LEGISLATION COMMENT

ULTRA VIRES, DIRECTORS' DUTIES AND THE COMPANIES AMENDMENT ACT (NO. 2) 1983

I. Introduction

Several substantive changes to company law have been brought about by the Companies Amendment Act (No. 2) 1983, some of which, on close analysis, appear to have far wider impact than was intended by the legislature.

The aim of this note is to discuss those changes which deal with the doctrine of *ultra vires* — *viz* sections 14A, 15, 16 and 18A — and to consider the efficacy of those changes in curing the difficulties that doctrine was perceived to produce.

The changes effected by the Amendment Act have addressed the *ultra vires* doctrine from two fronts. The first has been to confer on a company to which the amendments apply, all the "rights, powers and privileges of a natural person" (s 15A(1)). The second has been to prevent a company from pleading *ultra vires* against third parties to protect the latter from any loss which they might incur as a result of the doctrine (s 18A(1)). Innocuous as these changes may seem, their impact on company law is significant. This is particularly true of the change introduced by s 15A(1). Neither is this change uncontroversial, for the enactment of s 15A(1) has occurred despite the explicit recommendation to the contrary of the Macarthur Committee (Final Report of the Special Committee to Review the Companies Act (1973)).

The idea of conferring upon companies the powers of natural persons originated with the Cohen Report (Report of the Committee on Company Law Amendment Cmnd 6659 (1945)). The mischief this charge sought to remedy was the rigour of the *ultra vires* doctrine on those who dealt with the company in ignorance of the provisions of the company's memorandum.

As it applies to companies formed under the Companies Act, the doctrine of *ultra vires* may be stated as follows:

> The memorandum of a company defines its objects and a company's objects are limited to those expressly mentioned and such as are ancillary to the expressed objects. A contract made by the directors upon a matter not within the ambit of the company's objects is *ultra vires* the company and therefore, beyond the powers of the directors. This principle is intended to protect both those who deal with a company and its shareholders (Cohen Committee Report, para. 11).

The origin of the doctrine may be found in the decision of the House of Lords in *Ashbury Railway Carriage & Iron Co. v Riche* (1875) LR 7 HL 653. That case concerned a company whose main object was to make and sell railway carriages and rolling stock and to carry on the business of mechanical engineers and general contractors. The directors entered into an agreement for financing the construction of a railway in Belgium. Initially, the case proceeded upon the question of whether or not the agreement had been ratified by all the members. On appeal the point was taken that even the unanimous agreement of all the shareholders could not effectively ratify what was beyond the company's powers as expressed in the memorandum. The House of Lords was unanimous that ratification was impossible if the contract was beyond the scope of the memorandum. In enunciating the doctrine of *ultra vires* as we know it, Lord Cairns LC said:

> The provisions under which this system of limiting liability was inaugurated, were provisions not merely, perhaps I might say not mainly, for the benefit of the shareholders for the time being in the company, but were enactments intended to provide for the interests of two other very important bodies; in the first place those who might become shareholders in succession to the persons who were shareholders for the time being; and secondly, the outside public, and more particularly those who might be creditors of companies of this kind. (p 667)

This object of the *ultra vires* doctrine of protecting people who provided money to the company as shareholders, is not to be considered lightly.

It is through the vehicle of the limited liability that capital is channelled into commercial activities by large and small investors. These investors' ability to protect their funds invested from abuse by those entrusted with the powers of management of the funds is largely determined by the terms of the memorandum of association and articles of association of the company.

However though it gave those who allowed credit to a limited company some assurance that its assets would not be dissipated in unauthorised enterprises, its consequences were harsh upon those who traded with the company in ignorance of the provisions of the memorandum of association. Moreover, the practice developed of drafting memoranda of association very widely and at great length "so as to enable the company to engage in any form of activity in which it might conceivably at some later date wish to engage and so as to confer on it all ancillary powers which it might conceivably require in connection with such activities" (para 12 Cohen Report). As a consequence of the development of this practice the Cohen Committee concluded that the doctrine of *ultra vires* was "an illusory protection for the shareholders and yet may be a pitfall for third parties dealing with the company" and that, as now applied to companies, the *ultra vires* doctrine "served no positive purpose but is on the other hand a cause of unnecessary prolixity and vexation." This conclusion ought not to be unhesitatingly accepted however. If one accepts the power/object dichotomy of the English Court of Appeal in *In re Introductions* [1970] Ch 199, which serves to restrict the objects of companies that might otherwise be taken to have unlimited capacity, the *ultra vires* doctrine will continue to offer real shareholder protection. Moreover, there is nothing illusory about the lack of protection of the doctrine if one knows that a company's objects have been drawn with wide powers. For there to be an illusion one must have been expecting something different. This does not, of course, mean that one cannot draft narrow objects if protection is sought. A solicitor's nominee company is an obvious example.

Nevertheless the recommendation of the Cohen Committee was that the doctrine should be modified so that in dealing with third parties, the company would have all the powers of an individual person; and that the provisions of the memorandum of association would operate solely as a contract between a company and its shareholders as to the powers exercisable by the directors.

The later Jenkins Report (*Report of the Company Law Committee* Cmnd 1749 (1962)), however, did not accept the wide proposition that a company should have the powers of a natural person. The Macarthur Committee agreed:

> [a] company is not in fact a natural person, but an artificial creation, and it can act only through directors or agents who may exercise powers delegated to them by the company. To invest a company with the powers of a natural person is, in effect, to confer those powers on a company's board of directors. *This, in our opinion, would leave shareholders of public companies in particular with virtually no protection.* Other measures would have to be devised to ensure adequate control over the directors. It may be argued that shareholders and creditors are still protected by the necessity to state the objects, no matter how wide, in the memorandum, so that they will be aware of the directors' power. In our opinion, however, the giving of unlimited power to the directors of public companies to carry on whatever business they choose with shareholders' and creditors' money is undesirable. An investor has the right to know, in general terms, what his money is to be used for. (emphasis added)

Later they said:

> A natural person, it is true, may engage in any lawful activity he chooses, but without the benefit of limited liability. It seems to us that if a ... company is to enjoy the privilege of limited liability it must accept the restriction that it must define its objects (p 46).

In direct opposition to the recommendations of the Macarthur Committee the Amendment Act confers on companies just such powers of "natural persons".

II. The First Assault: Conferring Powers Of A Natural Person

The effect of conferring the powers of a natural person on a company and the implications for the *ultra vires* doctrine are significant.

Previously, for a company to have the capacity to enter a transaction the transaction had to come within the scope of the "objects" set out in the company's memorandum. After the amendment, a company to which s 15A(1) applies can enter any transaction it would be competent for a natural person to enter as well as some transactions which are purely corporate in character. Without more, this section would have entirely abolished the doctrine of ultra vires for companies incorporated after January 1984.

This however, was not the intention of the legislature. When the Companies Amendment Bill (No. 2) 1983 came before Parliament after its referral to the Statutes Revision Committee, the Committee reported it had not abolished the *ultra vires* rule altogether for "to have done so would have required a prohibition on the statement of objects in a company's memorandum of association. That would have gone too far. Some companies would still need to state their objects, such as solicitors' nominee companies and flat and office owning companies . . ." (454 NZPD 3657 (4 Nov. 1983)). Hence the Committee proposed s 14A which provides that "the memorandum of a company may state but shall not be required to state the objects of the company". But there are several important and apparently unperceived difficulties with the section as enacted. These can be grouped into two categories. The first category concerns the construction of ss 14A and 15A. The second is the consequences of conferring on a company the powers of a natural person of shareholder control of abuse of powers by directors.

(a) *The Construction of Sections 14A and 15A*

We have seen that the intention of the legislature was that the *ultra vires* doctrine be preserved by providing in s 14A that a company could continue to state objects. However, the actual effect of this section is not so clear. The difficulty arises with the rather unusual provision contained in s 15A(3):

> The memorandum and articles of a company shall not contain any provision with respect to the rights, powers, and privileges of the company except a provision that restricts or prohibits the exercise by the company of any of the rights, powers, and privileges referred to in sub-section (1) of this section.

It is when s 14A is construed against this sub-section that some doubt is placed upon the opinion of the Statutes Revision Committee as to the effect of s 14A in retaining the doctrine. Section 15A(3) provides a prohibition against positive expressions of the company's powers. Section 14A provides that a company may state its objects. The term "objects" and the term "powers" cannot be construed as synonyms, for otherwise s 14A and s 15A(3) would be contradictory: an "object" in the sense of a "capacity-defining statement" is clearly a "provision with respect to the rights, powers, and privileges of the company", the expression of which is prohibited by s 15A(3) unless expressed in a negative form.

It might be thought that this contradiction is resolved by applying the *Re Introductions* power/object distinction referred to above, where the Court of Appeal viewed "powers" as capable only of being exercised for a purpose which was ancillary to the pursuit of the company's main "objects". This distinction, however, would not seem capable of being applied to distinguish "objects" in s 14A from "powers" in s 15A(3) for it is apparent that, if a company does not state any "objects", and s 14A provides that it need not, the Act is clear that the company will still have capacity to enter any transaction by virtue of the "powers" it has as a natural person under s 15A(1). As the "powers" conferred by s 15A(1) need not be exercised in a manner ancillary to expressed main objects, they would seem properly interpreted as primary and not mere ancillary powers; in which case, in the terminology of *Re Introductions*, the "rights powers and privileges" conferred by s 15A(1) function as primary "objects".

On this view, by providing in s 14A that a company may state positive "objects", the Act could be construed as providing not that the company may, by stating such "objects", limit its capacity, but that it may express the *goals* for which its powers as a natural person may be exercised. In other words, by stating positive "objects" a company would be stating the objects *of* the exercise of its powers rather than defining what powers the company has.

However, the ability of incorporators to limit the capacity of a company is not completely defeated. Section 15A(3) does provide that the memorandum may contain provisions as to the "rights, powers and privileges of the company" provided these provisions restrict or prohibit the exercise of such. It would seem that when a memorandum contains such a provision the capacity of the company will be limited accordingly and any transaction entered into by the company which is prohibited by such a provision will be *ultra vires* and void, subject always to s 18A discussed below.

Section 15A(3) suffers from the further difficulty that the words "with respect to" in the subsection are open to two interpretations, one of which leads to an extraordinary result. If the words mean "anything that concerns" then the section would appear to render invalid many of the articles contained in the Third Schedule, Table A of the Companies Act 1955 because most of these are provisions that concern the company's rights, powers and privileges.

For example, article 80 which confers the powers of management of the company on the directors, is clearly a "provision with respect to the rights, powers and privileges of the company" in the sense that it concerns the conferring of certain of the company's powers (the powers of management), upon the directors. Neither is article 80 the only article which would be invalidated or impliedly repealed by such an interpretation of this sub-section. Others of note include article 6 which concerns the power to pay commissions conferred by s 61 of the Act; article 46 giving the company the power, by ordinary resolution, to consolidate, divide, subdivide or cancel its shares; article 114 conferring the power, to pay dividends (though article 116, which states that no dividends shall be paid otherwise than out of profits, would be valid as it is expressed in a negative form); and article 128 giving the company the power to capitalise reserves for the purposes of distribution to members.

The consequence of this illegality is not that the company necessarily is without the powers expressed in these illegal articles. This is because s 15A itself gives the company all the powers of a natural person, as well as the powers specified in s 15A(1)(a)-(h) which are of a peculiarly corporate character. For example, s 15A(1)(c) confers on the company the power to pay dividends, a power previously conferred by clause 23 of the Second Schedule and article 6 of Table A. Paragraph (h) of that subsection, which gives the company the power to "Do any other act that it is authorised to do by any other enactment or rule of law", will have the effect of filling any gaps left by the invalidation of such articles as article 6 allowing the company to exercise the powers conferred by section 61 of the Act (payment of commissions etc) or articles 82 and 83.

The notable exceptions to this "back-up" provided by s 15A(1) are the articles like article 80 which are "with respect to" the rights etc of the company in the sense that they confer the right to exercise these powers of the directors. Article 80 under such an interpretation of s 15A(3) would be illegal and void unless saved by the discretion given to the court under the Illegal Contracts Act 1970.

This extraordinary result leads one to seek an alternative meaning to the expression "with respect to". It would seem the expression is susceptible to the interpretation of "altering the scope of" the rights, powers and privileges of the company; ie, the words "with respect to" are an ellipsis meaning "with respect to the *scope of* the rights, powers and privileges of the company". Such an interpretation will avoid the apparent invalidation of those positively framed articles which are "provisions with respect to companies' powers" in the sense that they transfer such powers from the company at general meeting to the directors.

This interpretation of s 15A(3), as applied to provisions in the articles, is also consistent with the view expressed above that positively stated objects will be permissible under s 14A provided they are not capacity-defining but are statements of "goals" or "objects" of the exercise of the company's powers as a natural person.

A second possible factor ameliorating the interpretation of s 15A(3) is that the prohibition against positively expressed powers refers only to provisions which deal directly with powers exercised by *the company* and not with powers exercised by directors or by shareholders not acting together as "the company". This interpretation provides a further safeguard for articles such as article 80 conferring powers of management on the directors.

(b) *Shareholder Control of Directors*

The memorandum of association has a further function quite distinct from the role it has played in providing the scope of a company's capacity. This function is the expression of the interests or objects for which the company's powers are to be exercised. Equity has always required a director of a company to exercise his fiduciary powers *bona fide* in the interests of the company. When a company has all the "rights, powers and privileges" of a natural person the particular interests to which the director must have regard are not defined. As a result, the control the company in general meeting has over its directors has been reduced by the amendments because, without objects, there is no reference by which a court can determine whether a director has acted in the interests of "the company".

Prior to the Amendment Act companies could have quite diverse objects. Generally the object of a company was to trade, and the goal of trading was the making of a profit. However, equally common was the object of acting as a charity, and charitable companies were well known under the old provisions of the Act. So too can a natural person exercise his or her legal powers either with the object of making a profit or of acting as a charity, and it may equally be in the interests of a natural person to perform charitable acts as it is to perform acts with the intention of procuring pecuniary gain.

Consequently, if practitioners adopt the easy way out and, as provided in s 14A, exercise the option not to list the objects for which the company's "powers as a natural person" are to be exercised, there is no certainty that the company or the minority shareholders will have an action against directors who perform charitable acts with the funds invested in the company by the shareholders.

III. The Second Assault: Protection Of Third Parties

The second assault on the *ultra vires* doctrine made by the Amendment Act is found in s 18A which deals with *ultra vires* transactions. Such transactions will still be common while companies retain pre-amendment Act memoranda or where companies limit their capacity by including s 15A(3) "negative provisions" in their memoranda.

New s 18A(1) provides:-

> "Nothing done by a company and no conveyance or transfer of property, whether real or personal, to or by a company shall be invalid, void, or unenforceable by reason only of the fact that the company was without capacity or power to do it, or to execute, or give, or take such conveyance or transfer."

The object of this section is clear, but there are several points to be made on its construction and the limitation on its effect made by s 18A(2). In the first place the section addresses only those transactions which would otherwise be "invalid, void, or enforceable" because the company is "without capacity or power" to enter them. After the amendment a company will be without capacity to enter a transaction only if its capacity has been limited by a s 15A(3) negative power provision in its memorandum of association or the company, being incorporated prior to January 1984, and not having adopted the short form of memorandum provided for in s 14, has limited objects in its memorandum of association.

The second point of significance is that the expression "invalid, void, or unenforceable" would appear to refer only to transactions which would otherwise be nullities, and not transactions which are merely voidable. Nothing in this section prevents a transaction from continuing to be voidable for breach of duty by a director.

Thirdly, the transaction is not to be "invalid, void, or enforceable *by reason only of the fact* that the company was without capacity..." (emphasis mine). The inclusion of the words italicized suggests that a transaction may be "invalid, void, or unenforceable" by reason of the fact of want of capacity *and* some further factor. Such further factor might be the presence of actual notice or constructive notice on the part of the third party, of the company's want of capacity. Or a transaction may remain "invalid, void or unenforceable" if there is want of capacity coupled with some other factor such as being entered in breach of duty by the directors. The section gives no indication of what other factors might be relevant in determining whether the transaction is "invalid, void or unenforceable"; it simply says that want of capacity on its own will not have this effect. What additional factors may cause this invalidity may be narrowed down if and when certain proposed additional amendments to the sections are enacted. These additional amendments are in accordance with the recommendations of the Macarthur Committee and involve abolishing the rule as to constructive notice in relation to memoranda and articles of association; the enactment of the "indoor management" rule (the rule in *Royal British Bank v Turquand* (1856) 6 E&B 327) including the provision that the rule will apply notwithstanding fraud or forgery (hence overruling *Ruben v Great Fingall Consolidated* [1906] AC 439 and *South*

London Greyhound Racecourses v Wake [1931] 1 Ch 496). This will bring the amendments into line with the equivalent Australian legislation contained in ss 68A-D of the Companies Act 1981.

Most significantly, s 18A(1) does not have blanket application. Section 18A(2) provides that nothing in subsection (1) shall apply to proceedings against the company by a member of the company or by the holder of debentures secured by a floating charge over the company's undertaking, either to prevent the company entering a transaction which is beyond its capacity, or to obtain relief from the company on the grounds that the company did not have a capacity to enter the transaction. Nor does s 18A(1) apply in any proceedings by the company or any member of the company against an officer of the company in relation to the entry by the company into a transaction which is beyond its capacity, or in an application by the Registrar for the winding up of the company.

Hence a minority shareholder may still bring an action to prevent the company entering an *ultra vires* transaction (s 18A(2)(a)), or an action against a director for breach of fiduciary duty (s 18A(2)(b)), provided of course that the breach amounts to a fraud on the minority. Subsection (3) further provides that where the Court grants an injunction under s 18A(2)(a)(i) it may also make an order granting relief to the party who has suffered loss or damage as a result of the company being prevented from performing the contract. However, no relief can be granted in respect of the loss of anticipated or future profits (s 18A(4)).

IV. Conclusion

The *ultra vires* doctrine, to the limited extent that it has been preserved by s 15A(3), will still be available to the company and its shareholder as a means of controlling a director's abuse of his fiduciary position. This, of course, presupposes that practitioners will not adopt the short form of memorandum. More significantly, and apparently unforeseen by the legislature, if objects are not stated in a company's memorandum, the shareholders will lose not only the limited protection afforded by the *ultra vires* doctrine, but also the ability to bring an action for breach by a director of his duty to act in the interests of the (now undefined) company. The incorporation of a company is, as a consequence of the amendments, perhaps one circumstance where a client's interests are best served if his or her solicitor chooses not to take the easy way out but includes appropriately drafted objects in the company's memorandum.

— *Roger Partridge.*

THE EFFECT OF PART TWO OF THE INCOME TAX AMENDMENT ACT (No.3) ON TRANSFERS OF TRADING STOCK PURSUANT TO MATRIMONIAL AGREEMENTS

During its first reading, Part II of the Income Tax Amendment Bill (No.3) 1983 was hailed as "...a reform of incredible social significance ... a great step for marriage": Ruth Richardson (Govt., Selwyn) 454 NZPD 3502 (28 Oct. 1983).

The fostering of nuptial bliss would to most minds lie far from the generally conceived aims of revenue legislation. Why, then, was the Income Tax Act 1976, the fount of much of the economic and fiscal regulation in this country, amended to provide for social or matrimonial reform?

The answer appears to derive from the philosophy underlying the Matrimonial Property Act 1976: the recognition of marriage as a partnership of equals and of equal contribution. Inter alia, the Matrimonial Property Act allows for the determination of spouses' property rights by agreement (s 21) or order (s 25). The rights of a couple's children may also be considered (s 26) when an order is made.

However, the estate and gift duty and income tax ramifications of these matrimonial arrangements were not legislatively considered until the introduction, on Budget night (27 July) 1983, of the Estate and Gift Duties Amendment Act 1983, which provides an exemption from gift duty and an exclusion from dutiable estates of those transfers of matrimonial property made under the Matrimonial Property Act.

Until that date, the apparently "free" dispositions of property under the matrimonial property legislation were in fact dispositions with strings attached. Those strings formed part of the State's tax net which caught the disposition of income-earning property. The revenue statutes clearly inhibited the fulfilment of the aims of the Matrimonial Property Act 1976.

Half of the reform, aimed at removing the tax-based disincentives, has been mentioned above. Part II of the Income Tax Amendment Act (No.3) 1983 is the complement. It purports to remove any possible tax liability or disadvantage which may otherwise have arisen on a transfer of matrimonial property between husband and wife or a transfer of property between a couple in contemplation of marriage.

It is indeed heartening to note that Government views the resulting loss of state revenue as a small price to pay for the recognition of marriage as a partnership of equals.

The twenty sections which comprise Part II appear to achieve, with the usual prolixity, their desired ends. One aspect of the legislation, however, deserves closer scrutiny, as it may be less than a complete reform — namely, the matrimonial transfer of trading stock.

By way of foreword, the intended exemption from liability is applicable to transfers of matrimonial property where the agreement or court order was made on or after 28 July 1983. The scheme of the legislation, in most instances, is to allow transfers of income-earning assets under the Matrimonial Property Act to be deemed a conveyance at the value at which the property is recorded in the transferor's books of accounts. The recipient spouse is deemed to have acquired the property at that price and is therefore assessable on any profit which is made on it subsequent disposal.

An important exception to this scheme is found in a new proviso to s 65(2)(a) which plainly declares that the valuation of trading stock (including livestock) in these circumstances is to be solely by reference to the new code on valuation in s 91A. This section is thought to oust the Commissioner's discretion to value stock which has been transferred at inappropriate values. The concurrent amendment to s 90(3) and the new s 91(4) tend to confirm this view. Their effect is to exclude the Commissioner's power, first to treat a disposal of trading stock under a matrimonial agreement as a sale at retail (s 90(3)), and secondly to re-assess the consideration given for the transfer where the quid pro quo is seen to be inadequate (s 91(4)).

The new valuation code in s 91A recognises three different situations in which these transfers may occur:

1. Section 91A(2)(a): Where the stock transferred was used in the transferor's business and was recorded as "opening stock" in the books of account, the transfer value is deemed to be the greater of —

(i) the opening book values

(ii) the value adopted by the recipient spouse as his or her cost price, market selling, replacement or standard value.

2. Section 91A(2)(b): Where the stock was acquired by the transferor during the part of the financial year before the matrimonial division of assets occurred, it is deemed to have realised its purchase price.

3. Section 91A(2)(c): Where the stock was not used by the transferor in his business, it is to be given a value equal to cost price.

There can be no doubt that if, in the first example, the transferee adopts a higher value of the stock that had appeared in the transferor's books, a tax liability will arise in the hands of the transferor. This result was admitted to be correct during the first reading of the Bill in Parliament (John Falloon, Associate Minister of Finance, 454 NZPD 3498 (28 October 1983). It is suggested that this anomaly arose because of the need to allow the transferee to bring the new stock into the accounts at his or her current valuation for like stock.

Therefore, in the case of a matrimonial transfer of weaner Friesian bulls, if the recipient's approved standard value is $50 a head and the transferor's value is $40, the $10 difference per head transferred will form part of the transferor's income from farming activities.

Transfers of livestock, as described, appear straightforward because the approved standard values of each spouse for the same animal will often be roughly equivalent. The contingency of a transfer during a period of progressive writing down to standard is fully dealt with in s 86(2A).

Where the transfer is not of livestock, very different considerations apply. Since a transferee in this situation is not bound to apply a standard value to the stock received, it is suggested that the valuation adopted by him or her will depend largely on the nature of the matrimonial disposition.

In situations of matrimonial discord which frequently attend a division of matrimonial property by court order under s 25(2) of the Matrimonial Property Act, the recipient spouse may adopt a stock value under s 91A(2) which provides the greatest advantage in terms of tax savings and accounting practice. Row 3 of the Table appearing at the end of this note illustrates that this object is best achieved, in most instances, by adopting market selling price as the transfer value. (Public Information Bulletin No.82 (Inland Revenue Dept.) indicates that the Commissioner will accept the price at which goods will be sold at a later date. This may be a higher figure than present market selling price). It could be argued that, in adopting this alternative, the transferee spouse might derive smug satisfaction from the knowledge that the transferor spouse has been burdened with the entire tax liability attributable to the transfer.

If relations between transferor and transferee are especially bitter, the transferee might want to value the stock so transferred at grossly inflated prices. Eventually this stock will be sold at a loss, as shown in Row 4 of the Table. The unfortunate transferor sustains an artificially heavy tax liability whilst the transferee is able, by this chicanery, to claim a tax loss. The latter scheme would be most successfully employed when the subject matter of the transfer has a value which is difficult to determine objectively, for example works of art including antiques, paintings, fashion clothing or jewellery.

The statute apparently fails to prevent the inequitable results which stem from an abuse of rules which were designed to foster rational determination of matrimonial property rights. It is suggested that the potential disservice illustrated in Row 4 of the Table may be overcome by enacting a proviso to s 91A(2) in the following terms:

Provided that where the transferor objects to the value adopted by the transferee under s 91A(2)(a)(ii) the transferor may, by notice in writing within 12 months of the date of the matrimonial agreement, request the Commissioner to determine the price which the trading stock is deemed to have realised.

The above proviso would be necessary in circumstances where the division of property is at the behest of one spouse, typically under s 25(2) of the Matrimonial Property Act 1976. A division of matrimonial property for any other reason will generally be instituted with the full agreement of both spouses and their co-operation will usually forestall any dispute over valuation. Co-operation will ensure the adoption of a transfer value which suits the couple, and not simply the recipient.

It is suggested that where the division of property is amicable the transferee spouse will adopt the "cost price" alternative, as illustrated in Row 1 of the Table. The advantages for the couple are that there will be no need for a revaluation of the stock transferred and income splitting is maximised. That is, half of the profit on sale of a business' stock will be earned by the husband and half by the wife, where the agreement provides for a 50:50 division.

Valuation at replacement will usually allow the transferee to adopt a value part way between cost and market selling price. In times of rising prices the expense of replacing goods and restocking shelves will be greater than the expense incurred in acquiring the stock presently on hand. This option will allow a finer tuning of the income splitting process. Row 2 of the Table illustrates this concept. In the example, the recipient spouse may find that he or she is placed in a higher tax bracket if the consequent tax liability on the stock acquired is greater than $10,000. Adoption of a replacement value of $40,000 will allow some degrees of income splitting (75:25) without the disadvantage of the recipient spouse's being placed in a higher tax bracket.

On the one hand the new provisions relating to those transfers of trading stock pursuant to matrimonial agreements facilitate the splitting of a couple's income while they remain on good terms. But on the other hand if the relationship sours, the Statute may well provide an effective weapon in the armoury of a bitter spouse. Could the Member for Selwyn have foreseen this result when, during the Bill's first reading (*supra*, 3502) she stated: "I hope the professions understand the reform and advise their clients accordingly..."?

TABLE

An antique shop owned by the husband has stock valued at cost of $60,000. Current retail value of that stock is $100,000. To restock the shop would cost $80,000. Half of the business is transferred to his wife. The wife, however, values the stock at $140,000.

	COST (½ x 60,000)	TRANSFEREE'S ADOPTED VALUE	ASSESSABLE INCOME TO HUSBAND	RETAIL VALUE (½ x 100,000)	ASSES-SABLE INCOME TO WIFE
Cost (½ x 60,000)	30,000	30,000	Nil	50,000	20,000
Replacement	30,000	40,000	10,000	50,000	10,000
Market Selling	30,000	50,000	20,000	50,000	Nil
"Odium" Value	30,000	70,000	40,000	50,000	(20,000) **tax loss**

— *David Nicoll.*

THE INDUSTRIAL RELATIONS AMENDMENT ACT 1983

I. Introduction

On the 1st of February 1984 the Industrial Relations Amendment Act 1983 came into force, ending compulsory unionism. This note will briefly outline the Legislative changes that lead to the introduction of the 1983 Amendment, and then discuss the specific changes the Amendment makes in the law.

II. A Short Legislative History

In 1894 the Industrial Conciliation and Arbitration Act (hereafter the I.C.&A. Act) laid the foundation for the future industrial relations system in New Zealand. The I.C.&A. Act was entitled 'An Act to encourage the formation of industrial unions and associations and to facilitate the settlement of industrial disputes by conciliation and arbitration.' It defined "industrial matters", and provided for the compulsory conciliation and arbitration of disputes arising out of such matters. The I.C.&A. Act was intended to provide — as Brian Brooks suggests in *Trade Unionism in New Zealand* (Heinemann, 1975, at p.7) — a complete code for the conduct of industrial relations, and, by so doing, end the need for strikes and lockouts.

There was no compulsion to join a union which was registered under the I.C.&A. Act. Preference provisions could be included in awards or registered agreements between employers and workers, however. Preference provisions were clauses in an award or agreement that required the employer to give priority of employment to union members over equally-qualified non-union members. The Arbitration Court upheld the inclusion of preference clauses in awards despite resistance. In *Taylor and Oakley v Edwards* (1900) 18 NZLR 876 the right of the Arbitration Court to include in an award an order that employers shall give preference to unionists over non-unionists was challenged in the Court of Appeal. The three man bench unanimously upheld the power of the Arbitrarion Court to include such a clause.

In 1900 the I.C.&A. Act was amended and s 2 of the consolidating Act redefined industrial matters to include "the claim of members of industrial unions of workers to be employed in preference to non-members." This gave statutory force to the decision in *Taylor's* case. Following this decision there were several attempts by unions to have compulsory union membership clauses included in their awards. In *Magner v Gohns* [1916] NZLR 529 the Court of Appeal rejected such a clause as being outside the powers of the Arbitration Court under the I.C.&A. Act. In *Federated Seamans Union v Sandford* [1930] NZLR 460 the Court of Appeal upheld their previous decision in *Butt v Frazer* [1929] NZLR 636 and were of the view the I.C.&A. Act did not give the Arbitration Court the power to include anything more than a qualified preference clause in an award or agreement registered under the Act.

The first Labour Government introduced compulsory unionism. Section 318 of the Industrial Conciliation and Arbitrarion Act 1936 provided that:

> it shall not be lawful for any employer bound (by an award or industrial agreement) ... to employ or to continue to employ in the industry to which the award (or agreement) relates any adult person who is not for the time being a member of an industrial union of workers....

Compulsory unionism remained unaffected by legislation until 1961. During the 1950's, the National Government had advocated a legislative end to compulsory unionism, however no firm commitment was made by the National Party until 1960. The promise of voluntary union membership was given effect in 1961 but sincere advocates of a voluntary system of union membership were disappointed. The legislation of 1961 ended compulsory unionism as established by the I.C.&A. Act 1936. But under the new amendment parties to an award or agreement registered under the Act were free to include an unqualified preference clause in any award or agreement so registered. The effect of such a clause was that any worker not being a member of a union bound by the award had to become a member of that union within fourteen days of that worker's commencement of employment, and remain a member for as long he or she continued in a position of employment. The failure of a worker to join the union was a breach of the award or registered agreement by both the worker and the employer.

Compulsory unionism continued because virtually every union had an unqualified preference clause in their respective awards or agreements. The alternative qualified clause, which gave priority to unionists but did not exclude non-unionists where employment was available, was completely ignored.

In 1973 the Industrial Relations Act absorbed and replaced the I.C.&A. Act 1954. The Labour Government of that year made substantial changes to the industrial relations legislation but did not feel any need to change the union membership provisions. The National Government introduced further changes with the Industrial Relations Amendment Act 1976. The Minister of Labour was given the power under ss 101A to 101H of that amendment to require a postal ballot to be held of every adult worker in any selected union on the question of whether they wished to retain an unqualified preference clause in their governing award or agreement. The Minister was given the power to find out the "real" opinion of union members on compulsory union membership.

The Industrial Relations Amendment Act 1982 extended the ballot provisions. Under s 101CA union members could apply to the Registrar of the Arbitration Court for a ballot on unqualified preference. The enforcement of any unqualified preference clause was no longer a matter for the Inspector of Awards. By virtue of s 103AB the burden of enforcement proceedings was shifted onto the union.

In practise none of these legislative changes altered the status of compulsory unionism. Not one ballot favoured the removal of an unqualified preference provision. The majority of union members were happy with union membership. It should also be noted that under s 105 of the Industrial Relations Act 1973 there was provision for exempting workers from joining a union where they showed a genuine and conscientious objection to union membership on religious or other grounds.

III. Arguments In Favour Of Voluntary Unionism

The more recent advocates of voluntary unionism have rested their argument on two basic principles: individual freedom and freedom of association. The Minister of Labour has stated, in "Reasons for Voluntary Unionism 1983" (*Voluntary Unionism* ed. Peter Brosnan, Industrial Relations Centre, Victoria University Wellington, p 24) that the central issue is one of freedom of choice. Various other arguments in favour of voluntary unionism have been put forward. There have been claims that unions are run by irresponsible minorities not reflecting the majority viewpoint, and that voluntary unionism will change this situation. It is not within the ambit of this article to canvass and analyse the relative merits of such views — it is intended, however, to discuss whether the new Amendment does uphold the basic principles its proponents advocate.

IV. The Industrial Relations Amendment Act 1983

The Act covers all sectors of employment excluding professional bodies. It must be assumed professional bodies do not have compulsory membership or that they are being unduly prejudiced by not having the benefit of the new legislation. Their members have not been clamouring to be included under the auspices of the Act. It might be argued that if the principles of freedom are so compelling, the legislation should be extended to cover professional bodies and such organisations as students' unions, or associations, many of which effectively have compulsory membership although admittedly arising out of differing circumstances and statutes.

Section 5 of the 1983 Amendment repeals ss 98A to 112A of the principal Act. These sections include all the requirements relating to preference clauses, the ballot provisions and the exemption from union membership provisions. Sections 99 to 102, and 103A to 103G are substituted by the Amendment for the repealed sections.

Section 99(1) states that:

> Nothing in any award or collective agreement shall require any person,
> a) to become or remain a member of any union or,
> b) to cease to be a member of any union or,
> c) not to become a member of any union.

Section 99(2) provides that any such clause shall be of no effect. By virtue of s 100, it is unlawful to provide preference in obtaining or retaining employment or in terms or conditions of employment on the basis of regard to that worker's membership or non-membership of a union. Discrimination by employers against an individual worker on the basis of regard to that worker's membership, intended membership, or non-membership of a union is prohibited: s 101. This section covers four specific areas:

a) Refusal or omission to employ any person;

b) Dismissal or subjection to detriment;

c) Redundancy;

d) Determination of the formula that will be used to assess compensation for redundancy.

The existence of preference is now not even a matter for bargaining, it is totally prohibited. Previously, the inclusion or non-inclusion of preference was a matter for negotiation.

In her submissions to the Special Parliamentary Select Committee (Industrial Law Reform Bill), Ms. M.A.Wilson suggested that the immediate result of the Act would be the introduction of closed shops. If this is so, then individual freedom will be curtailed in certain industries to a greater extent than before the new Amendment. Ms. Wilson believes that unions' ability to negotiate will be weakened and this will mean they can offer less protection to individuals, consequently workers' standards of living and working conditions will drop. She also points out that ss 99, 100 and 102 will be a source of industrial conflict, because the benefits of union action will be equally shared by unionists and non-unionist alike.

The problem of "free-riders" in the work place may prove significant. It amounts to an inequality imposed by statute, as an employer is not free to provide benefits to unionists alone, while they carry out all the negotiation. Where a union exists, non-unionists are not given the freedom to make their own bargains, and will have to accept the conditions negotiated by the union. In practise, this situation could prove unworkable.

The discrimination provisions may not protect individual rights to the extent envisaged. How will an individual worker prove he or she has been discriminated against in all but blatant cases? The level of proof required is unclear, particularly in regard to s 101(b). Does subjection to detriment mean only subjection to financial and promotional disadvantage? Will it include cases where workers are given less favourable working conditions than their fellow workers (e.g. more noise, more dirt, etc)? A worker can be subtley subjected to detriment and proof of such discrimination will be very difficult.

It is noteworthy that the European Court has denied the legitimacy of a closed shop situation. In *Young, James & Webster v United Kingdom* [1981] IRLR 408, Young et al were employees of British Rail which had a closed shop agreement with various unions. They refused to join those unions and were dismissed as union membership was a condition of employment. The European Court held this was a breach of Article 11 of the Convention on Human Rights.

The Article stated:

> Everyone has a right to freedom of peaceful assembly and to freedom of association with others including the right to form and join trade unions for the protection of their interests.

The Court said trade union freedom involved freedom of choice as to whether a person belongs to an association or not. In a closed shop, the negative aspect of freedom of association — i.e. the right to choose not to belong — was denied. This decision supports the principles that have been suggested as being behind voluntary unionism. But it is not clear that the European Court would have made the same decision where a negotiated unqualified preference clause was at issue.

Under s 102 the Arbitration Court (or its Registrar as the case may be) can not make any award or register any collective agreement that contravenes ss 99-100. Where such an agreement is registered, it has no force: s 102(2).

It is an offence to exert undue influence upon a person on the question of whether that person should or should not be a union member: s 103. Section 103(2) provides a series of graduated penalties depending on the status of the inducer. Under s 103(2)(a) an individual is liable to a $300 fine, while s 103(2)(d) provides if a union or employer is involved the penalty is up to $3000. In the past the New Zealand system has been one of conciliation and the imposition of fines will not assist harmonious industrial relations. The law might have been more concerned with entente and communication than penalty and fault. This is particularly true of ss 103A to 103G, where further penalties are imposed for breaches of s 101, for breaches of reinstatement orders under s 103C, and for strikes and lockouts under ss 103D and 103E.

Section 103D creates a statutory tort. Any worker who strikes to induce an employer to breach s 101 is liable to a $5000 fine (s 103D(1)), as is an employer who stages a lock-out to affect issues of union membership (s 103D(2)).

These provisions give the Arbitration Court wide powers and allow the imposition of heavy penalties. Section 103F provides the Arbitration Court with full and exclusive jurisdiction to deal with all actions under ss 103D or 103E. Similar provisions are included in the other penalty sections. Further, the Court no longer has to consist of a Judge, an employers' representative and a union representative. For the penalty sections, the Judge has been empowered to act alone. The acceptance of decisions that are not seen as joint worker/employer determinations may be less readily forthcoming. The practical application of these sections may be difficult.

The personal grievance provisions of the principal Act are amended by s 9 which adds ss 117A to 117F. The alternative procedure under s 117A applies to any worker who is covered by an award or agreement but is not a member of a union or party to an award or agreement.

The effect of this section is that a worker or group of workers who are not parties to an award or agreement could create a dispute on the interpretation of such an award or agreement and have that agreement changed or interpreted in a manner not agreed upon by the original parties. The freedom of those parties to reach mutually acceptable agreement is abrogated by third parties, who can accept the benefits of such an agreement but may not be prepared to suffer any detriment. Such a provision holds within it a source of industrial conflict.

Section 96 of the principal Act has been amended by s 3 of the amendment Act. The statutory right of entry of a union's authorised representative onto a work site under an award has ended. To secure the effective operation of any award the Court may include an entry provision. But otherwise the right of entry is an industrial matter as defined in s 2 of the amendment Act, and therefore is subject to revocation or amendment by the Court. Furthermore, by virtue of s 13 of the amendment the right to entry by a union official under a collective agreement has also become an industrial matter, subject to negotiation. The purpose of the change is unclear. In the past most union officials notified employers when they intended to enter the work place and their right of entry was not abused. The new provision may mean that where unions are weak the representative's right of entry may end. This could further weaken the effectiveness of the union. The provision was unnecessary. It has the capacity to be used to prevent free and effective representation and is not a section that is truly aimed at ensuring voluntary unionism, but rather at undermining effective union representation, giving credence to K.G.Douglas' comment that "... effective unionism is the real issue, not voluntary or compulsory union membership." ("Implications of Voluntary Unionism: The Union Perspective," *Voluntary Unionism*, *supra*, p 34.)

Finally, the amendment repeals statutory restrictions on union membership subscriptions, while maintaining the present restrictions on special levies. This is a good change allowing more freedom for unions to assess their own needs and levy accordingly. The existence of voluntary unionism will act as a bar to excessive subscription unless closed shop situations develop in which the provisions are capable of abuse.

V. Conclusion

The practical implications of the amendment are as yet unclear. So far, there has been no obvious movement away from unions. In cases where people have resigned from union membership, either their reinstatement has subsequently occurred or they have left their place of employment. The unions in a few instances have accepted the non-unionist as a conscientious objector and the dispute has been resolved in that manner. At the time of writing, the penalty provisions had yet to be invoked by employers or unions. Both sides appear to be unsure of the practical outcome of adopting a hard line by enforcing the Statute to its letter. If the law remains unchanged the conflict between organised labour, employer groups and non-unionised labour will centre on voluntary unionism. For instance, during a strike or lock-out the ability of a union to keep its members will determine its ultimate effectiveness at the sharp end of industrial relations.

The Amendment has done more than introduce voluntary unionism: it alters wage fixing, award and agreement systems which have been long established. The old system has been changed by legislation, but the legislation has left unclear what the new parameters of the industrial system will be.

— *Ian Davidson.*