

# LEGISLATION NOTES

## TE TURE WHENUA MAORI ACT 1993

*The Maori Affairs Bill was introduced into Parliament in 1978 and enacted fifteen years later, making it the longest running Bill in the history of New Zealand.*

There is something offensive in the way Te Ture Whenua Maori Act 1993 (“the Act”) classifies *Tangata Whenua of Aotearoa* (“the First People of New Zealand”) as “the preferred classes of aliens”.<sup>1</sup> It diminishes the importance of *Whakapapa* (genealogy) - the basis of Maori social, political, and “legal” structures - the essence of being Maori. This classification does not accurately reflect the relationship Maori have to either the land or to each other. Instead, it reflects English concepts of land tenure relating to selling, transferring, leasing, or mortgaging land. This conflict of terminology and ideology exemplifies the inherent difficulty the courts face in trying to recognise traditional Maori concepts of land, in a way which is acceptable to Maori. The new alienation provisions of the Act, ss 145-150, give rise to a metaphorical eternal triangle: protection of Maori land in Maori hands, giving recognition to *Pakeha* (English) law, and at the same time allowing the Maori Land Court (“the Court”) to continue its judicial paternalism.

To any Maori landowner, this Act could well represent a continuation, albeit refined, of Dickensian policies which originated in the Native Land Act 1862. For many, it is a bitter irony that a succession of Native Land Acts which have been responsible for reducing the Maori estate to less than three million of the original 66 million acres, has finally resulted in an Act which seeks to protect what little land is left in Maori hands. For these people, the Act is at least 150 years too late.

### Kaupapa

The *kaupapa* (philosophy) of the Act is to ensure that owners of Maori freehold land (multiple-owned land held under the Act) retain it, so that it can be passed on to future generations. It is as well to remind ourselves that Maori have their roots in New Zealand and nowhere else. In the past, Maori have sought recognition of this from the various courts by consistently arguing that *their* use and control of *their* land be viewed differently from, but *not as less than*, ownership in Pakeha legal terms. The inability of the Courts to understand *tikanga Maori* (Maori custom) has resulted in the limited success of such arguments. Whether this continues under the new Act remains to be seen.

There are certainly safeguards within the Act aimed at ensuring the retention of land in Maori hands. The Hon Doug Kidd, the Minister of Maori Affairs, stated that the *kaupapa* of the Act is:<sup>2</sup>

[T]o ensure that [the] process of alienation does not continue ... [The Government has] moved away from alienation and ‘bleaching’ of Maori land, through the era of paternalism, to empowering owners in respect of their land .... Previous Government policies relating to Maori land have led to chronic fragmentation, but that need no longer paralyse future use and development.

- 1 Section 4. This term defines descent groups with Whakapapa links to Maori land that is to be transferred, sold, leased, or mortgaged.
- 2 Hon D Kidd, “Ministerial Address - Revitalisation of the Treaty - Reversing the Negative Trend in Maori Development and Participation”, Speech to the Conference of the Institute for International Research (18 March 1993) p3, 4, and 5.

Retaining their land is of paramount importance to Maori, because it is a resource which provides both an economic base and a source of spiritual *mana* (authority) binding the people together. It is essential, therefore, not only to preserve this base but to broaden it, thereby maintaining the identity, through land-based Whakapapa links, of its owners.

The New Zealand Maori Council (“the Council”) stated in a discussion paper on guidelines for legislation concerning Maori land that:<sup>3</sup>

The purpose of the Treaty [of Waitangi] ... was to secure an exchange of sovereignty for protection of rangatiratanga [chieftainship] .... [W]hile rangatiratanga may indeed mean ‘possession’, it also means ... the wise administration of all the assets possessed by a group for that group’s benefit: in a word, trusteeship .... Rangatiratanga, is, in short, the single most potent factor in Maori social organisation and the most effective catalyst for constructive change.

The Council’s objective in proposing the guidelines was:<sup>4</sup>

[T]o keep Maori land in the undisturbed possession of its owners; and its occupation, use and administration by them or for their benefit .... We do not propose the abolition of individual ownership in favour of communal ownership but we emphasise that the true benefit from fractional interests in Maori land can only be achieved by drawing these interests together.

The Council asserted that interests in Maori land should be recognised as being held in trust for future generations. These views have provided the basis for the principles set out in the Preamble to the Act. Section 2(1) states that it is Parliament’s intention that the Act be interpreted in a manner that best furthers those principles. Section 2(2) states:

Without limiting the generality of subsection (1) of this section, it is the intention of Parliament that powers, duties, and discretions conferred by this Act shall be exercised, as far as possible, in a manner that facilitates and promotes the retention, use, development, and control of Maori Land as taonga tukuiho [a treasure to be handed down] by Maori owners, their whanau [family], their hapu [sub-tribe] and their descendants.

In the event of any conflict between the Maori and Pakeha versions of the Preamble, the Maori version prevails.<sup>5</sup>

The Maori Land Court continues to exist under the Act. It is effectively, despite its billing as a court of record in s 6, a specialist tribunal.<sup>6</sup> Central to its new functions under the Act is the ability to include members who possess knowledge and experience of matters relating to tikanga Maori.<sup>7</sup> Despite this, and the direction in the Preamble that emphasis be given to *tino rangatiratanga* (unqualified exercise of chieftainship), “some will [still] regard the confirmation role of the Court as a continuation of paternalism”.<sup>8</sup> According to Judge Spencer, the challenge for the Court is “[t]o make the connection with Maori land law, a hybrid of traditional Maori values expressed (or interpreted paternally) through English equitable principles”.<sup>9</sup> In saying this, he articulates the underlying difficulties inherent in the Act.

3 New Zealand Maori Council, *Kaupapa: Te Wahanga Tuatahi* (February 1983) p4, 5, and 6.

4 *Ibid*, p10 and 13.

5 Section 2(3).

6 McGuire, “The Status and Functions of the Maori Land Court” (1993) 8 Otago ULR 125, 126.

7 See, for example, s 62. See also Hon D Kidd 533 NZPD 13658 (3 March 1993).

8 Mikaere, “Maori Issues” [1993] NZ Recent Law Review 308, 313.

9 Maori Land Court (Taitokerau District), *Panui*, Vol 6 No 7 July 1994, 3-4.

## Key Features

The Act both consolidates the Maori Affairs Act 1953 and builds upon it. It comprises some eighteen parts including: Part I (ss 6-49) dealing with the Court, Part IV (ss 99-121) dealing with the administration of estates, Part V (ss 122-128) dealing with the recording of ownership, Part VI (ss 129-144) dealing with the status of land, Part VII (ss 145-150) dealing with alienation, Part IX (ss 169-179) dealing with the powers of the assembled owners, and Part XII (ss 211-245) dealing with the land-owning trusts.

In the writer's view, there are four key features of the Act aimed at encouraging retention and utilisation of the land, and creating barriers to passing land out of Whanau control:

- (i) it establishes five land-owning trusts. This "allow[s] owners to arrest and roll back the process of fragmentation";<sup>10</sup>
- (ii) it requires 75 percent of the owners to agree before major changes are effected on or to the land.<sup>11</sup> Those alienating land must give the right of first refusal to assignees or transferees who belong to a "preferred class of alienee";<sup>12</sup>
- (iii) the Court *must* confirm dealings with the land;<sup>13</sup> and
- (iv) rigid quorum and voting requirements must be satisfied at any meeting of assembled owners.<sup>14</sup>

One notable feature of the Act is its inclusion of five new land-owning trusts. These are:

- (i) Putea Trusts (s 212): these deal with small land-holdings which are too difficult to administer or whose owners cannot be found. Only three have been ordered in the year ended 30 June 1994.<sup>15</sup>
- (ii) Whanau Trusts (s 214): these allow a family to consolidate land interests and share holdings. They must be formed with the consent of all owners. Seventy-two have been ordered.<sup>16</sup>
- (iii) Ahu Whenua Trusts (s 215): these are the equivalent of trusts formed under s 438 of the Maori Affairs Act 1953. They promote the use and administration of land in the interests of owners. One hundred and eleven have been ordered, compared with 432 trusts ordered under s 438 in the year ended 30 June 1993.<sup>17</sup>
- (iv) Whenua Topu (s 216): all or part of the land owned, its assets, and

<sup>10</sup> Hon D Kidd, *supra* at note 2, at p5.

<sup>11</sup> Section 228.

<sup>12</sup> Section 147(2). See also s 148.

<sup>13</sup> Sections 150-156.

<sup>14</sup> Sections 169-179.

<sup>15</sup> Department of Justice (Maori Land Court Division), Monthly Statistics for the year ended 30 June 1994.

<sup>16</sup> *Ibid.*

<sup>17</sup> *Ibid.* Cf Department of Justice (Maori Land Court Division), Monthly Statistics for the year ended 30 June 1993.

income are held under these trusts for community purposes. No individual may succeed to any interest under this trust. Three have been ordered.<sup>18</sup>

- (v) Kai Tiaki Trusts (s 217): these are to be set up for those who are disabled and unable to manage their affairs. Rights of succession are protected. Sixteen have been ordered.<sup>19</sup>

That Maori land legislation "has consistently been in direct contravention of the Treaty"<sup>20</sup> may explain the somewhat cautious approach of Maori in utilising the new trust provisions.

### **The Act in Practice**

Coming to the Court is the first step for Maori in the difficult process of protecting or otherwise dealing with their interests in Maori freehold land. Maori Land Court Registrars have provided valuable direction to Maori landowners as they seek information, not only on how to use the provisions of the Act, but, more importantly, on their various meanings and applications.

Court Registrars report that prior to the Act their clients were elderly Maori who had "returned home" looking for ancestral land on which to retire. However, since the passing of the Act, there has been an unprecedented level of interest and positive use of the Court by Maori to obtain information. In total, there have been 28,234 counter inquiries, 25,561 telephone inquiries, and 16,531 written inquiries (an 11 percent increase on the 14,933 written inquiries of the previous year).<sup>21</sup>

In addition, 103,468 new ownerships affecting 24,052 blocks of land have been recorded in the 1993-1994 year, only slightly down from the 114,423 ownerships affecting 24,867 blocks of land in 1992-1993.<sup>22</sup> Last year the Government reported that 10,123 blocks of Maori land remained unsurveyed. The Department of Justice is updating its listing of current owners in each block and plans to complete this exercise by December 1997.<sup>23</sup>

These achievements have not happened overnight. A typical search of the Court's land minute books takes on average three months. Because many Maori do not have the necessary skills to make searches of this nature, Court Registrars, particularly at Taitokerau, are now offering free training to clients. If information is accessed showing entitlement to an interest in Maori freehold land, families then have to identify, locate, and establish contact with other presumed owners - a lengthy process not without its frustrations. Once the documentation is completed, it must be registered for a hearing which may demand many appearances, depending on the complexity of the task and on the number of owners who desire to be heard. The application must then be ratified by the Court which is charged with ensuring that the particular proposal before it is in the best interests of all the owners, and that 75 percent of them are in agreement.

Interestingly many inquiries to the Court begin as requests from Maori seeking to find their ancestry through its official land records. Entitlement to interests in Maori freehold land is of secondary importance.

18 Department of Justice (Maori Land Court Division), *supra* at note 15.

19 *Ibid.*

20 Mikare, *supra* at note 8.

21 Department of Justice (Maori Land Court Division), *supra* at note 15.

22 *Ibid.* Cf *supra* at note 17.

23 (1993) 16 TCL 10/3.

## Conclusion

The Maori Land Court's role has always been contradictory. In 1862 it was established to convert Maori communal title to individual title, in order to make land more easily available to individual Pakeha buyers. The processes of the Court have been instrumental in destroying traditional Maori society, while at the same time purporting to protect its land-base.

Under the new Act there is a significant (if rather late) about-face. Today, the Court is the first resort for Maori seeking to protect their land entitlements. The Preamble to the Act, explicitly recognises the Treaty of Waitangi as the basis upon which to ensure retention of Maori land in Maori hands.<sup>24</sup> Increasing numbers of Maori are using the Court for this purpose.

While the outer parameters of the Act are still largely untested, Judge Spencer has stated: "[It] will surely, on its second anniversary, justify further comment!"<sup>25</sup> The last word, however, belongs to the Hon Doug Kidd who in 1993 speculated:<sup>26</sup>

[W]hat would be the social and economic status of rural New Zealand today if all landowners had been cursed with the system imposed upon Maori land[?] New Zealanders of European descent might have been poorly reflected in statistics if they found themselves in the same position.

What indeed!

*D C Webster\**

\* The writer's tribal affiliations are Ngati Mahanga, Ngati Whawhokia, Ngati Te Weehi, Waikato, Tainui.

## THE FILMS VIDEOS AND PUBLICATIONS CLASSIFICATION ACT 1993

The Films Videos and Publications Classification Act 1993 ("the Act") is the culmination of a law reform process which began with the appointment of the New Zealand Ministerial Committee of Inquiry into Pornography in 1987. The aim of the process was to enact:<sup>1</sup>

A simplified, coherent classification regime [which] should be more accessible by the public, provide a much clearer description of the kinds of material that should be prohibited or restricted, and enhance enforcement of the law.

The impetus for reform came not from the conservative right but from feminist concerns about the degradation, objectification and commodification of women in sexually explicit material. During the Committee's inquiry, women's groups

<sup>24</sup> McGuire, *supra* at note 6, at 142-143.

<sup>25</sup> *Supra* at note 9, at 4.

<sup>26</sup> *Supra* at note 2, at p5.

<sup>1</sup> Hon W Jefferies, "Foreword" to Department of Justice, *Censorship and Pornography: Proposals for Legislation* (October 1990).

dominated submissions and the final report of the Committee stated that it placed itself “in the middle of feminist thought”.<sup>2</sup>

During its first reading the Bill gained unanimous approval. Elizabeth Tennet, MP for Island Bays, summed up the mood of the House when she commented:<sup>3</sup>

In my view, public opinion has moved against pornography and, in fact, this Bill is catching up with it. I believe that it is the role of legislators to move against pornography: to say that it is wrong and damaging, and to advance a framework of legal constraints to promote attitudinal and ongoing moral constraints .... [T]his legislation has to make New Zealand a safer place for women and children.

The clear expectations of this Act are that it will bring consistency to, and strengthen, our classification legislation. The first of these aims is uncontroversial but the latter has given rise to concerns. One writer warns that the Act “tilts the balance towards illiberal repression”.<sup>4</sup> There are also fears that the new regime will result in a ban on serious discussions of unpalatable topics.

### Administrative Changes

The three existing censorship bodies, the Indecent Publications Tribunal, the Video Recordings Authority, and the Chief Film Censor, are unified in an Office of Film and Literature Classification (“the Office”). The Office will consist of a Chief Censor, a Deputy Chief Censor, and nine Classification Officers, whose function is to determine the legal status of publications submitted to it. No special qualification is required for a position in the Office, but the Minister of Internal Affairs, who appoints the Chief and Deputy Chief Censors with the concurrence of the Ministers of Women’s Affairs and Justice, is to have regard to the person’s knowledge or experience in the matters likely to come before the Office.<sup>5</sup> A person may be appointed for any period up to three years.<sup>6</sup>

The Office will not function as a tribunal. An unmodified adversarial approach, such as that used by the Indecent Publications Tribunal, was considered, with good reason, to be impractical and a relic of an earlier and simpler age.<sup>7</sup>

In 1964, the first year of the Tribunal’s operation, it considered seven novels, including *Another Country*, by James Baldwin, *No Adam in Eden* by Grace Metalious and *Lolita* by Vladimir Nabokov. In 1988, the Tribunal made classification decisions upon nearly 800 written works, the vast majority of which were magazines containing photographs of people in various sexual poses .... The proliferation of these types of materials since 1964 has made the Tribunal’s present task, and its adversarial style of operation ... unmanageable.

Accordingly, the Office’s procedure is now submissions-based and written reasons must accompany its decisions.<sup>8</sup> A Film and Literature Board of Review (“the Board”) was set up to hear applications for review of the Office’s decisions. The Board consists of nine members, appointed by the Governor-General on the

2 *Pornography: Report of the Ministerial Committee of Inquiry into Pornography* (1989) (Morris Report) 60.

3 532 NZPD 12762 (2 December 1992).

4 Dugdale, “Films Videos and Publications Classifications Bill” [1993] NZLJ 16, 17.

5 Section 80(3). Section 80(4) requires the Chief Censor to have regard to the same considerations in appointing Classification Officers under s 80(2).

6 Section 81(1).

7 Morris Report, *supra* at note 2, at 96-97.

8 Section 38.

recommendation of the Minister of Internal Affairs, again acting with the concurrence of the Ministers of Women's Affairs and Justice.<sup>9</sup> The President of the Board must have held a practising certificate as a barrister or solicitor for at least seven years,<sup>10</sup> but otherwise the criteria for membership are the same as for the Office.

These reforms are sensible and should avoid the labelling inconsistencies that occasionally occurred under the old system, for example, when the film, *Henry, Portrait Of A Serial Killer*, was banned by the Chief Film Censor, but passed by the Video Recordings Authority.

It is obvious that the Government will take a keen interest in the new regime. The appointment of the Chief Censor and Deputy Chief Censor is no longer a matter for the public service, but is now under ministerial control. This increased political interest in censorship is typified by the comments of Bay of Islands' MP, John Carter:<sup>11</sup>

[W]e do not want the legal fraternity to interpret this legislation with its own values ... and we must ensure that we do not allow a liberal interpretation to be presented .... While there is scope for [the censors] to ... exercise their judgment responsibly within the guidelines, there are clear signals of the standards that we expect the censors to apply .... [The legislation] ensures that the censors will be more accountable to the Government for their decisions than ever before.

Whether this is a statement of serious intent or merely political grandstanding is difficult to ascertain. Nothing in the appointments made thus far indicates a particularly pronounced pro-censorship slant, but it is not unknown for censors to come under considerable political pressure when their decisions are seen as out of line with community expectations. For example, Arthur Everard, who as Chief Film Censor did not ban a single film, was effectively fired by an amendment to the Films Act which limited the term of censors.<sup>12</sup>

The Act establishes an Information Unit to supply the Office with research services, and to disseminate to the public information about the Office and its procedures.<sup>13</sup> It will provide a public forum for complaints and a screening device to ensure that the Office is not inundated. Where unclassified material is brought to the Office by the public, the Unit will be able to recommend which pieces of material require classification.

The Information Unit represents implementation of the Morris Report's call for education and censorship to work together.<sup>14</sup> As well as giving the Office a higher public profile, it will monitor overseas legislation and case law. In practice, the efficacy of the Information Unit's research and education functions are likely to depend on finance. Nevertheless, its inclusion in the Act provides statutory recognition of the importance of public awareness and education in the censorship process.<sup>15</sup>

### Substantive Changes

While the ultimate standard of "injurious to the public good" remains, the term

<sup>9</sup> Section 93(2).

<sup>10</sup> Section 93(4).

<sup>11</sup> 536 NZPD 15986 (22 June 1993).

<sup>12</sup> Section 2(1) of the Films Amendment Act 1990 amended s 5 of the Films Act 1983.

<sup>13</sup> Section 88.

<sup>14</sup> *Supra* at note 2, at 157.

<sup>15</sup> Its importance can be gauged by the fact that the then Minister of Internal Affairs called it "the engine room" of the new legislation, Hon G Lee 532 NZPD 12768 (2 December 1992).

“indecent” has been replaced by “objectionable”. There is now a two-tiered system of classification. Section 3(2) sets out acts that *will* render a publication objectionable. Section 3(3) sets out factors which *may* render a publication not falling within s 3(2) objectionable.

Section 3 (2) states that a publication will be deemed objectionable if it:

[P]romotes or supports, or tends to promote or support,

- (a) The exploitation of children, or young persons, or both, for sexual purposes; or
- (b) The use of violence or coercion to compel any person to participate in, or submit to, sexual conduct; or
- (c) Sexual conduct with or upon the body of a dead person; or
- (d) The use of urine or excrement in association with degrading or dehumanising conduct or sexual conduct; or
- (e) Bestiality; or
- (f) Acts of torture or the infliction of extreme violence or extreme cruelty.

Any publication which does fall into these categories will not be considered with reference to the contextual matters normally considered by censorship bodies, such as the dominant effect of the publication as a whole and its purpose. Thus, artistic or literary merit will not enter into consideration. This is a very real concern. No-one can doubt that the items listed are objectionable, but it seems regressive to ban them without considering their context.

The key point will be the interpretation of “promotes or supports”. It seems possible to argue that any representation of one of the listed activities promotes it. The use of the word “supports” is also interesting. It was once said that “the highest moral offence a writer can commit ... [is] that of making an unworthy character interesting in the eyes of the reader”.<sup>16</sup> If someone writes a book about a charming, erudite, and much loved politician who is also a necrophiliac, does this support necrophilia? Should this be banned as supporting necrophilia? One of the defining characteristics of great art is that it presents the world in a different light and challenges our assumptions. Surely one of Nabokov’s greatest triumphs was making Humbert Humbert seem such a compelling character. In 1993’s controversial film, *Romper Stomper*, the same effect was achieved when a Nazi-worshipping leader of a thuggish street gang was portrayed as a charismatic and engaging leader. One hopes that common sense will prevail and that this section will not be used often, otherwise society may be denied the opportunity to give serious consideration to difficult issues.

Of chief interest in s 3(3) is the use of the word “demean”. Section 3(3)(a)(iii) directs the Censor to have regard to “sexual or physical conduct of a degrading or

<sup>16</sup> Chandos, “My Brother’s Keeper” in Chandos (ed), *To Deprave and Corrupt* (1962) 26.



dehumanising or demeaning nature”, while s 3(3)(c) concerns material which “degrades or dehumanises or demeans any person”.

“Demean” was added in the Select Committee phase and was designed to overcome the problems that have occurred with concepts such as “denigrating any particular class of the public”. The Morris Report summarised the rationale for this decision thus:<sup>17</sup>

To *demean* a class of people ... is to lower the *dignity* of that class. To *degrade* a class of people is to reduce that class to a lower rank .... We feel that to draw attention to the extent and degree to, and the manner in which a work *demeans* a class of people directs classifying bodies to take into account the perceptions of the people *in* that class about the work's effect upon them to a greater degree than may be invited by the use of the word “degrades”.

Thus there will no longer be concerns about whether a representational view of women can be said to denigrate women as a class. All that is required is that someone be demeaned. This may create some concerns of its own however:<sup>18</sup>

What will this demeaning mean? Is it simply there to dispense with pornography or will it have a wider application? .... Nobody would deny that Harvey's jerk-off aria [In the film, *Bad Lieutenant*, Harvey Keitel plays a policeman who at one stage masturbates while arresting two women.] was a demeaning one .... Will this also mean no more anti-gay jokes in Eddie Murphy movies? No more psycho lesbians? No more bimbos on our screens? No demonising the Japanese? No gags involving fat people? No more indigenous peoples in contentedly subservient roles? Can it possibly mean no more Peter Greenaway films in New Zealand? Is Utopia here?

Ignoring that the loss of the above may not grieve anyone, the concerns expressed do have validity. “Demean” is a vague word. Although it is just one factor to be taken into account, and although the context provisions of s 3(4) will still apply, the degree to which it is taken into account may well depend upon the identity of the Censor.

Under s 27 of the Act, the Classification Office is required to consider the means by which a restricted publication may be displayed.<sup>19</sup> These include sealing the item in an opaque package, only having it behind the shop counter, and making it available only to those who ask for it. Advertising it can also be banned.<sup>20</sup> This is a sensible balancing act between the individual's right to read material and the right of people not to be confronted by offensive materials.

Previous censorship legislation has not dealt with private possession. Section 131 now makes it a strict liability offence to possess an objectionable publication. This provision marks the seriousness of Parliament's intention to change attitudes. However, there could well be problems with enforcement, and one imagines that great public dissatisfaction may be caused by people being prosecuted for having objectionable material in their possession. This has been a far from a popular feature of the Act, with the New Zealand Law Society claiming that the “wrong that it is directed against does not outweigh the civil right it offends”.<sup>21</sup>

However, most of the Act's resources are still targeted at the public availability of materials, that is, against those who sell, hire, import, or manufacture objection-

17 *Supra* at note 2, at 91.

18 *Rip It Up*, No 192 July 1993, 4.

19 The Indecent Publications Tribunal has previously used such restrictions. See, for example, IPT Decision 16/93. It is now an offence not to comply with such restrictions.

20 Section 27(4).

21 “Porn debate centres on problem clause”, *New Zealand Herald*, 12 April 1993, section 1, 9.

able material.<sup>22</sup> It may well be that the value of s 131 will be more educative than anything else.

### Conclusion

Early indications are that this Act has not fully satisfied anyone. There are concerns that the new censorship criteria and the politicisation of the appointment process will result in a regime that erodes freedom of expression. On the other hand, feminists believe that the Act does not go far enough. They would like it to cover live shows and television and believe that the criteria of the Act do not give full enough expression to their concerns. It is said that fines, though increased, are still too low and that the system is still too inaccessible.

In either case, there is certainly considerable discretion residing in the Censor. As Caldwell notes:<sup>23</sup>

[I]mprecision unavoidably remains. It is thus the judgment and philosophies of the newly-established Office of Film and Literature Classification ... and the Film and Literature Board of Review ... that will define the direction and effectiveness of the new regime.

Just as the Indecent Publications Tribunal was seen as an indicator of a more liberal regime, so this Act may be seen as an indicator of a stricter regime. This may be its legacy, a signpost of where society stood after the permissiveness of the 1960s and 1970s had, at least to a degree, dissipated.

The Act makes some sensible administrative changes. Its effect on the substance of censorship decisions is yet to be determined, but the clear indicators are that the liberalism of the past will be curtailed.

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## THE HUMAN RIGHTS ACT 1993

The Human Rights Act 1993 ("the Act") is a somewhat misleading name for what is essentially anti-discrimination legislation. The statute is the result of an extensive reform process. The Human Rights Commission Act 1977 had been criticised for providing inadequate protection against discrimination and for breaching New Zealand's international human rights obligations.<sup>1</sup> The Act consolidates and amends the Race Relations Act 1971 and the Human Rights Commission Act 1977 (both of which are repealed by the Act).

<sup>22</sup> Sections 123-124.

<sup>23</sup> Caldwell, "Pornography - An Argument For Censorship" (1992) 5 *Canta LR* 171, 173.

<sup>1</sup> Chen, "The inadequacies of New Zealand's discrimination law" [1992] *NZLJ* 137.

The success of this reform can be judged not only by whether the Act answers the criticisms levelled at the previous legislative scheme, but also by the extent to which it evidences a coherent philosophy on the protection of human rights.

### Administrative Structure

The Act retains the Human Rights Commission (“the Commission”), and increases its functions and powers.<sup>2</sup> The Commission’s structure includes a Complaints Division which receives, investigates, and mediates complaints, and a Proceedings Commissioner who prosecutes unsettled complaints of substance before a Complaints Review Tribunal (“the Tribunal”). The Tribunal, which replaces the Equal Opportunities Tribunal, is an independent body comprising a chairperson and two other members appointed for each hearing by the chairperson from a panel chosen by the Minister of Justice. The functions of the Tribunal include adjudicating upon proceedings brought under the Act.<sup>3</sup>

The Complaints Division is required to attempt conciliation before referring complaints to the Proceedings Commissioner.<sup>4</sup> In the past, the Commission aimed to settle 90 percent of complaints.<sup>5</sup> To this end, the Complaints Division is empowered to compel attendance at a conciliation conference,<sup>6</sup> and to refer breaches of settlement terms to the Proceedings Commissioner.<sup>7</sup> If a complaint is not settled, the Proceedings Commissioner may bring civil proceedings before the Tribunal.<sup>8</sup> Where the Complaints Division decides the complaint is not one of substance, or the Proceedings Commissioner declines to take proceedings, complainants may themselves bring proceedings.<sup>9</sup>

In providing relief, the Tribunal may issue declarations, grant restraining orders, award damages,<sup>10</sup> make orders for specific performance, grant relief in accordance with the Illegal Contracts Act 1970, or grant such other relief as it thinks fit.<sup>11</sup> Awards for costs or damages can be enforced as if they are orders of a District Court.<sup>12</sup> The penalty for non-compliance with other remedial orders made under s 86 is a \$5000 fine.<sup>13</sup> The chairperson of the Tribunal also has the power to make interim orders preserving the position of the parties pending the final outcome of proceedings, if it is in the interests of justice to do so.<sup>14</sup>

This complaints procedure answers many of the earlier criticisms relating to the length of the mediation process, the powers of the Commission in negotiating settlements, and the remedies available to enforce orders and settlements.<sup>15</sup> One

2 Section 5.

3 Under s 123, there is a general right of appeal to the High Court.

4 Section 81.

5 Human Rights Commission and the Office of the Race Relations Conciliator, *Report for the Year ended 30 June 1992* (1992) 23.

6 Section 80 empowers the Complaints Division to issue a summons to parties to the complaint, to which s 20(1)-(3) and (5) of the Summary Proceedings Act 1957 applies as if it were a witness summons issued under that section. This power is a major advance on the conciliation process under the Human Rights Commission Act 1977. See Chen, “Reforming New Zealand’s anti-discrimination law” [1992] NZLJ 172, 177.

7 Under s 83, the Proceedings Commissioner can bring civil proceedings for such breaches before the Tribunal.

8 Section 82(1)(e).

9 Section 83(4).

10 Section 89 equates the jurisdictional limit of the Tribunal with that of District Courts under the District Court Act 1947 (currently \$200,000).

11 Section 86.

12 Section 121.

13 *Ibid.*

14 Section 95. This remedies the injustices caused by the inability under the previous legislation to make interim orders during the lengthy mediation process.

15 See Chen, *supra* at note 6, at 176-180.

impediment to efficiency, however, is the continued under-resourcing of the Commission. The Commission stated in its 1991 report that:<sup>16</sup>

In a time of financial stringency the Commission has been unable to apply extra funds to the problem [of an increased workload] and some delays have resulted. That some complainants, particularly those complaining of sexual harassment, must wait many months, even years, for their case to be completed, is of great concern. Little relief seems possible, however, when budgets continue to decline in real terms.

Under the Act, the jurisdiction of the Commission has increased from five to 13 prohibited grounds of discrimination, including such potentially large areas as age, sexual orientation, and disability. It is unlikely that resource allocation to the Commission will increase to the same extent, significantly restricting the potential of the Act. One wonders about the prevailing political commitment to human rights when protection from discrimination is compromised to such an extent by monetary considerations.

### Defining Discrimination

The Act does not define discrimination. Rather, a complainant must show they were the victim of discrimination on one of the grounds described in s 21, and that they were subjected to this discrimination while participating (or attempting to participate) in one of several public spheres in which such discrimination is prohibited. However, discrimination is permitted if it falls within a statutory exception relevant to the sphere in question.<sup>17</sup>

There are 13 prohibited grounds of discrimination. These include the established grounds of sex, marital status, age, religious and ethical belief,<sup>18</sup> colour, race, and ethnic or national origin.<sup>19</sup> The new grounds are disability, political opinion, employment status, family status, and sexual orientation.

The public spheres in which discrimination is prohibited are employment, partnerships, industrial and professional associations, qualifying bodies, vocational training bodies, access to places, vehicles and facilities, provision of goods and services, provision of land, housing and other accommodation, and access to educational establishments.<sup>20</sup>

Each section detailing a protected public sphere provides that it shall be unlawful to do certain acts, or to omit to do certain acts, *by reason of* any of the prohibited grounds of discrimination. Discrimination is by reason of a prohibited ground if, on the balance of probabilities, the prohibited ground was a substantial and operative factor behind the discrimination.<sup>21</sup>

The specific exceptions within each protected sphere are supplemented by a new "floating exception" provision. Section 97 empowers the Tribunal to declare that any otherwise unlawful discrimination is lawful if it constitutes a genuine occupational qualification (in relation to ss 22-41) or a genuine justification (in relation to ss 42-60). This section is not available to defendants at the earlier

16 Human Rights Commission and the Office of the Race Relations Conciliator, *Report for the Year ended 30 June 1991* (1991) 20.

17 Section 85 places the onus of proving this on the defendant.

18 Prohibited under the Human Rights Commission Act 1977.

19 Prohibited under the Race Relations Act 1971.

20 Sections 22, 36, 37, 38, 40, 42, 44, 53, and 57. A notable exception is immigration, which is specifically excluded from coverage by s 153(3) of the Act.

21 *Human Rights Commission v Eric Sides Motors Company Ltd* (1981) 2 NZAR 447, 456-457 (Equal Opportunities Tribunal).

conciliation stage, and can only be relied on upon application to the Tribunal, where it offers the flexibility to react fairly to unforeseen circumstances.

### **Prohibited Grounds of Discrimination**

In response to criticism of the narrow breadth of protection, the number of prohibited grounds of discrimination has more than doubled. Although some of the new grounds can be seen as long overdue, for example, physical disability, age,<sup>22</sup> and political opinion, the new grounds raise serious questions.

Little indication can be gained from the Act about the breadth of protection offered by the new grounds. Currently, any analysis must weigh the application of these progressive grounds in a broad range of public spheres against an extensive exception structure. The stage seems set for some surprising decisions. For example, the new ground of disability has potentially huge implications for discrimination in the areas of employment, professional associations, provision of goods and services, housing, and education. The utility of legislating in the face of such uncertainty remains to be seen.

The new grounds squarely raise issues of the role of human rights law and the nature of human rights themselves. The public reaction to the inclusion of sexual orientation as a prohibited ground of discrimination<sup>23</sup> highlights that the new grounds reflect a political conception of human rights that is more than just a status quo or moral consensus construction. In this respect the Act may be leading, rather than following, popular opinion.

### **Exceptions Within the Protected Spheres**

The aim of the exceptions is to strike a politically acceptable balance between the interests of victims of discrimination and those of providers in the various public spheres.

The conclusion seems to have been that, in order to protect the legitimate interests of providers, the exceptions must be as numerous as the new prohibited grounds are progressive. To use the ground of disability as an example, there are 11 sections detailing a variety of circumstances where discrimination on the basis of disability will not be illegal.<sup>24</sup> The same picture emerges for protection against age discrimination, where there are 13 separate exception provisions.<sup>25</sup>

This means that the wide declarations of protection in each public sphere are not so wide in effect. Although the exceptions are an attempt at balance, the number of exceptions show how much balancing of interests is needed for a progressive new ground to be politically acceptable: the new ground may be progressive, but the increase in protection is merely incremental.

Anomalies are created where exceptions allow discrimination on some grounds, but not others. For example, in the sphere of employment, where a position is for the purpose of an organised religion, discrimination is allowed on

<sup>22</sup> Age was introduced as a prohibited ground in 1992: see the Human Rights Amendment Act 1992. However, the protection given was very limited, and primarily a political response to an increase in the eligibility age for National Superannuation.

<sup>23</sup> Six hundred and forty out of 700 submissions to the Justice and Law Reform Select Committee on the Human Rights Bill dealt with the grounds of sexual orientation and organisms in the body capable of causing illness, which, at that stage, were not even in the Bill. These grounds were introduced by Supplementary Order at the Committee stage: see 536 NZPD 16741 (22 July 1993).

<sup>24</sup> Sections 25, 29, 36, 39, 41, 43, 48, 49, 52, 56, and 60.

<sup>25</sup> Sections 26, 27, 30, 36, 37, 39, 41, 48, 50, 51, 55, 58, and 70.

the basis of sex, but not on the basis of sexual orientation or family status.<sup>26</sup> Church administrators are thus able to continue to discriminate against women who wish to lead worship - but not against homosexual or married men. The aim of the exception structure is to strike a balance between competing interests, but it is difficult to see what balance is struck in such circumstances, or whether the inconsistent protection given advances the position at all.

As well as the prohibited grounds and protected areas machinery of the Act, there are specific sections relating to other forms of discrimination.<sup>27</sup> Preferential treatment in the interests of affirmative action or granted by reason of pregnancy or childcare responsibilities is allowed.<sup>28</sup>

### *Coburn v Human Rights Commission*<sup>29</sup>

In *Coburn v Human Rights Commission*, a superannuation scheme provided benefits to surviving spouses of members. While the central legal issue was not difficult - the scheme clearly discriminated on the prohibited ground of marital status - the case highlights several other difficulties.

Although the possible consequences of the decision were enormous,<sup>30</sup> Thorp J found no indication that the impact of the ground of marital status had been considered by Parliament.<sup>31</sup> The Act simply adopts a progressive stance in relation to marital status, and leaves the finer details of policy to the Courts. Thorp J recognised that the judicial forum was inadequate to accumulate the facts needed and to balance the interests of unmarried couples, same sex partners, single people, and the recipients of the spousal pensions - predominantly women who had sacrificed any opportunity they had for employment to move to company-towns with their spouses.<sup>32</sup> Small wonder his Honour called for a "legislative rather than judicial determination of at least the central issues".<sup>33</sup>

The case also illustrates the remedial freedom available to judges. The solution was an unusual remedy - a prospective order that amendments made to effect compliance with the Act should apply only to benefits deriving from contributions made on or after 1 February 1994 (the date on which the Act came into force).<sup>34</sup>

Despite the expense of litigation, such test cases may be effective tools for the resource-starved Commission. The effects of this decision will be significant - as will the gains made in education and publicity about the Act.

### Conclusion

The Act can be evaluated in a number of contexts. From an initial report recommending change in 1987<sup>35</sup> to its passing in 1993, the Act was developed within a prevailing liberal ideology, emphasising freedom to determine one's own behaviour and destiny.<sup>36</sup> This ideology's rigid adherence to equal treatment ignores structural inequalities resulting from past prejudices,<sup>37</sup> and the contradic-

26 Section 28.

27 See ss 61-69.

28 Sections 73 and 74.

29 High Court, Auckland. 3 June 1994 M1947/93 Thorp J.

30 *Ibid*, p3.

31 *Ibid*, p49-50.

32 *Ibid*, p72-73.

33 *Ibid*, p73.

34 *Ibid*, p66.

35 Report to the Minister of Justice by the Human Rights Commission, *Review of the Human Rights Commission Act 1977* (1987).

36 Kelsey, *Rolling Back the State* (1993) 16.

37 *Ibid*, 305.

tion in asking the disempowered to operate as equals on a white male able-bodied heterosexual playing field. The Act largely reflects this emphasis on equal treatment.<sup>38</sup>

The limitations of anti-discrimination law should also be recognised. Its focus is individual instances of discrimination, not the wider restructuring of social relations necessary to counter systemic discrimination.

The Act can be seen as an answer, albeit incomplete, to the inadequacies of past legislation. The prohibited grounds of discrimination have been expanded greatly, and the administrative structure improved. However, there are many exceptions, and the effect of the floating exception in s 97 is unclear. Protection has increased, but it is difficult to say by how much, and the courts have been left policy questions with which they are institutionally ill-equipped to deal.

The effectiveness of the Act will largely depend on the resources the Commission receives, the way the Commission chooses to allocate those resources, and the priorities it chooses to pursue. As McLean asked:<sup>39</sup>

Will this Act be used to play around the edges of "human rights" or will its users be people who are most in need of help? What will be the Human Rights Commission's agenda and its process of deciding priorities? Will those processes be open ones? .... I do not know what kind of social vision this legislation offers from the words of the Act. Its challenge to us is to work out in open discussion a process for determining what it should be.

*Andrew Nicholls*

## THE CONSUMER GUARANTEES ACT 1993

The Consumer Guarantees Act 1993 ("the Act") came into force on 1 April 1994. It was enacted to impose strict obligations upon suppliers of goods and services, and to provide more effective remedies for consumers who have purchased defective goods or services.<sup>1</sup> The Act amends both the guarantees given by suppliers and manufacturers, and the remedies available against suppliers and manufacturers who breach those guarantees. This note intends to determine whether the Act can fulfil these aims, and to examine its likely effect upon consumers and suppliers.

The rationale of the Act is based upon several conclusions. First, while current legislation adequately protects business customers, it does not effectively protect individual consumers such as householders. Second, New Zealand lags behind comparable overseas jurisdictions in consumer protection.<sup>2</sup> Third, the previous law was archaic and confusing to both suppliers and consumers. In order to promote a clear understanding of obligations and rights, it was necessary to replace old-fashioned and poorly understood terminology.

<sup>38</sup> See McLean, "Overview: Challenges and Prospects", unpublished seminar paper presented at the Legal Information Seminar on the Human Rights Act 1993 (18 June 1994) p5.

<sup>39</sup> *Ibid.*, p7.

<sup>1</sup> Under previous legislation, manufacturers and suppliers higher up the chain of supply often avoided liability because of the absence of privity between themselves and the customer. At the same time, the last supplier in the chain might avoid liability by showing that they were not negligent in supplying the goods. Where they were negligent, often they had gone out of business. This left the consumer with a defective product but no redress.

<sup>2</sup> The Act borrows many of its principles from Part V of the Trade Practices Act 1974 (Australia), the Supply of Goods and Services Act 1982 (UK), and the Consumer Products Warranties Act 1977 (Saskatchewan).

### When Does the Act Apply?

The drafters of the Act did not intend to repeal existing statutory safeguards, but rather to complement and clarify the protection they offer.<sup>3</sup> For example, the Act amends the warranty provisions of the Hire Purchase Act 1971 and the Sale of Goods Act 1908, deeming them subject to it.<sup>4</sup> This excludes their application in situations where the Act applies, while preserving their application where it does not. Thus, the Sale of Goods Act will continue to govern the sale of goods in non-consumer transactions. As a result, determining to which transactions the Act applies is an issue of primary importance.

The Act applies to the “supply” of “goods” and “services” by “persons in trade” (part of the definition of “supplier”) to a “consumer”. Each of these key words has been defined widely by s 2(1) and therefore most transactions involving the acquisition of goods or services (with or without consideration) will be subject to the Act. In particular, it covers sales of new and second-hand goods,<sup>5</sup> hire purchase agreements, exchanges, leases, and gifts.

It is likely that the definition of consumer will provoke the most debate. A consumer is defined as a person who:

- (a) Acquires from a supplier goods or services of a kind ordinarily acquired for personal, domestic, or household use or consumption; and
- (b) Does not acquire the goods or services, or hold himself or herself out as acquiring the goods or services, for the purpose of -
  - (i) Resupplying them in trade; or
  - (ii) Consuming them in the course of a process of production or manufacture; or
  - (iii) In the case of goods, repairing or treating in trade other goods or fixtures on land ....

The phrase “ordinarily acquired for personal, domestic, or household use” creates an objective test for the application of the Act. The difficulty for a supplier will be to determine which goods are capable of being purchased for such a purpose.<sup>6</sup> This has serious implications extending beyond whether the guarantees of the Act apply. For example, where a supplier concludes wrongly and attempts to contract out of the Act, he or she breaches s 43, which is deemed to be an offence under s 13(i) of the Fair Trading Act 1986. Individuals face fines of up to \$30,000, while a company faces a penalty not exceeding \$100,000.

The term “supplier” includes those who provide professional services as well as tradespeople. This has provoked criticism that the guarantees are inappropriate to many professions. Nevertheless, the Select Committee decided not to exclude any services because, “the exclusion of particular services would detract from the present comprehensive character of the Bill”.<sup>7</sup>

<sup>3</sup> Section 4 states that the Act is not a code. See also s 41.

<sup>4</sup> Sections 48 and 49.

<sup>5</sup> Note, however, that private sales of second-hand goods are not covered.

<sup>6</sup> See Dean and Jew, “Consumer Guarantees Act” [1994] NZLJ 98, 98-99.

<sup>7</sup> W Kyd 536 NZPD 16567 (20 July 1993).



The final test for the Act's applicability requires that the transaction has occurred "in trade". The term is widely defined and will include all forms of business sales to the public. Private sales, auctions, and the supply of goods and services by charitable organisations are generally not covered.

### Contracting Out

Section 43 provides a general prohibition on contracting out, except as provided by the Act. The main exception is where a consumer acquires, or holds himself or herself out as acquiring, goods or services for a business purpose.<sup>8</sup> However, this exception is not available automatically. Before a supplier can contract out, the agreement must either be in writing, or where it is not possible to conclude the agreement in writing, the supplier must have clearly displayed the terms and conditions of service at every place of the supplier's business.<sup>9</sup>

Section 43 also means that the use of exclusion clauses is now severely limited. A supplier can no longer disclaim responsibility for loss or damage, however caused, or for consequential losses. It is also a breach of the Act to purport to exclude claims over a certain amount, or after a certain period of time.

### The Guarantees

The Act separates guarantees into those relating to goods and those relating to services. The Act also states that any express guarantee given by a party is enforceable, including any express guarantee given by a manufacturer in a document relating to goods.<sup>10</sup>

#### (a) Guarantees relating to goods

There are seven specific provisions concerning guarantees in relation to goods. These are guarantees as to title, acceptable quality, fitness for particular purpose, correspondence with description, correspondence with sample, price, and availability of repairs and spare parts. The guarantees concerning correspondence with description and with sample simply restate the position under the Sale of Goods Act 1908 and will not be discussed.<sup>11</sup> The remaining five guarantees are:

##### (i) Title<sup>12</sup>

Suppliers are deemed to guarantee that they have the right to sell the goods and that the goods are free from any undisclosed security. While the guarantee will not prohibit the use of Romalpa clauses to retain title, it requires suppliers to obtain written acceptance from the consumer before a right to repossess is available. From the consumer's point of view, this reform is particularly valuable because it requires suppliers to clearly explain the purpose and effect of such clauses within their contracts.<sup>13</sup>

<sup>8</sup> There is also a narrow exception in relation to the guarantee as to repairs and spare parts under s 42.

<sup>9</sup> Section 43(2)(b). Arguably, the ability to contract out by displaying the terms and conditions of service applies only to contracts for services: see Ewen and Grice, *The Consumer Guarantees Act 1993* (New Zealand Law Society Seminar, March 1994) 30-31.

<sup>10</sup> Sections 13 and 14. See also s 43(6).

<sup>11</sup> See, for example, *Grant v Australian Knitting Mills Ltd* [1936] AC 85 (PC) and *E and S Ruben Ltd v Faire Bros Ltd* [1949] 1 KB 254. See also Hawes, "Consumer Law Reform: the Consumer Guarantees Bill" (1992) 5 *Canta LR* 17.

<sup>12</sup> Section 5.

<sup>13</sup> Section 5(1)(c)(ii)(A) and (B). See Dean and Jew, *supra* at note 6, at 100.

*(ii) Acceptable quality*<sup>14</sup>

This guarantee applies to both suppliers and manufacturers of goods. Goods are of acceptable quality if they are as:

- (a) Fit for all the purposes for which goods of the type in question are commonly supplied; and
- (b) Acceptable in appearance and finish; and
- (c) Free from minor defects; and
- (d) Safe; and
- (e) Durable;  
as a reasonable consumer fully acquainted with the state and condition of the goods, including any hidden defects would regard as acceptable.

What a reasonable consumer would regard as acceptable further depends on the nature and price of the goods and any other relevant representations or circumstances. Where defects in the goods have been specifically brought to the consumer's attention prior to the making of an agreement, the goods will not fail to comply with the guarantee by reason only of those defects.

The wording of the definition closely follows the requirements of the case law on merchantable quality.<sup>15</sup> Clearly, "acceptable quality" replaces that concept for the purposes of the Act. However, the section does more than merely restate the case law. Rather, it has broadened the scope of what was merchantable and clarified its content.

*(iii) Fitness for purpose*<sup>16</sup>

This guarantee states that, where goods are supplied to a consumer, those goods must be reasonably fit for the particular purpose which the consumer has expressly or impliedly made known to the supplier. The Act, as with s 16 of the Sale of Goods Act 1908, requires that reliance on the seller's judgment be proved. However, an important distinction between s 8 of the Act and s 16 is that s 8(1) and (2) reverses the onus of proof. Consequently, a buyer need only show that he or she made the purpose known to the supplier, and a presumption of reliance which the seller must disprove then arises.<sup>17</sup>

As with s 7 of the Act, it is possible for suppliers to avoid liability by drawing defects to the attention of the consumer.<sup>18</sup>

*(iv) Reasonable price*<sup>19</sup>

This guarantee affects only those transactions in which the contract does not

<sup>14</sup> Sections 6 and 7.

<sup>15</sup> *Kendall v Lillico* [1969] 2 AC 31 (HL).

<sup>16</sup> Section 8.

<sup>17</sup> See Ewen and Grice, *supra* at note 9, at 38.

<sup>18</sup> *Grant v Australian Knitting Mills Ltd*, *supra* at note 11.

<sup>19</sup> Section 11.

determine the price, or where there is no course of dealing or mechanism in the contract to determine the price between the parties.

(v) *Repairs and spare parts*<sup>20</sup>

Facilities for the repair of goods and the supply of parts must be made reasonably available for a reasonable period of time after the goods are supplied to the consumer. This guarantee applies only to manufacturers and importers of goods.

(b) *Guarantees relating to services*

The guarantees enacted largely mirror the previous common law and statutory position with regard to the supply of goods.<sup>21</sup> Thus, case law relating to the supply of goods will be useful in defining the scope of the guarantees relating to services.<sup>22</sup> Those guarantees are:

(i) *Reasonable care and skill*<sup>23</sup>

(ii) *Fitness for purpose*<sup>24</sup>

This guarantee requires consideration whether the consumer's reasonable expectations are satisfied. As with s 8, it does not apply where the circumstances show that the consumer did not rely on the supplier's judgment or skill, or where it would be unreasonable for the consumer to do so. However, s 29, unlike s 8, does not state whether the purpose of supply may be made known to the supplier both expressly and by implication. Section 29 also requires that the purpose must be made known before or at the time the contract is made. Section 8 is silent on this issue.

(iii) *Completion within a reasonable time*<sup>25</sup>

(iv) *Reasonable price*<sup>26</sup>

Both these guarantees apply only where the time of completion or the price is not fixed or determined by the contract or a course of dealings between the parties. The requirement as to reasonable price is identical to that for the supply of goods.

## Remedies

Where the Act applies, and has not been contracted out of, a failure to comply with its guarantees makes different remedies available according to whether the failure can be remedied or not.

Where the failure can be remedied, the consumer may require the supplier to remedy the failure within a reasonable time or may have the failure remedied

<sup>20</sup> Section 12.

<sup>21</sup> Cf Fraser, "The Liability of Service Providers under the Consumer Guarantees Act 1993" (1994) 16 NZULR 23.

<sup>22</sup> See Atiyah, *The Sale of Goods* (8th ed 1990) 123-204 for a general discussion of the relevant law.

<sup>23</sup> Section 28. There is little indication of what this will require. For the common law position (with regard to accountants and auditors), see *Scott Group Ltd v MacFarlane* [1978] 1 NZLR 553 (CA).

<sup>24</sup> Section 29.

<sup>25</sup> Section 30.

<sup>26</sup> Section 31.

elsewhere at the cost of the supplier. Alternatively, the consumer may reject goods and demand an exchange or refund, or cancel a contract for services. He or she may also recover for reasonably foreseeable consequential loss.<sup>27</sup>

Where the failure cannot be remedied or is substantial,<sup>28</sup> the consumer may reject the goods and obtain a refund or exchange, or cancel a contract for services. Alternatively, a consumer may keep the goods and seek damages for the reduction in value of the goods or service. Again, he or she may seek damages for any reasonably foreseeable loss resulting from the failure.<sup>29</sup>

Although these provisions clearly benefit consumers, there are anomalies concerning from whom the consumer can seek a remedy. It is likely that both manufacturers and suppliers will be liable for the other's actions, or failures to act.<sup>30</sup> Manufacturers, on the other hand, are unable to contract out of the Act, although they are protected when a supplier does so. Thus, a supplier's failure to contract out exposes manufacturers to potential liability. It has been suggested that this broad imposition of liability along the chain of supply reflects the "fix it first, sort it out later approach" of the Act.<sup>31</sup>

## Conclusion

The Act is concerned with protecting individual customers from defects in goods and the poor workmanship of those who supply goods and services. In the writer's view the Act achieves this aim. Its provisions go much further than previous legislation (for example, the Act applies to services) in its efforts to provide clear, comprehensive, and effective protection to consumers.

Not surprisingly, suppliers will be concerned about the scope and effect of this legislation. For them, it means that the risks of supplying goods and services have increased. Liability no longer requires privity of contract, but is created from representations made by any party, directly or indirectly, and from the existence of the defect. Liability may also attach to innocent suppliers merely because they fail to understand the Act's provisions. In particular, inadvertent mistakes in contracting out will lead to harsh penalties.

Because the Act cuts across the need for privity, manufacturers are also significantly affected. Claims will now be more readily laid against the manufacturer of goods in respect of express guarantees, guarantees as to acceptable quality, compliance with description, and the availability of repairs and spare parts. Suppliers and manufacturers must be clear about their obligations and re-examine their terms of trade and sales procedures.

On the whole, this reform is commendable. It creates a safer environment for consumers, and demands an increased awareness from suppliers and manufacturers about the quality of their products and services. The Act is intended to provide remedies for defective goods and services, and against the unscrupulous or incompetent supplier. Those who supply goods and services of reasonable quality, competently and bona fide, should not fear.

*Marcus Hinkley\**

\*BA

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27 Sections 18(2) and (4), 23 and 32(a).

28 "Substantial" is defined by s 21.

29 Sections 18(3), 21, 23, 32(b), and 34-36.

30 This will be the case except where ss 12, 17, and 26 apply.

31 Ewen and Grice, *supra* at note 9, at 32.

## THE COMPANIES ACT 1993: CAPITAL MAINTENANCE

On 28 September 1993, the long-awaited Company Law Reform Package was given royal assent. Fundamental to the package is the Companies Act 1993 (“the Act”). The Act introduces significant conceptual and practical changes to the way in which companies are formed, controlled, and managed.

The Act endeavours to allow companies greater flexibility in the arrangement and management of their capital while improving protection of creditors and minority shareholders. Significant changes in this regard include the abolition of the concept of par value and the substitution of a solvency test for the traditional capital maintenance rules.<sup>1</sup>

Under the capital maintenance rules, the acquisition by a company of its own shares was prohibited.<sup>2</sup> Under the Act, this is now possible. This note focuses on the application of the solvency test and the procedural requirements of the Act to share repurchases.<sup>3</sup>

### Abolition of Par Value

The term “share capital” refers to the funds of a company contributed by shareholders upon the issue of shares. Previously, the total share capital of a company was arbitrarily divided into shares of a fixed amount. That fixed amount was known as the par value of the share. In order to protect shareholders, further shares could not be issued at a price lower than par value because this diluted the value of existing shares.<sup>4</sup> Par value also provided the foundation upon which the traditional capital maintenance rules have been developed to protect both creditors and shareholders from the risk of prejudice or discrimination in a company’s dealings with its capital. The rationale for such rules was stated by Jessel MR in *Re Exchange Banking Co, Flitcroft’s Case*:<sup>5</sup>

The creditor has no debtor but that impalpable thing the corporation, which has no property except the assets of the business. The creditor ... gives credit to that capital, gives credit to the company on the faith of the representation that the capital shall be applied only for the purposes of the business, and he has therefore a right to say that the corporation shall keep its capital and not return it to the shareholders ....

The three fundamental rules of capital maintenance were that companies could not purchase their own shares,<sup>6</sup> finance the purchase of their own shares,<sup>7</sup> or pay dividends other than from profits.<sup>8</sup>

However, par value is of little use as a basis for measurement of a company’s

1 These changes have not been included in the amended Companies Act 1955, and do not apply to companies which continue to be or are registered under that Act. Note, however, that after 30 June 1997 all companies which have not registered or re-registered under the new Act are deemed to have done so. See ss 3 and 13 of the Companies Reregistration Act 1993.

2 *Trevor v Whitworth* (1887) 12 AC 409 (HL).

3 Specifically, the note will focus on share repurchases under ss 59-66 of the Act. For a discussion of repurchases under s 107(1)(c) or under ss 110-112, see Jones, *Company Law in New Zealand* (1993) 53-54 and 77-89.

4 This assumed that the existing shares had a value at least equal to their par value. This was often not the case, because the actual value of a company’s shares at any time was determined by its trading proficiency. See Jones, *ibid*, 27-28.

5 (1882) 21 ChD 519, 533-534.

6 *Trevor v Whitworth*, *supra* at note 2.

7 Section 62 of the Companies Act 1955.

8 *Bond v Barrow Haematite Steel* [1902] 1 Ch 353.

capital position once it starts trading. Similarly, the capital maintenance rules cannot protect creditors from capital fund depletion caused by adverse trading. Thus, the “perceived safeguards provided ... proved to be illusory”.<sup>9</sup> As a result, the New Zealand Law Commission recommended that the concept of par value capital should be replaced by a purposive method of maintaining capital.<sup>10</sup>

This has resulted in the abolition of the concept of par value.<sup>11</sup> It has been replaced by new rules regulating the method by which shares are valued, bought, and sold. Under the Act, shares can be issued in any number, and with any conditions attached.<sup>12</sup> The price of shares is no longer set by reference to an arbitrary amount, but rather at a price which the board determines to be fair and reasonable.<sup>13</sup>

The Commission also recognised that there are often circumstances where a return of capital will not unfairly prejudice creditors or shareholders. In these circumstances, the capital maintenance rules adversely affect the efficiency of the corporate structure by reducing a company’s ability to arrange and manage its capital. Although the need to restrict the transfer of wealth in order to protect creditors and minority shareholders remains, the abolition of par value has provided an opportunity to adopt a more flexible approach to capital maintenance.

### The Solvency Test

The adoption of the solvency test to replace the capital maintenance rules has been heralded as one of the most significant reforms of the Act:<sup>14</sup>

The solvency test ... is pivotal to the scheme of the Act. It applies to all transactions which transfer wealth from the company to the prejudice of creditors and, where some shareholders only receive benefit, to the prejudice of non-participating shareholders.

The test represents a transformation in approach. The Companies Act 1955 (“the 1955 Act”) was based on English company law models. The new Act is based on North American company law. Under North American models, companies are able to distribute dividends from capital, repurchase and redeem shares, and give financial assistance, subject to safeguards.<sup>15</sup> The advantages of the solvency test are clear. It allows a company to transfer capital where it was previously unable to do so. Creditors and shareholders are protected because the distribution can only be made if it leaves the company solvent.

The solvency test is set out in s 4 of the Act.<sup>16</sup> The test has two limbs. The first involves an equity or liquidity test requiring a company to be able to pay its debts as they become due in the normal course of business.<sup>17</sup> The second limb, known as the balance sheet test, requires a company to have assets greater in value than

9 Commerce Clearing House, *New Zealand Company Law and Practice* (1993) para 3-140. See also Beck & Borrowdale, *Guidebook to New Zealand Companies and Securities Law* (1994) para 509.

10 New Zealand Law Commission, *Company Law Reform and Restatement* NZLC R9 (1989) para 146.

11 Section 38.

12 Sections 35-51. For a general discussion of the new share regime, see Jones, *supra* at note 3, at 25-39.

13 Section 47(1).

14 New Zealand Law Commission, *supra* at note 10, at para 330.

15 See, for example, the Canada Business Corporations Act 1974-75-76, c 33, ss 34-35, and 40.

16 *Inter alia*, the test applies to the distribution of dividends (s 53), shareholder discounts (s 55), the reduction of shareholder liability (s 57), share repurchases (s 59), the redemption of shares (ss 70, 74, and 75), and to the giving of financial assistance (s 77).

17 Section 4(1)(a).

liabilities, including contingent liabilities.<sup>18</sup> Together, it is argued that these tests ensure that “known obligations can reasonably be expected to be satisfied during the time within which they fall due”.<sup>19</sup>

In determining whether the value of the company’s assets exceeds the value of its liabilities, the directors must have regard to the most recent financial statements of the company,<sup>20</sup> and all other circumstances that the directors know, or ought to know affect, or may affect, the value of the company’s assets and liabilities, including its contingent liabilities.<sup>21</sup> Directors may rely on valuations of assets or estimates of liabilities that are reasonable in the circumstances.<sup>22</sup>

Directors who vote in favour of a distribution must certify that the company will be able to satisfy the test and state the basis for that conclusion.<sup>23</sup> A company can recover distributions made to shareholders if the solvency test was not met immediately after the distribution was made. Although the company’s right to recover the distribution from a shareholder is limited by s 56(1), directors may be personally liable to repay to the company the portion of the distribution not recovered from the shareholders.<sup>24</sup>

### Share Repurchases and the Solvency Test

The acquisition by a company of its own shares was prohibited at common law by the rule in *Trevor v Whitworth*.<sup>25</sup> Section 58 of the Act overrides this prohibition, expressly providing that a company may acquire its own shares in three situations:

- (i) where the procedures laid down in ss 59 to 66 have been followed;
- (ii) where all entitled persons agree (s 107(1)(c));<sup>26</sup> or
- (iii) where a shareholder has exercised a minority buy-out right under ss 110 to 112.

Under s 59(1), a company may acquire its own shares only where its constitution expressly permits the acquisition, and where a modified solvency test is satisfied. Section 59(2) requires that the procedural requirements of ss 60, 63, and 65 are also met.

The solvency test which applies is a modified form of the test in s 4(1). As with that test, the directors must determine and certify that, immediately after the repurchase, the company will be able to satisfy both the liquidity test and the balance sheet test.<sup>27</sup>

The basic test is modified by s 52 which applies to distributions to shareholders. The modified test uses an extended definition of “debts” and “liabilities”. “Debts” is defined by s 52(4) to include fixed preferential returns on shares ranking

<sup>18</sup> Section 4(1)(b).

<sup>19</sup> Jones, *supra* at note 3, at 43.

<sup>20</sup> Section 4(2)(a). These statements must comply with the Financial Reporting Act 1993.

<sup>21</sup> In determining the value of a contingent liability, directors may take account of the likelihood of the contingency occurring, and any claim the company is entitled to make and can reasonably expect to be met which would reduce or extinguish the contingent liability: section 4(4).

<sup>22</sup> Section 4(2)(b).

<sup>23</sup> See, for example, s 52(2) and (5).

<sup>24</sup> Section 56(2).

<sup>25</sup> *Supra* at note 2.

<sup>26</sup> The term “entitled persons” is defined in s 2(1).

<sup>27</sup> Section 52(1), (2), and (5).

ahead of those on which a distribution is to be made. "Liabilities" includes the amount that would be necessary to repay all fixed preferential amounts payable to shareholders if the company were to be removed from the register after the distribution. The expanded scope of the test is intended to protect shareholders with fixed entitlements from prejudice arising through distributions to shareholders who rank after them.

Contracts to repurchase shares are not enforceable when the company will be unable to satisfy the solvency test as a result of the repurchase.<sup>28</sup> The enforceability of the contract is suspended, although only until the test can be met.

Under ss 60, 63, and 65, a company may repurchase its shares by means of any one of three forms of offer. The first is an offer to all shareholders for a proportion of their shares, which would, if accepted, leave the relative voting and distribution rights unaffected (a "proportionate offer").<sup>29</sup> The second is a selective offer to one or more shareholders. All shareholders must have consented to a selective offer in writing, or it must be expressly permitted by the constitution. It must also have been made in accordance with s 61. Sections 63 and 65 provide for a repurchase through the stock exchange (a form of selective offer).<sup>30</sup>

The procedural requirements of s 60 apply to both proportionate and selective repurchases. Under s 60(3), the board is not permitted to make either form of offer unless and until it resolves that the acquisition is in the best interests of the company, and that the terms and the price of the offer are fair and reasonable to the company. The board must further resolve that it is not aware of any information that will not be disclosed to shareholders and so would make the offer unfair to shareholders accepting it.

The resolution must set out the full reasoning for the directors' conclusions, and directors voting in favour of the resolution must certify that all these requirements are met.<sup>31</sup> Failure to comply with the duty to certify is an offence.<sup>32</sup>

In addition, the board must further resolve for selective offers that the acquisition is of benefit to shareholders who have not received an offer to acquire their shares and that the terms and price of the offer are fair and reasonable to those shareholders.<sup>33</sup> This resolution must similarly be accompanied by reasoning and certification.<sup>34</sup>

Prior to a selective offer, there is an additional requirement that the company disclose to all shareholders the nature and terms of the offer, to whom it will be made, and any relevant interests of directors. The company must also disclose the text of the resolution required by s 61(1), and any further information necessary to allow reasonable shareholders to understand the implications for the company and shareholders of the proposed acquisition.<sup>35</sup>

For a general stock exchange offer, the matters to be resolved by the board under s 63 are similar to the resolutions required of selective offers generally. However, because of the practical difficulties in giving pre-notification of the nature and terms of the offer, the disclosure requirements under ss 63(6) and 64 are modified. The company must notify each shareholder of the maximum number of shares that it has resolved to acquire under s 63(1), the nature and terms of the offer

28 Section 67.

29 Section 60(1)(a).

30 Section 60(1)(b).

31 Section 60(4) and (5). See also ss 52(2), 61(2) and (3).

32 Section 60(7).

33 Section 61(1).

34 Section 61(2) and (3). See also s 61(9) with regard to offences.

35 Section 61(5). See also s 61(7).



(though not its price), and of any relevant interests of directors. It must also disclose the text of the resolution required by s 63(1), together with any other information necessary to enable a reasonable shareholder to understand the implications of the offer for shareholders and the company.

Where the number of shares a company proposes to repurchase through the stock exchange, together with any already acquired under s 65 in the previous 12 months, does not exceed five percent of the shares in that class, the repurchase is not subject to any pre-notification requirements.<sup>36</sup>

## Conclusion

The Act, through its departure from the capital maintenance rules in favour of the solvency test, confers upon companies greater flexibility in the management and organisation of their capital. The introduction of this increased flexibility has been accompanied by a corresponding increase in procedural safeguards to ensure the protection of creditors and shareholders who might otherwise be vulnerable to discriminatory and prejudicial distributions. Although aspects of the procedural requirements have been described as “clumsy and probably excessive”<sup>37</sup> the situation under the new Act is preferable to the inflexibility of the 1955 Act and the common law.

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## THE COMPANIES ACT 1993: SHAREHOLDERS' REMEDIES

The Companies Act 1993 (“the Act”) introduces many significant reforms. This note describes only one aspect: shareholders’ remedies. In particular, the focus is on two of the most important changes brought about by the new legislation, the statutory derivative action, and minority buy-out rights. The Act only applies to companies which are registered or have re-registered under it,<sup>1</sup> but many of the new features of the Act (though not minority buy-out rights) have been included in the amended Companies Act 1955 (“the 1955 Act”) and so apply to companies still registered under that statute.

In proposing a new Act, the Law Commission formed the view that the general meeting is not an adequate forum for protecting shareholders from abuse of management power.<sup>2</sup> The Act has not increased shareholder powers in general meeting, but instead gives shareholders an expanded array of remedies.

### New Remedies

Before considering the new remedies offered by the Act, it is desirable to consider the standing of a shareholder to sue at common law. For a long time,

<sup>36</sup> Section 65. The company is subject to limited post-acquisition notification requirements under s 65(2).

<sup>37</sup> Jones, *supra* at note 3, at 58.

<sup>1</sup> Companies may voluntarily re-register under the new Act until 30 June 1997, after which date they are deemed to have done so. See ss 3 and 13 of the Companies Reregistration Act 1993.

<sup>2</sup> New Zealand Law Commission, *Company Law Reform and Restatement*, NZLC R9 (1989) para 197.

standing was determined by the rule in *Foss v Harbottle*.<sup>3</sup> There are two parts to the rule. The first is the internal management rule: “the Court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so”.<sup>4</sup> The second is the proper plaintiff rule: “in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should prima facie be brought by the company itself”.<sup>5</sup> Taken together, these two rules could prevent a shareholder from bringing an action to remedy a wrong done to a company. There were four exceptions to the rule in *Foss v Harbottle*. The rule did not apply:

- (i) if the act complained of was ultra vires the company or illegal; or
- (ii) if the matter was one that could only be done or sanctioned by a special majority, but was not; or
- (iii) if the matter involved an infringement of the plaintiff’s personal rights; or
- (iv) if there was a fraud on the minority and the wrongdoers were in effective control of the company and using their control to prevent the company from taking the action against them. The common law allowed a shareholder who could show a fraud on the minority to bring a derivative action, suing in the name of the company.

The rule was most problematic when the decision not to sue recalcitrant directors had been ratified by the shareholders. The rule has proven to be an inadequate means of enforcing the duties of directors and officers of the company, and to be unfair to minority shareholders. The law was also complex. The fraud on the minority exception involved a “jangle of discordant cases”<sup>6</sup> regarding when a breach was ratifiable and when a derivative action could be brought. The distinction between personal and derivative rights was also unsettled and complex. The Act seeks to remedy this situation by providing shareholders with a number of statutory remedies.

Shareholders can enforce the company’s constitution, the Act, and the Financial Reporting Act 1993 by applying to the High Court (“the Court”) for injunctions, or compliance orders against directors or the company.<sup>7</sup> The Court may also grant such consequential relief as it thinks fit.

The Act maintains the oppression remedy found in s 209 of the 1955 Act in a largely unchanged form,<sup>8</sup> but extends its coverage to former shareholders and “entitled persons”.<sup>9</sup> The Act now deems the breach of certain sections of the Act to be conduct that is unfairly prejudicial.<sup>10</sup>

The Act provides a procedure whereby a shareholder or former shareholder may bring a personal action against a director for breach of a duty owed to him or her as a shareholder, and categorises certain duties of directors as being either duties owed to the shareholders or duties owed to the company.<sup>11</sup> In doing so, the

3 (1843) 2 Hare 461; 67 ER 189.

4 *Burland v Earle* [1902] AC 83, 93 (PC).

5 *Ibid.*

6 Wedderburn, “Shareholders’ Rights and the Rule in *Foss v Harbottle* (continued)” [1958] CLJ 93, 105.

7 Sections 164, 170, and 172.

8 Section 174. The section is entitled “Prejudiced Shareholders”.

9 For the definition of “entitled person”, see s 2(1).

10 Section 175.

11 Section 169.

Act helps to resolve the problems of the personal/derivative distinction which was so troublesome at common-law.

A shareholder may also bring a personal action against the company for breach of a duty owed by the company to him or her as a shareholder.<sup>12</sup> Shareholders may bring a representative action when other shareholders have the same or substantially the same interest in relation to proceedings against the company or a director.<sup>13</sup>

### Statutory Derivative Actions

Section 165 creates a statutory derivative action to replace the common law derivative action and to define the circumstances in which a shareholder can sue on behalf of the company. "A statutory [derivative] action is the minority shareholder's sword to the majority's twin shields of corporate personality and majority rule."<sup>14</sup> Section 165 is wider than the common law derivative action. There is no requirement that the wrongdoers be in control of the company, and it is not limited to certain classes of action. Derivative actions can now be brought by directors, as well as shareholders, and can be brought on behalf of related companies.

A shareholder must apply to the Court for leave to bring a statutory derivative action. This prevents unmeritorious and trivial actions from proceeding, and prevents abuse by the plaintiff shareholder, whose own motives may differ from the interests of the company. The Court retains control of the proceedings, and the action cannot be settled or withdrawn without leave of the Court. Thus, one shareholder cannot take the relief the company should receive, and the shareholder cannot be bought off by the company at the expense of other shareholders.

The Court, in deciding whether to grant leave, may face a situation where the shareholders have approved what has been done. Section 177, the only provision in the Act dealing with ratification, expressly permits ratification in the case of an usurpation of shareholder power. Ratification of a usurpation does not affect the Court's power. However, the section expressly states that it does not affect the law of ratification with respect to other acts or omissions of directors. If this is interpreted to mean that the law of ratification is unchanged by the Act, then effectively the rule in *Foss v Harbottle* lives on. This is clearly not the intention of the Law Commission,<sup>15</sup> and would be an extremely unsatisfactory result from a statute intended to rectify the common law's failings.

The Court may find that the solution is to follow the approach taken by many Canadian company law statutes which expressly provide that majority shareholder ratification does not prevent a minority shareholder from succeeding in a statutory derivative action. Instead, ratification plays an evidential role, as evidence that the matter ratified is in the interests of the company.<sup>16</sup> Thus, shareholders have a role to play in the process of application for leave, but the courts retain the final say. This is consistent with recognition of the failings of the general meeting, and is the approach most consistent with the objectives of the Act.

Another consideration which may be relevant to the Court's decision to grant leave is the recommendation of a special litigation committee. This is a committee of independent directors appointed by the Board to determine whether an action is in the interests of the company. This practice is used in many American jurisdic-

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<sup>12</sup> Section 171.

<sup>13</sup> Section 173.

<sup>14</sup> Welling, *Corporate Law in Canada* (2nd ed 1991) 526.

<sup>15</sup> *Supra* at note 2, at paras 568-569.

<sup>16</sup> See, for example, the Canada Business Corporations Act 1974-75-76, c 33, s 242(1).

tions. New Zealand companies may follow suit. However, in America, special litigation committees seldom recommend that the company should vigorously pursue a derivative action against a director.<sup>17</sup> This raises the question whether such committees are always truly objective. Courts should not be bound by their recommendations.

The beauty of the statutory derivative action "lies in its simplicity; a few strokes of the legislative pen effectively disposed of one of the most consistently troublesome areas of corporate law".<sup>18</sup> However, the remedy will not succeed unless all the problems of the common law are addressed. In addition to the law's complication, there are economic considerations which inhibit shareholders from bringing derivative actions. Litigation is expensive, and the shareholder runs the risk that he or she will have to pay all the costs if the action was unsuccessful. Furthermore, the shareholder could only hope to benefit in proportion to his or her shareholding since, in a derivative action, any damages paid by the defendant go to the company, and not the plaintiff shareholder. The Act does address the problem of costs as a disincentive to pursuing a derivative action. Under s 166, if the shareholder applies, the Court can order the company to pay all or part of the reasonable costs of bringing the action. However, it is unclear whether the company can recover costs from shareholders, which could be appropriate if the facts upon which the application for leave is based turn out to be wholly untrue. It is also unclear whether the shareholder can be awarded the costs of the application for leave or can recover costs from related companies.

Provided the law of ratification does not survive the Act unchanged, shareholders now have a means of bringing a meritorious action on behalf of the company, an action that does not require the support of their fellow shareholders or the directors.

### Minority Buy-out Rights

Another new form of remedy in the Act, minority buy-out rights,<sup>19</sup> are modelled on American and Canadian appraisal rights.<sup>20</sup> The minority buy-out rights provide a remedy for minority shareholders who dissent to certain fundamental changes to the company or to shareholders' class rights. Under the Act, the dissenting shareholder can now require the company to purchase his or her shares, as a means of exiting the company, and avoiding the effects of changes to which the shareholder objects. The buy-out rights do not affect majority rule but will discourage the majority from making decisions which adversely affect the minority or which decrease the value of the company, since widespread buy-outs would drain the resources of the company. In contrast to the oppression remedy, there is no need to litigate any questions of unfairness. Thus, buy-out rights are a more efficient remedy.

The right is especially valuable where there is no ready market for the shares of the company (for example, for unlisted companies). The right is also valuable to shareholders in publicly listed companies when share markets respond too quickly for a shareholder to obtain a price untainted by the proposed action.

To exercise a buy-out right a shareholder must vote against the proposal in question and then give written notice to the company requiring it to purchase his or

17 In 1987, no committee had ever recommended that a derivative action be continued in its entirety. See DeMott, "Shareholder Litigation in Australia and the United States: Common Problems, Uncommon Solutions" (1987) 11 Syd L Rev 259, 277.

18 Welling, *supra* at note 14, at 525.

19 Sections 110-115, and 118.

20 See, for example, the Canada Business Corporations Act 1974-75-76, c 33, s 190.

her shares. The company must then either agree to purchase the shares, arrange for someone else to purchase them, apply to the Court for an exemption from its buy-out obligation, or arrange for the resolution to be rescinded.

When the company agrees to purchase the shares, or arranges for someone else to purchase them, it must nominate a fair and reasonable price. If the shareholder objects to this price, the question is referred to an arbitrator, and the company must pay the nominated price as a provisional price. In Canada, the payment of a provisional price pending the settlement of the valuation is not required and value is determined by litigation. The intention in New Zealand is that arbitration will prove to be a more efficient method of determining a fair value, and payment of a provisional price will allow the shareholder to reinvest the funds earlier and provide some cashflow.

In Canada, courts have held that the exercise of buy-out rights does not preclude a shareholder from pursuing other remedies, for example, an oppression action.<sup>21</sup> However, if a minority shareholder, exercising a buy-out right, can continue to hamper the majority through the oppression remedy, then the company receives no benefit from the buy-out. In addition, the cost of litigation would be reduced if oppression actions are avoided.

The accuracy of the buy-out price is crucial. If the shares are valued too low, then the shareholder will not be adequately compensated, and the function of buy-out rights will be defeated. If arbitration consistently values shares too highly, then there will be an incentive for shareholders to dissent even to beneficial fundamental changes. If the result is uncertain, then the remedy will be perceived as being risky.

Cases regarding valuation in the context of the oppression remedy are likely to be relevant.<sup>22</sup> There are three aspects to the question of valuation. The first is the date of the valuation. This is relevant because circumstances beyond the control of the company can affect the share price. The Act does not specify on which date the valuation is to be based. It should be the date on which notice of the exercise of a buy-out right is given, since this will reduce the risk that a shareholder will exercise the buy-out right in response to, or suffer a loss from, events other than the fundamental change.

A second issue is whether the fundamental change's effect on the firm's value should be included in the valuation. Generally such effects should be excluded,<sup>23</sup> otherwise the object of the buy-out right will be defeated.

The third consideration is the valuation method used by the Court or the arbitrator. Market price is the simplest method of valuation but a reliable market value may not be available. Asset values are generally not very relevant when the business is a going concern. Earnings-based valuations require so much estimation of uncertainties that "almost any value may be propounded with a straight face".<sup>24</sup> In *Holt v Holt*,<sup>25</sup> McMullin J described the Court's valuation as "little less than an estimate but something more than a guess".<sup>26</sup> The inaccuracy of valuation is one of the weaknesses of buy-out rights.

Any costs incurred on the exercise of buy-out rights will reduce the effectiveness of the remedy.<sup>27</sup> Exercising a buy-out right may incur tax costs, brokerage

21 *Re Brant Investments Ltd and Keeprite Inc* (1984) 5 DLR (4th) 116 (Ont HC).

22 See, for example, *Clark v Clark* (1989) 4 NZCLC 96,273.

23 *Smeenk v Dexeigh Corp* (1990) 74 OR (2d) 385 (Ont HC).

24 Easterbrook and Fischel, *The Economic Structure of Corporate Law* (1991) 155.

25 [1987] 1 NZLR 85(CA).

26 *Ibid*, 94.

27 MacIntosh, "The Shareholders' Appraisal Right in Canada: A Critical Reappraisal" (1987) 24 Osgoode Hall LJ 201, 249-264.

costs will arise on reinvestment of the funds, and the uncertainty surrounding valuation represents a cost to a risk-averse investor. Uncertainty about the responsibility for the costs of arbitration<sup>28</sup> could deter a shareholder from exercising buy-out rights, or encourage the shareholder to accept an inadequate nominated price.

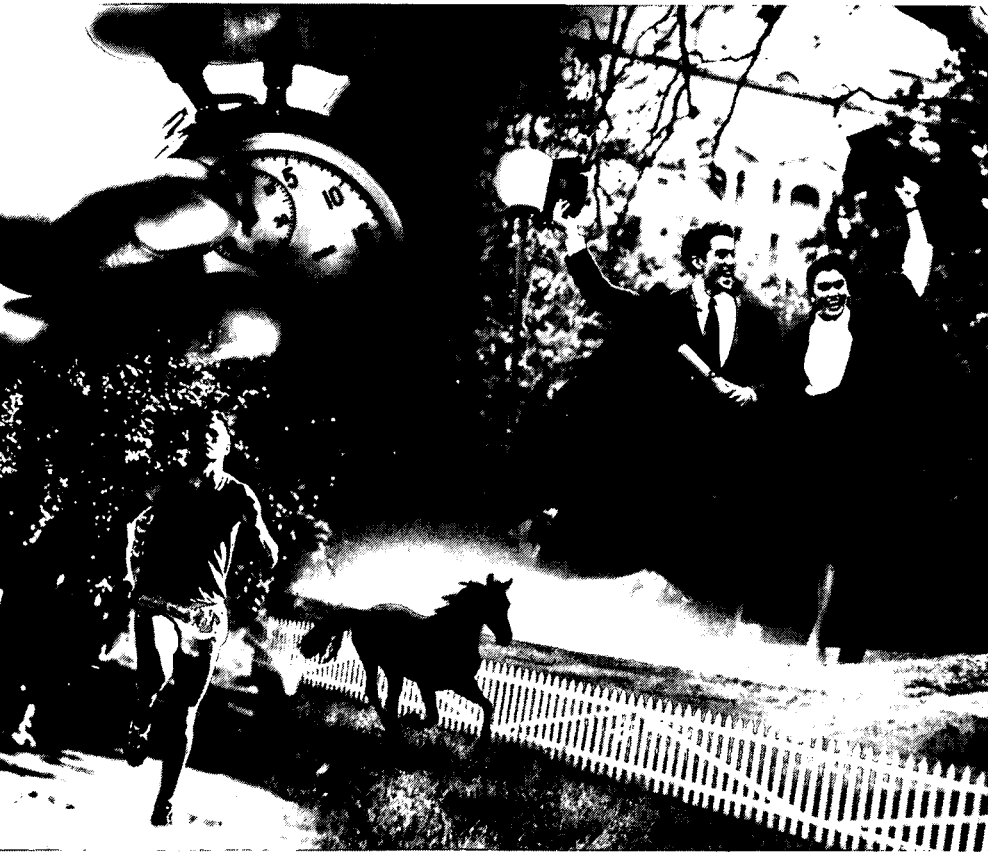
### **Conclusion**

The Act certainly provides the minority shareholder with more protection. Arguably, it has tipped the balance too far in favour of the minority. It must be remembered that the possibility of the majority adversely affecting the minority can be foreseen by the minority when they purchase their shares. This risk will be reflected in the price they pay for their shares. Minority protection will decrease the cost of capital of the company, only to the extent that it does not hamper the ability of the majority or the directors to effectively control the company and take acceptable business risks. Companies will negate shareholder remedies in their constitutions if, *ex ante*, they decrease the value of the firm.

*Andrew Fraser*

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<sup>28</sup> See s 21 of the Arbitration Act 1908.



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