the law would fail in its purpose. Injustice would be done without redress." (my emphasis)"*

He continued at *[74]:*

> *"As I have said, the question is simply a question of the plaintiff's standing to sue. This would have been obvious when the procedure was for the proposed plaintiff to apply to the court for leave to use the company's name. On a question of standing, the court must ask itself whether the plaintiff has a legitimate interest in the relief claimed sufficient to justify him in bringing proceedings to obtain it. The answer in the case of person wishing to bring a multiple derivative action is plainly "yes"."*

See also *Universal Project Management Services Ltd v Fort Gilkicker Limited [2013] EWHC 348,* Briggs J at *[17] - [24].* As Briggs J said at *[24]:*

> *"Once it is recognised that the derivative action is merely a procedural device designed to prevent a wrong going without a remedy (see Nurcombe v Nurcombe [1985] 1 WLR 370 at 376A) then it is unsurprising to find the court extending locus standi to members of the wronged company's holding company, where the holding company is itself in the same wrongdoer control. The would-be claimant is not exercising some right inherent in its membership, but availing itself of the court's readiness to permit someone with a sufficient interest to sue as the company's representative claimant, for the benefit of all its stakeholders."*

Personal Claims

In *Sherbourne Park*, Hoffmann J was faced with an application seeking an indemnity in respect of costs incurred by a shareholder in pursuing an unfair prejudice petition which sought to challenge an allotment of shares as being for an improper purpose. He said:

"[The challenge to the validity of the allotment], whether brought by writ or petition under s 459 [CA 1985] this is not, in my judgment, a derivative action [at common law]. Although the alleged breach of fiduciary duty by the board is in theory a breach of its duty to the company, the wrong to the company is not the substance of the complaint. The company is not particularly concerned with who its shareholders are. The true basis of the action is an alleged infringement of the petitioner's individual rights as a shareholder. The allotment is alleged to be an improper and unlawful exercise of the powers granted to the board by the articles of association, which constitute a contract between the company and its members. These are fiduciary powers, not to be exercised for an improper purpose, and it is generally speaking improper -

> *"for the directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist."*

(see Howard Smith Ltd v Ampol petroleum Ltd. An abuse of these powers is an infringement of a member's contractual rights under the articles.")

Ratification

As we have said, in *China Biologic,* Kawaley J relied on *Bamford*. As identified above, the Court of Appeal in *Bamford* proceeded on the basis that:

(a) the allotment of shares was a wrong done to the company, and accordingly the proper claimant was the company;

(b) the alleged wrong was capable of ratification by a majority of shareholders.

Of course, if the wronged party is indeed the company, for example where the directors allot the shares to a third party for an improper purpose and at an undervalue, so that all existing shareholders are affected equally, that analysis may well be correct.

It is always open to the general body of shareholders to ratify and adopt on behalf of a company an act which is said to have been improper (other than an act **(i)** which is ultra vires, or in excess of, the power in question or **(ii)** which is directed at some only of those shareholders), or to waive the consequences of that act. As a consequence, **(a)** the act will cease to be an abuse of power, and **(b)** as a result, there will be no wrong for which a remedy may be sought by any person, be that the company itself or any shareholder. It will be recalled that in *Bamford,* it was alleged that "[*t]he harm done by the assumed improperly-motivated allotment* ***is a harm done to the company****, of which only the company can complain"*. The Court of Appeal found that that alleged breach of duty was ratifiable.

However, where, as in *Howard Smith,* and as in *Tianrui*, the wrongful act was (alleged to have been) directed at one existing shareholder to its detriment and to the benefit of another shareholder, we suggest that such a wrong is done to a shareholder, for which that shareholder is entitled to seek redress, and that that wrong is not capable of ratification by a majority so as to deprive the wronged shareholder of a remedy.

There is no reason why such ratification should be permitted. In our view it is not. The wrongful act is discriminatory. Ratification (were it to be possible) would deprive the wronged shareholder of relief, at the will of unaffected shareholders and possibly even of those shareholders who have benefitted from the wrong.

'Personal Claims' brought 'derivatively'

As a trust fund has no legal personality, it cannot sue third parties for losses or for an account of profits. Instead, it is the trustees who sue, or are sued by, third parties. Obviously this raises the question of what happens if the trustees decide not to sue a third party? There may be many reasons why they might choose not to embark on litigation.

In *Roberts v Gill [2010] UKSC 22 (**Roberts v Gill**),* the Supreme Court gave guidance on the circumstances in which a beneficiary would be permitted to bring such proceedings on behalf of a trust, holding that it might be permitted where "special circumstances" are found to exist. In effect, such an action is treated as being brought by the legal holder, albeit articulated by the beneficial owner and with the beneficial owner being the actual named 'claimant'.

Trust derivative claims are clearly important in this context and in circumstances in which shares are often held through a nominee (for example in a CREST account, or another 'street name'). Indeed, *Eclairs* was a personal action brought by the beneficial owner of shares registered in the name of another, by way of a trust derivative claim.

Beneficiaries may be able to argue that a failure by a trustees to sue amounts to a breach of trust entitling them, on their personal account, to sue the trustees and require them to restore the trust fund to the value it would have had but for their breach of trust. Alternatively, and as developed in the authorities to which we have referred, if "special circumstances" exist, the beneficiaries might be able to take advantage of the trustees' right of action and directly sue the third party.

As *Roberts v Gill* confirms, the trustees must be joined to such an action so that they will be bound by the judgment and able to receive the money augmenting the value

of the trust fund, such fund then being available to satisfy creditors' claims having priority over the beneficiaries' interests in the net fund.

As Lord Collins said:

> *"The special circumstances which were identified in the earliest authorities as justifying a beneficiary's action were fraud on the part of the trustee, or collusion between the trustee and the third party, or the insolvency of the trustee, but it has always been clear that these are merely examples of special circumstances, and that the underlying question is whether the circumstances are sufficiently special to make it just for the beneficiary to have the remedy'.*

A beneficiary's cause of action against a third party therefore depends upon there being a failure, excusable or inexcusable, by the trustees in the performance of the duty they owe to the beneficiary to protect the trust estate or to protect the interests of the beneficiary in the trust estate. Where this amounts to a breach of trust, it will normally be just for the beneficiary to sue the third party.

However, it will not be a breach of trust where, taking account of the value of the trust fund, the uncertainty of winning a proposed law suit against a third party and the amount claimable in that suit, the trustees decide not to pursue the suit. A beneficiary will not be permitted to bring a derivative action merely because he will be legally aided, where that is the reason the trustees decide not to proceed themselves on behalf of the trust, and choose to let the beneficiary proceed: *Roberts v Gill,* at *[43]*).

But there may be a genuine dispute between the beneficiaries as to whether to bring an action against a third party. In such circumstances, the authors of *Lewin on Trusts* suggest that (at *43-05*):

> *"If there is a genuine dispute between the beneficiaries as to whether an action against a third party would be in the interests of the trust, then an administration action should be brought so that the matter might be determined as between the beneficiaries before proceedings are commenced in the name of any of them or in the name of the trustee.'*

This passage was endorsed by Arden LJ in the Court of Appeal in *Roberts v Gill* (at *[55]*).

Conclusions / Take-Aways

It is suggested that the take-aways from these authorities are as follows:

(1) In each of *Grand View* and *Tianrui*, the powers under consideration were fiduciary powers and thus their exercise was subject to duties and restrictions imposed by equity.
(2) It is a fundamental principle of equity that a fiduciary power may be exercised only for a purpose for which the power has been conferred.
(3) There is a distinction to be drawn between acts in excess of power and those in abuse of power.
    (a) An act which is beyond the scope of the instrument creating a power as a matter of construction or implication is characterised as an excess of power.
    (b) An act which is within the scope of a power but which is done for an improper reason is characterised as an abuse of power.
    (c) In the former case, the issue being one of contractual interpretation, evidence of the parties' subjective intention being inadmissible, the test is objective.
    (d) In the latter case the state of mind of those who acted and their motive are admissible and of primary importance.
(4) A donor's purpose in conferring any power, whether contractual or fiduciary, is to be determined objectively as at the date of the instrument in which the power is conferred.
    (a) The entirety of the instrument will be considered in order to determine the purpose of the power.
    (b) Contemporaneous documents forming part of the factual matrix in which the instrument is executed will also be considered in interpreting the power and in ascertaining its purpose. In the case of a trust, a contemporaneous, but not future, letter of wishes may be considered.
(5) The characterisation of an abuse of power as a "fraud on a power" should be confined to history in favour of reference to "the proper purpose rule".
(6) The question of the purpose of such a power is **not** to be answered by applying, as an overriding principle, a rule that all powers must be exercised in the interests of some or all of the beneficiaries, unless express provision to the contrary is made.
    (a) The task is to discern the intended purpose of the particular power of addition and exclusion in the context of the particular trust.
    (b) Where contractual and fiduciary relationships co-exist between the same parties it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties.
    (c) The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them.

(d) The fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction.

(7) Where the terms of the governing instrument provide no clear indications as to their existence and the extent of any constraints on the exercise of a power, those constraints may arise from the nature of the relationships between the donor and the donee of the power.

(8) In relation to fiduciary powers it has been said that the proper purpose rule does not necessarily depend upon any limitation on the scope of the power as a matter of construction. Rather it is a principle by which equity controls the exercise of a fiduciary's powers in respects which are not, or not necessarily, determined by the instrument.

(9) In relation to contractual powers, constraints on their exercise may be implied on the basis **(i)** of obvious inference or **(ii)** of necessity to give effect to the reasonable expectations of the parties, or **(iii)** generally in contracts or arrangements of particular types.

(10) Any exercise of a fiduciary power, it is suggested, is constrained by the obligation of loyalty owed by the fiduciary.

(11) An exercise of a power which is vitiated as a fraud on a power is void in equity - it does not alter the beneficial interests. It is not merely voidable but rather the exercise is outside the purpose of the power and is treated as not having taken place.

(12) Typically one sees proper purpose challenges arising in the context of a donee exercising a power ostensibly in favour of an object of the power but with the ulterior purpose of benefiting a person who is not an object of the power. However, in *Grand View,* the principle was stated in arguably wider terms, as being a principle that a power may be exercised only for a purpose for which the power has been conferred, even though there is no intention to benefit a non-object (*Lewin on Trusts, 20th edn, at 30-078A).*

(13) The juridical basis for a personal claim in company law is that an abuse of power for a collateral purpose constitutes an infringement of the shareholder's individual rights.

(14) The issue of standing to bring and maintain a personal claim is primarily determined by identifying:

(a) who is affected by the acts of which complaint is made;

(b) who is the most appropriate person to pursue a remedy on behalf of those so affected;

(c) does that person have a cause of action in respect of those acts; and

(d) can that action be defeated by a ratification of those acts by a majority.

(15) Those questions are apposite to both company law claims and to trust law claims.

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