

## update

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## Friday Facts: Inspection of a company's books – An effective tool or an abuse of process?

*Section 247A(1) of the Corporations Act (2001) ("the Act") provides that a member/ shareholder of a company who holds shares in the company may seek an order to inspect the "books" of the company.*

The section provides an effective tool for assessing the merits of potential litigation by a shareholder against companies and directors.

"Books" are defined widely under section 9 of the Act to include the register, any record of information, financial reports or financial records however compiled, ordered or stored.

Under section 247A, the Court has the power to include in any order the authority of another person (whether a member or not) to inspect the books and records of the company on the applicant's behalf. This provides scope for lawyers to inspect the books and records on behalf of their clients. Section 247A (2) also provides that a person authorised to inspect the books can make copies unless the Court orders otherwise.

### *Requirements of good faith and proper purpose*

The Court will only make the order if it is satisfied that the applicant is acting in good faith and that the inspection is for a proper purpose. It is the applicant who bears the onus of proving good faith and proper purpose, as demonstrated in *Intercapital Holdings Ltd v EH Ltd*.

Whether the applicant is acting in good faith and for a proper purpose is an objective test, as demonstrated in the cases of *Barrack Mines Ltd v Grants Patch Mining Ltd* and *Knightswood Nominees Pty Ltd v Sherwin Pastoral Company Ltd*.

Importantly, inspection of the books for the purpose of determining whether to commence litigation against the officers and

directors or former officers and directors of the company is regarded as acting in good faith and for a proper purpose. A factor such as the applicant being a substantial shareholder of long standing may in itself be sufficient to discharge the onus of good faith, which was demonstrated in *Quinlan v Vital Technology Ltd* and *Grants Patch Mining Ltd*.

A proper purpose is a purpose connected to an applicant's status as a member or reasonably related to his or her interest as a member, as demonstrated in *Knightswood Nominees Pty Ltd*.

Examples of applications deemed to be for a proper purpose are:

- an application for inspection where a member suspects that the company's directors have been in breach of their duties and the member requires more information to decide on the appropriate action to be taken, as seen in *Unity APA Ltd v Humes Ltd* and *Biala Pty Ltd v Mallina Holdings Ltd*
- an application for inspection prior to commencing proceedings against a company for oppressive and unfair conduct against a member or members, as seen in the cases of *Re Augold NL*, *Humes Ltd*, *Re Dernacourt Investments Pty Ltd*
- an application for inspection to enable a member to ascertain the fair market value of shares in order to give effect to provisions in the constitution of the corporation conferring pre-emptive rights to share sales – also demonstrated in *Re Augold NL*

An example of lack of proper purpose is where a member is motivated by a wish to obtain confidential information for the benefit of one of the company's competitors, as in the case of *Knightswood Nominees Pty Ltd*, or to facilitate a take-over bid, which was seen in *Garina Pty Ltd v Action Holdings Ltd*. It is also not a proper purpose to use section 247A to inspect books in order to overcome the obstacle of legal professional privilege claimed in another proceeding, which was demonstrated in *Czerwinski v Syrena Royal Pty Ltd (No 1)*.

The rights provided by s247A should not be regarded as affecting the basic rule of Corporations law that a shareholder should not ordinarily have recourse to the courts to challenge a managerial decision made by or with the approval of the directors. This was seen in the cases of *Re Humes Ltd* and *Grants Patch Mining Ltd*. However, since every shareholder has a right to apply under the section for an inspection order, it is no answer to an application that, if an order is made, the applicant may acquire information not available to other shareholders and thereby be in a more advantageous position than those shareholders. This was demonstrated in *Re Humes Ltd* and *Grants Patch Mining*.

Ultimately, it must be acknowledged that even where the applicant is acting bona fide and has shown a proper purpose, the Court has the discretion whether to order inspection, as in the case of *Re Humes Ltd*, and the extent of the books to be inspected – as demonstrated in *Majestic Resources NL v Caveat Pty Ltd & Ors*.

Section 247A should be kept in mind when considering the most cost effective and efficient way for members/shareholders of companies to obtain information concerning the potential causes of action which may exist against a company.

Similarly, companies should be aware that an inspection of company's books by a member or shareholder may be for a purpose other than simply becoming more knowledgeable about the company's business, and ensure that any purpose for inspection other than that of a proper purpose in good faith is challenged.

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