LEGAL RESEARCH FOUNDATION

BUSINESS LAW SYMPOSIUM

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UNIVERSITY OF AUCKLAND

MONDAY, 22nd NOVEMBER, 1965

LEGAL Research Foundation

Business Law Symposium

Periodicals : LRF

ACKNOWLEDGEMENT

The most difficult but certainly most pleasant task of the members of the Council of the Legal Research Foundation Incorporated has been to express their corporate and individual appreciation of the assistance and support they have received in their organisation of this Symposium.

In particular we would like to thank our guest speakers the Hon. J.R. Hanan (Minister for Justice), Dr J.L. Robson, Dr R.G. McElroy, Professor David Allan, Mr Duncan S. Cox, Dr C.J. Fernyhough, Dr H.C. Holland and Professor J.F. Northey. We are grateful to the Council of the University of Auckland for the use of its facilities. We are also appreciative of the encouragement and support we have received from our Patrons, Vice-Patrons and officers of all organisations associated with the sponsoring of this Symposium. Finally may we extend our appreciation to our special advisers Mr R. Phillip Seagar, Mr W.N. Pearman, and Mr Adrian Sturman and the large number of other persons from whom we have received help and inspiration. The Business Law Symposium could not be the success we fully anticipate it will be without this assistance and support and we are indeed grateful for it. Our sincere thanks.

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PROGRAMME
BUSINESS LAW SYMPOSIUM

4.15 p.m. Lower Lecture Theatre

Recommendations for Commercial Law Reform

(A practical paper written for laymen covering aspects of the law directly affecting the buying and selling of goods, consumer protection and raising business finance)

Author: *Dr C.J. Fernyhough*
(Who has made a special study of the revolutionary Uniform Commercial Code at the University of Chicago, U.S.A.)

Commentators: *Professor David Allan,* Professor of Commercial Law, Victoria University, Wellington; Vice-President of the N.Z. Business Law Association; a member of the Law Revision Committee at present engaged in research on this topic.
Dr H.C. Holland, a scientist; Managing-Director, W. Sutherland & Co. Ltd.; Vice-President of the Auckland Manufacturers' Association.

Audience Point of View: Contributions and questions from the floor

Summing-Up: *Hon. J.R. Hanan,* Minister for Justice; Chairman of the Law Revision Committee

6 p.m. *COCKTAILS AND BUFFET TEA at the University (for all delegates)*

7.15 p.m. Lower Lecture Theatre

Recommendations for Company Law Reform

(A paper written for laymen containing practical suggestions for reforming the law affecting the day-to-day legal obligations of company directors and managers as well as investor and creditor protection)

Author:	*Professor J.F. Northey* Dean Faculty of Law, University of Auckland. Author "Introduction to Company Law in New Zealand"
Commentators:	*Mr Duncan S. Cox*, past President N.Z. Society of Accountants and Company Director. *Dr R.G. McElroy*, Director of the Reserve Bank of New Zealand and numerous companies.
Audience Point of View:	Contributions and questions from the floor
Summing-Up:	*Dr J.L. Robson*, Secretary for Justice; Member of the Law Revision Committee; Chairman Company Law Advisory Committee
9 p.m.	*SUPPER* *at the University (for all delegates)*

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INFORMATION CENTRE

An Information Centre will be located at the Law School Library, Pembridge, 31 Princes Street. Telephone: 30-060.

PARKING

Some parking is available in the following streets near the University - Grafton Road, Eden Crescent, Wynyard Street and Princes Street. The Council is at present endeavouring to make special parking arrangements at the University for delegates. Further information will be supplied at a later date.

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THE NEED AND OPPORTUNITY

FOR

COMMERCIAL LAW REFORM

BY

DR C. J. FERNYHOUGH

THE NEED AND OPPORTUNITY FOR COMMERCIAL LAW REFORM

Objects of Commercial Law:

The commercial law of any given community ought to achieve two objects. In the first place it should in its application lead to results which are acceptable to those members of the community affected by it. Secondly, it ought to be so stated as to be readily understandable and accessible. The commercial law of New Zealand fails to achieve either of these objects.

The first aim is that the application of the commercial law should lead to acceptable results. The law should be such that it furthers and not frustrates the reasonable expectations of those in the commercial community and it should satisfactorily and fairly adjust the competing rights and interests of buyer and seller, lender and borrower, consumer and retailer, retailer and manufacturer, and creditor and debtor.

Insofar as accessibility and comprehensibility are concerned the commercial law should be contained in a source which can be readily referred to and easily understood. It is important that the rights of those in the commercial world should be capable of determination quickly and expeditiously because speed is of the essence in most commercial law disputes. Goods are on the move in a chain set-up where the rights and interests of a great number of people may be involved. A dispute arises at some point along the chain and speedy resolution of that dispute is called for if the whole set-up is not to grind to a halt.

Thus, the wholesaler might supply the retailer with non-conforming goods and the retailer wants to know whether he has to pay for them. The wholesaler wants the cash and the wholesaler's creditors are relying on the proceeds to clear debts owing to them. The retailer might have the opportunity of purchasing conforming goods from another source and that other source might be able to supply only if the order is firmed up within a day. A speedy determination of the retailer's right to reject is crucial if the wheels of commerce are to continue to turn. Each commercial transaction is usually part of a larger transaction or is related to or contingent on some other transaction and failure to speedily resolve a conflict at one point between two parties might vitally affect a number of other parties.

Ideally what is required then is a code dealing with the commercial law as a whole in a readily accessible and easily understandable form. The commercial law must be seen in its entirety as possessing a functional unity, resting on movements of goods by sale and incidental services of carriers, warehousemen, bankers, finance companies and the like. Each part is interdependent with the other.

It is proposed in this paper to take but two aspects of the commercial law to establish the writer's point, namely that the commercial law of New Zealand is inadequate inasmuch as it falls far short of attaining the ideals mentioned above. The two aspects taken to illustrate this thesis are law relating to sales and financing. Probably these two segments constitute the most important elements in the commercial law as the law which most vitally affects the commercial community is the law which regulates the sale of goods and the borrowing of money to provide facilities for the manufacture or distribution of those goods. Incidental reference will be made to some aspects of hire purchase law.

Sales:

The law relating to the sale of goods is contained in a number of different sources. Of these, the most important is the Sale of Goods Act 1908. It dates back to the nineteenth century and is closely modelled on the English Sale of Goods Act which was a codification of the decisions of the English Courts at that time.

Consumer Protection:

In those days a sale of goods, at least at the consumer level, was likely to be a transaction effected for cash by a buyer who knew what he wanted and could inspect the goods he was purchasing. The consumer would most likely call at his local store and deal with a man he knew personally in respect of goods which were thoroughly familiar to him. Conditions today are vastly changed. The consumer is frequently dealing with technical goods which he is incapable of accurately assessing. He is dealing with goods which are pre-packaged and which deny him the opportuniy of inspection prior to purchase and his desire to purchase may be stimulated not so much by need but by the advertising media employed by the manufacturer. Consumer transactions at the time of passage of the Sale of Goods Act followed from the need of the buyer and the ability of the individual retailer to promote the sale. The retailer in those days would be personally acquainted with the quality of the goods he sold, would be knowledgeable concerning them, and

could be expected to make representations to the buyer concerning their quality and usefulness.

Today, the retailer is often little more than a stockist. He has the goods on his shelves but frequently he will know little about their technical nature and the buyer will be influenced in his purchase not so much by what the retailer says to him but by the advertising and promotion campaigns of the manufacturer who will represent say, that his pop-up toaster is of a superior design, is used by all the right people and ensures a perfectly browned and crisp slice. He might also say that his pop-up toasters are guaranteed and every sale is accompanied by a special guarantee card which is good for six months.

The buyer, in reliance on these representations, purchases the pop-up toaster but under the Sale of Goods Act he has no remedy against the manufacturer if the toaster burns every slice. He may not even have a remedy against the retailer. It is said that he has no remedy against the manufacturer because there is no privity of contract. The buyer's reaction might well be to ask what kind of nonsense this is because it was the manufacturer after all who lead him to believe that this was a pop-up toaster of quality. Circumstances have changed over the years and it is time that we had a closer look at this notion of privity instead of merely accepting it as one of the axiomatic principles of the law of contract.

Not only is the luckless buyer without redress against the manufacturer but he may also be without remedy against the retailer. When the consumer looks to the retailer he will most likely be met with the guarantee card which was one of the reasons which lead him to purchase the goods. The so-called 'guarantee' will exclude all representations made by the retailer and all terms and conditions implied in the Sale of Goods Act. The Act specifically permits sellers to contract out of the protection which the Act purports to afford the consumer. Thus it takes away by the one hand what it gives with the other.

The Act was drafted at a time when it could be assumed that there was some equality of bargaining power between the buyer and the seller. If there was such equality it was reasonable to permit the parties to strike whatever bargain they could. Equality of bargaining power today is a thing of the past and the consumer must either take it or leave it. It is not within his power to negotiate with the seller on the question of whether the implied terms of the Sale of Goods Act should or should not be excluded and it is utterly unrealistic to assume that an exclusion of the implied terms is the result of a freely entered

and negotiated bargain.

The Courts have in fact recognised this and have done everything within their power to over-ride exemption clauses in contracts of sale. In order to do so, however, the Courts have been forced to draw a number of highly artificial distinctions which have rendered the law undertain in its application and almost impossible to understand. Thus the various terms in contracts of sale are variously described as conditions, warranties, collateral warranties and fundamental terms. It is difficult enough to distinguish between a condition and a warranty. It is virtually impossible to distinguish between a condition and a fundamental term.

Technical Distinctions - Right of Rejection:

The difficulty is that in the law of sales we have created a number of technical distinctions for the purpose of solving what are essentially simple questions.

For example, the buyer's right to reject goods which do not conform to the terms of the contract turns in the first place on whether the failure to conform is due to a breach of a condition or the breach of a warranty. The notion is that a condition is a fundamental term which goes to the root of the contract and it is only in respect of breach of such a term that there is a right of rejection. Warranties, on the other hand, are said to be less important terms and the remedy in the case of breach is merely an action for damages.

However, the right to reject turns not only on the differences between a condition and a warranty but also on whether the property in the goods has passed. Whether the property in the goods has passed is determined by a number of complicated rules, but in the case of an unconditional contract for the sale of specific goods in a deliverable state the property passes at the time the contract is made. Most retail sales are sales of specific goods and the result therefore is that the buyer who gets the goods home and finds that they have a defect is deprived of the remedy of rejection. He cannot take the goods back to the seller. All he can do is sue for damages and this it can be readily appreciated is a hopelessly cumbersome remedy for the consumer who has just bought his new pop-up toaster. What he wants, and what he needs and ought to have, is a right to return the goods and demand his cash back. In an effort to avoid an unjust result the New Zealand Courts have departed from the holdings of the English Courts and adopted a tortuous construction of the Act whereby the buyer will at

least in some cases have the right of rejection in the circumstances above-mentioned.

Compounded on these intricacies is the further rule that the buyer loses his right to rejection if he has accepted the goods. Recent commercial litigation proves that there is a great deal of uncertainty as to the meaning of 'acceptance' in a commercial setting.

Rights of Unpaid Sellers:

Also unsatisfactory is the position of the unpaid seller who on default of payment by the buyer resells the goods. If the seller resells at a higher price must be disgorge the difference to the original buyer? Alternatively, if he resells the goods for a lower price can he sue the original buyer for the deficiency? These are simple questions but the answers, while certainly complex, are unclear. They turn on a number of issues: did the buyer's default amount to a repudiation? was the seller exercising his statutory right of stoppage in transit and resale? did the seller expressly receive the right to resell? had the property in the goods passed? - and so forth. Even when the answers are worked out they are found to be unsatisfactory. Thus, under certain circumstances the seller will have to disgorge the profit on resale but if he expressly reserved the right of resale he can keep the profit. Why the difference?

Uncertainty as to Performance:

In the commercial setting one of the essentials of a sale contract is that the parties should have confidence in performance by each other of their respective obligations. Take the case of a buyer of 5,000 sets of roller bearings to be used by him in a production run of motor mowers. He arranges to purchase the bearing from the seller in Wellington, delivery to be at the buyer's plant in Auckland by instalments of 1,000 per month, first shipment three months from the date of contract. Shortly after the date of contract the buyer contracts to sell 5,000 mowers to a wholesaler on a falling market. Two months before the first instalment of bearings is due for delivery the buyer hears from a reputable source that the seller is having great difficulty in maintaining production standards and that buyers in the Wellington area have been having a lot of trouble with late deliveries of poor quality bearings. The buyer becomes apprehensive and knows that he can obtain 1,000 bearings from a local source, delivery one month from date of order. He also knows that if the seller's bearings are not up to scratch his sale of 5,000 mowers will fall through and he will be left with the prospect of selling his mowers at a late stage as best he can on

a falling market. He therefore contacts the seller and asks for an assurance that conforming bearings will be delivered on time. The seller advises that he is having difficulties but that the buyer should bear with him and that 'things will probably turn out O.K.'. The buyer hears further distressing reports from the south about the seller's production difficulties and feels that he is entitled to a much firmer assurance from the seller.

As the law now stands the buyer is in a dilemma. The seller is not in breach of contract at that stage and if, therefore, the buyer decides that he cannot risk it and goes ahead and buys from the local source he risks a breach of contract action against him by the seller if the seller ultimately does deliver the goods. On the other hand, if he stays with the seller he risks the loss of his 5,000 mowers sale and goodwill. It is no answer to say that in the latter event the buyer will have a legal action against the seller. What the buyer wants is not the chance of winning a protracted law suit involving difficulties in proving loss of profit but the right to buy elsewhere without the risk of a law suit when the seller cannot give him an adequate assurance of performance.

The chance of winning a protracted law suit is all that our law affords the luckless buyer. Black is black and white is white with the law - either the seller has breached his contract or he has not. As the seller has not at the material time breached the contract the buyer is left lamenting. It is suggested that commercial realities dictate a change in this particular aspect of the law.

More generally those same realities dictate change throughout the law of sales.

Basis of Contractual Obligations:

It is not possible in a paper of this nature to conduct an exhaustive review of the deficiencies of our law of sales and the final example is selected because it relates not only to sales but also to commercial obligations in a wider field.

A promise is binding under our law not because it is a promise solemnly given or an undertaking formally entered into or a representation upon which another person has relied but because it is given in return for something. The notion is that a promise should only be binding if it forms part of a bargain where the promisor and the promisee each get something. In legal jargon it is said that a promise is only binding if given for consideration.

The notion of bargain as the foundation of contractual obligations is deep-rooted in our law but this is not to say that in today's conditions it is the proper foundation for determining when a person will be bound to keep his promise. The Courts have in recent years recognised that promises given during the performance of a contract ought to be binding if the other party has relied on them and would suffer if the promisor was not kept to his promise.

On the other hand, the Courts have refused to go one step further and hold that a promise given outside the sphere of a binding contract is enforceable. Thus, if the buyer promises the seller after the contract of sale is concluded that he will accept the goods if they are delivered in Wellington and not in Auckland as originally stipulated, the seller can properly deliver the goods in Auckland without risk that the buyer will repudiate the contract. The buyer will be bound to accept delivery in Auckland notwithstanding that his waiver at the seller's request of the obligation to deliver in Wellington is given without any quid pro quo. This is a promise given without consideration but nevertheless given in the context and during the course of performance of a binding contract and the Courts have held the promise of the buyer to be binding.

However in the following example the result is quite different. The buyer might be tendering for the construction of, let us say, a sub-station for a local authority. In order to settle his tender price he wants to be sure of the price of his materials. He therefore contacts the seller and asks for a firm quote on the price of a particular kind of transformer. On the basis of this firm quote he lodges his tender and a few weeks later finds out that it is successful. Before he is able to contact the seller the seller writes advising that his earlier price no longer stands and that he can now supply the goods only on the basis of a price 50% higher than that originally quoted. By this time the buyer is of course bound to construct the sub-station for a given figure and the difference between the two prices for the transformer is the difference between a profit and a loss.

As our law stands the buyer cannot hold the seller to the original figure, even though the seller knew that the buyer was relying on it in making a tender to the local authority. The reason why the seller's quote or original promise to sell the transformer at a given figure is not binding is that no consideration has been given for the promise to keep the offer to sell open for a period.

It is high time that this concept of bargain and

consideration be re-examined in the context of commercial dealings. A firm promise given in a commercial setting ought to be binding at the very least if the person making it knows that the person to whom it is made is going to rely on it and if the latter person does in fact rely on it.

Hire Purchase:

Another aspect of our commercial law urgently in need of reform is the law relating to hire purchase. The task of ascertaining what the law is with regard to a hire purchase transaction is extremely difficult. The law on the topic is splattered over a number of sources including vast numbers of decisions by the Courts and a miscellany of statutory provisions contained inter alia in the Hire Purchase Act 1939, the Sale of Goods Act 1908, the Property Law Act 1952, the Bankruptcy Act 1908, the Mercantile Law Act 1908, the Chattels Transfer Act 1924, the Chattels Transfer Amendment Act 1931, the Chattels Transfer Amendment Act 1953 and the Statutes Amendment Act 1936.

The writer respectfully adopts the submission of the Hire Purchase Association of New Zealand to the Tariff and Development Board when it said of hire purchase law:

> "It is submitted that the current legislation is to be condemned on account of unnecessary complexity; much of it is archaic; many important provisions are obscure; a number of arbitrary distinctions are drawn; in some respects it is inflexible to the point of harshness; in places it exhibits a curious confusion between concepts usually distinct and in some places it is contradictory."

Because of the complexity of the procedure required for the registration of security instruments, hire purchase agreements in respect of a number of goods (known as customary chattels) are excluded from the requirements as to registration. Unsatisfactory features result from this system. In the first place we will always have anomalies arising from the exclusion or inclusion of certain goods from the description of a customary chattel. Thus, the New Zealand Law Reports are customary chattels but none of the Australian Law Reports are included.

More serious, however, is the problem of the person buying a customary chattel from somebody else. He can never know whether the seller is really the true owner because without registration there is no record to which he can turn to ascertain whether the goods he is purchasing are really owned by the vendor or whether

they are held by him under a hire purchase agreement. The luckless purchaser who buys a customary chattel, e.g., a motor mower, from a vendor who holds it on hire purchase, will be left lamenting. The finance company or the dealer can repossess it and the purchaser has no rights.

What is needed is a central register for all hire purchase agreements with legislation making it compulsory to have brief particulars noted in a central register to which any person can have access. An information service along these lines is run by a private company in England but there is no parallel service in New Zealand, or at least no service which enables any member of the general public to ascertain whether his prospective vendor or mortgagor holds the asset on hire purchase.

There are a number of other aspects in the law of hire purchase which give cause for concern. From the consumer's point of view there are shortcomings when goods are legally purchased from the finance company and not from the dealer. This is the usual English and Australian set-up and while not prevalent in New Zealand it is becoming more common. Under it, the goods are sold by the dealer to the finance company and the finance company then sells on hire purchase to the customer. The customer thinks he is buying from the dealer - in law he is buying from the finance company. The problem is that the dealer may make representations concerning the quality of the goods and these may prove to be false. The customer then refuses to meet the hire purchase payments to the finance company on the grounds that he has been misled as to the nature and quality of the goods. He will find, however, that in many cases the finance company can enforce the agreement in its full rigour because the dealer in law is not the agent of the finance company.

The Courts are now starting to have second thoughts about this rule but the balance of authority is in favour of the view that quite apart from any exemption clauses the customer will have no remedy against the finance company for misrepresentations which do not amount to a fundamental breach. We should give consideration to amending the law to make the finance company responsible for the dealer's representations. Although the finance companies would not be at all happy about this they could protect themselves by adequate recourse agreements against the dealers. Furthermore, such an amendment would provide an effective incentive to ensure that finance companies back only reputable dealers.

Another area where the rights of the respective

parties is far from clear arises when something is added to the item purchased on hire purchase. For example, tyres purchased on hire purchase might be fitted to a vehicle purchased on hire purchase. On repossession does the vendor of the vehicle get priority over the vendor of the tyres? The answer is far from clear. A similar sort of problem arises where chattels under hire purchase are affixed to land.

The Hire Purchase Act 1939 is designed to give the hirer protection where the goods are repossessed but curiously the same protection does not endure for the hirer who voluntarily gives up the goods and in the latter case the hirer may be in a considerably worse position than he would have been if the goods had been forcibly retaken, by reason of certain minimum payment clauses contained in the hire purchase agreement.

Other problem areas include the rights of hirers to rebates for early repayments and the rights of hirers who voluntarily return the goods when they cannot keep up the payments.

Finally, it should be said of hire purchase law that it provides a good example of the failure on our part to treat commercial law as an organic whole and to see the way in which commercial transactions and concepts interlock. We have tended in the past to emphasise the extent to which a hire purchase contract resembles a sales contract and while an analogy may be good for some purposes it is vitally important that we should recognise that in many other respects a hire purchase transaction is really of the nature of a lending transaction. The vendor under a hire purchase agreement is in many ways the equivalent of a lender. He is owed money and he has a security interest in the goods to secure payment of that money. If sales, hire purchase and security interests are all dealt with in one comprehensive code there will be recognition of the interdependence of these different transactions.

Borrowing:

We have reached a stage where even some finance companies lending at interest rates of 12% and upwards are entertaining loan applications only on the basis that the borrower can offer land as security. Forms of security over other types of property are regarded by lenders as suspect to a lesser or greater degree. It is true that reliance is placed on the debenture as a security device but even this leaves a good deal to be desired.

Whether the attitude of caution and scepticism on the part of lenders is wholly justified is open to

question but nevertheless in the writer's experience it is the case that security other than in the form of mortgages over land will be looked at long and hard by lenders. This attitude is engendered at least in part by the advice that the legal profession has had to give to lenders on the workings of security devices other than mortgages of land. A complete revamping of the law relating to securities would go a considerable distance towards allaying the caution hitherto exhibited by lenders.

It is illogical that a commercial borrower with a piece of land worth £5,000 should have no difficulty in raising £3,000 but that a dealer in, say, motor vehicles with stock on hand worth, say, £10,000 should have difficulty in securing a loan at all mainly because he is situated on short term leasehold and not freehold premises. The obstacles in the way of achieving satisfactory security interest in chattels are numerous and it is proposed to consider them briefly in this paper as an illustration of the shortcomings of our commercial law generally.

Floor Planning:

A case which illustrates some of the inadequacies is the case of the motor vehicle dealer who needs finance to enable him to build up his stock of motor vehicles. Because the nature of his stock involves heavy outlay he is obliged to look for finance. This is generally effected in New Zealand through what is known as a floor plan or a stocking agreement. The financer purchases the vehicles from the manufacturer and leases them to the dealer or sells them to the dealer on a conditional sale which reserves title to the vehicles in the financer. The security interest for the financer rests in his title to the goods. The notion is that although the vehicles are on the dealer's floor they really belong to the financer.

Registration of separate documentation for each transaction is impractical and the security interest obtained is for a number of reasons quite unsatisfactory. In the first place, the lender loses his security interest when the vehicle is sold. Furthermore, the lender is in all probability deprived of his security interest in the event of bankruptcy of the dealer because the vehicles will be held to be within the order and disposition of the bankrupt dealer. The lender can also in certain circumstances be deprived of his security where the unsatisfied creditors of the dealer seize the vehicles. Finally, there is a real question in New Zealand whether such a floor plan arrangement or stocking agreement might be entirely void inasmuch as it may amount to money-lending and be unenforceable under the provisions of the Money-

lenders Act.

Line of Credit on Shifting Stock:

So much for the motor vehicle dealer. Consider now the case of Mr Jones. Mr Jones has hit upon a means of distributing fertiliser over farm land which is far superior to any device hitherto used for the purpose. He has a flood of enquiries not only from New Zealand but from Australia and it is evident that there is a good export market for his machine. He is in business in a small way and he does not have the finance to enable him to forge ahead. He has no established past record and the Banks turn him down so he turns to the finance company and offers as security the machines which he has in stock together with a stock of fire extinguishers which he is wholesaling. Both the fertiliser machines and fire extinguishers are excellent security insofar as there is a ready and proven market for them. The finance companies, however, turn him down flat and it is worthwhile considering why.

What the lender requires is one simple agreement which will secure not only money advanced at the time of the agreement but further advances that are required by the borrower from time to time. Because the nature of the security is comprised in stock in trade it will be important to the lender that the security attach not only to the stock in the hands of the borrower at the time of the agreement but also to the stock acquired thereafter. It will also be important to the lender that the proceeds from disposal of the fertiliser machines be available to the lender as security. Thus, if Mr Jones sells on hire purchase the lender will want the hire purchase paper to stand as security in place of the machines sold. Neither the lender nor the borrower want to be put to the trouble of executing fresh documents on each occasion that a further advance is required by the borrower or when further property is acquired by the borrower which replaces stock in trade disposed of. However, the law is such that filing of successive security instruments is necessary in each of the events aforementioned if the lender is to have satisfactory security.

It would be open for the lender to take a debenture if the borrower was a company and the position of a debenture will be considered hereunder, but apart from the debenture our law provides for no effective security device to secure further advances, property acquired after the date of the first advance and the proceeds of sale of stock in trade.

It is possible to take a mortgage (called an

instrument by way of security) over the machines but the legislation states that the property affected by the mortgage must be precisely specified in the instrument and further states that the security will be void as against bona fide purchasers and creditors of the borrower in respect of property acquired after the date of the instrument. With regard to after acquired property there are some statutory exceptions relating to substitute machinery, engines, plant etc., houses on specified land and livestock but these exceptions do not go far enough and to all intents and purposes a lender is not able to obtain an effective security in respect of after acquired property.

With respect to further advances (that is, advances made after the date of the security instrument) the Legislature has recently attempted to modify the law so as to permit further advances being effectively secured by an earlier instrument over the property specified in that instrument but unfortunately the provision is quite ineffective in the context of this problem.

It would be possible for the lender to obtain adequate security by insisting on registration of a new instrument each time there was a further advance. However, such a procedure is quite impractical. In the first place the listing of the security would be extremely tedious, especially where the security is over stock in trade comprised of, say, bolts of material. Secondly, the borrower will be most reluctant to have a number of instruments registered against his name appearing in the Mercantile Gazette.

The Government has indicated an intention to set up a Development Finance Corporation and one of the reasons for so doing was that certain promising and developing commercial concerns required in the national interest financial support which could not be obtained through existing institutions. Mr Jones' business would presumably be a typical case. One wonders whether the justification for the proposed new institution would continue to exist if existing lenders could obtain a satisfactory security interest in stock in trade.

Protection for Third Parties Unsatisfactory:

Quite apart from the unsatisfactory nature of the security offered to the lender the position of parties other than the borrower and the lender is also unsatisfactory. Thus, where a chattel mortgage is registered a bona fide purchaser of stock in trade from the borrower will take subject to the lender's charge. A purchaser of a piece of machinery might

find some months after completion of the purchase that a lender he has not heard of wants to seize the goods and sell them. There is nothing that the purchaser can do about it. The answer usually given is that it is the purchaser's own fault because the charge was disclosed on a public register and could have been discovered if a search had been made. In the context of a commercial purchase of inventory in the usual course of business this is an utterly unrealistic approach.

Even if the buyer is minded to search the register his protection is inadequate. Let us suppose that you want to buy a boat or lend money on the security of a boat. You want to make sure that the seller can give you unencumbered title or security. If the seller is a company you will have to search at the Companies Office of whichever centre the company was registered. If the seller is an individual there is no way of being sure of the position short of searching at each of the Supreme Court Registries thoughout the country. If you search only at Auckland you may later find to your sorrow that an unpaid mortgagee will seize the boat under an instrument registered at Whangarei.

The rights of other creditors are defeated where the lender finances a borrower dealer by buying the dealer's stock, allowing the dealer possession and selling it to him on hire purchase or allowing him to hold it on bailment. The general body of creditors may extend credit to the dealer on the basis that the dealer holds valuable stock which gives him the appearance of substance. The unpaid creditor sues the dealer and goes to levy execution against the stock only to find that it does not really belong to the dealer. The agreement between the dealer and the lender is not registered and the creditors had no means of checking as to whether the dealer really owned the stock. The execution creditor has no remedy against that stock, nor has the liquidator if the dealer is a company. If the dealer is an individual and goes bankrupt the Official Assignee may be able to take the stock for the benefit of the creditors, but even he will be powerless if the lender is a wholesaler and the stock is comprised of customary chattels.

The law so stated is patently unsatisfactory but the means by which the law has to be ascertained is even more cause for despair. Space does not permit us to trace in this paper the reasoning behind the propositions baldly stated but the reader can be assured that it is complex and tedious, requiring a degree of mental agility which we are not justified in demanding - even of the legal profession.

Debentures:

An argument will no doubt be advanced in reply to some of the points made urging that security interests can satisfactorily be obtained in property other than land provided that a debenture is taken by the lender. In the first place this argument acknowledges that there is no inherent reason why satisfactory security interests and chattels for the purposes of inventory financing cannot be obtained. With that acknowledgement the question must immediately be asked why it is that we should permit of such a security in the case of companies but prohibit it in the case of an individual or partnerships. It is difficult to think of any substantive reason why companies should be treated differently.

But quite apart from this objection the debenture as a security instrument leaves a lot to be desired. A debenture is said to create a floating charge which attaches only on the happening of a given event. Usually it attaches only when the borrower gets into difficulties. By that time of course it may be too late. Before the lender has notice of the fact that the borrower is in difficulties a buyer might have purchased all of the stock in trade and acquired title thereto, leaving a debt owing to the company which may not be enforceable or if enforceable leading only to an empty judgment. Furthermore the charge given by a debenture can usually be defeated by later specific charges given over specific assets.

One of the main difficulties with a debenture is that it does not give security to the lender in respect of further advances where the debenture holder has notice of a charge given to somebody else after the date of the debenture. The Legislature attempted to get over this difficulty by passing section 80(a) of the Property Law Act 1952. This section, however, is inadequate because among other reasons it applies only to debentures which specify a total principal sum to be advanced and this is quite impractical in the case of bank debentures and current account lending by suppliers and finance companies. In the result a debenture which secures current account lending can be defeated by charges given by the borrower prior to the time when the further advances are made.

The floating charge is also defeated by judgment creditors and landlords distraining for rent if they complete their execution before the charge in the debenture crystallises.

If the security given to a lender by a debenture is not all that the lender would like it might be

inferred that other creditors have greater rights than they should be entitled to. Curiously this is not the case. A debenture can be used to secure a debt which should not be secured and to defeat the rights of other creditors. A floating charge given to secure a past advance within twelve months of winding up by a company insolvent at the time of its execution will be void as against the general body of creditors if the company folds within the twelve month period. The idea is that one creditor should not be permitted to obtain an unfair preference over the others by taking a debenture to secure his debt when the company is insolvent. The trouble is that the prohibition is easily circumvented. Astute creditors adopt one of two ploys. The prohibition relates only to floating charges so one answer is to make the debenture a fixed charge over as many of the assets of the company as prudence permits. The other tactic is to enter the debt owing at the time of the debenture in a current account and supply the debtor company with as many goods as possible after the granting of the debenture and at the same time ensure that they are paid for by, say, monthly remittances which do not correspond with any particular invoice. These payments are then appropriated by the creditor to the current account and the result is that under the rule in Clayton's case the debt owing at the time of taking the debenture is liquidated by the time of winding up. At winding up the debenture holder has a debt which has wholly arisen since the execution of the debenture and the general body of creditors are left lamenting.

Moneylenders Act:

Without doubt the most glaring legislative anomaly in New Zealand commercial law is the Money-lenders Act 1908. This anachronistic piece of English nineteenth century legislation was an attempt to redress the balance between loan sharks with three-ball signs on the street and the gulliable Mr John Public whose education had been stinted by employment in a cotton mill from the tender age of 12. But because of the wide definition of 'moneylender' contained in the Act it applies today to commercial loans between reputable finance companies and substantial companies under the control of sophisticated and intelligent management. The raison d'etre of the legislation no longer exists, at least inasmuch as it applies to loans to companies. Some of the consequences are quite appalling and if the writer sounds a little bitter it is because the legal profession, particularly those members acting for finance companies, bears the brunt of the criticism of the commercial community when its desires and objects are frustrated by legal advice to the effect that the transaction cannot be done in the way it is required to be done, or cannot be done

To take but a few of the examples of the irksome and senseless restrictions contained in the Act will suffice to make the point. Progress payment loans cannot be safely made by a finance company. It is a legitimate and proper function for finance companies to provide interim finance to enable a company to, say, construct a building. It is essential in such a lending transaction that the money be made available by a number of instalments as the building progresses and the builder calls for progress payments. The normal procedure adopted by institutions which are outside the provisions of the Moneylenders Act is to have the mortgage expressed to secure, say, £50,000 to be advanced by such instalments and at such times as the borrower may require subject to the lender being satisfied that there is adequate security for the further advances. The Moneylenders Act requires, however, that prior to the money being lent or the security being given a memorandum of contract must be executed by the borrower, containing all the terms of the loan including the date of the loan. By virtue of the Acts Interpretation Act it is possible to read "date" in the plural, but in the light of a recent Court of Appeal decision it would be most dangerous to assume that the term "date" meant a date to be fixed by the parties in accordance with a formula.

By the very nature of a progress payment loan the dates on which the further advances will be required cannot be set out at the time the mortgage is given. It is therefore impossible to comply with the terms of the Act and the finance company cannot safely proceed with a progress payment loan because under the provisions of the Act failure to conform therewith results in an unenforceable obligation to repay.

For similar reasons a variation of a moneylending transaction is impossible. It may be, for example, that the borrower wishes to have the term of his loan extended for, say, one year. If the finance company simply agrees to this it finishes up with an unenforceable loan. When it comes to enforcing the loan the borrower is able to say that there is no memorandum of contract in respect of the varied loan, or if there was a further memorandum executed at the time of variation, that that memorandum was not executed prior to the security being given.

To take another instance where the unsuspecting finance company can find itself in trouble, consider the case where Mr Jones duly executes a proper memorandum of contract and borrows £1,000 on the security of a speculation house purchase. Two months later he sells to Mr Smith, another speculator, subject to the mortgage but without reference to the finance company. Mr Smith takes up payments to the finance

company but shortly thereafter he defaults. The finance company goes to sell the property under the powers of sale in the mortgage only to be confronted by the argument that the loan is unenforceable against Smith because he did not sign a memorandum of contract before the security was given.

The traps in the Act are legion. As has already been pointed out if the parties wish to vary the terms of the deal during the currency of the loan a complete set of fresh documents must be executed. This in itself is bad enough but the problems by no means end at that point. It may be that the lender has agreed to extend the terms but that the prevailing interest rates have gone up and that the extended term will therefore be at a slightly higher rate of interest. If the original loan is not at that time due for repayment it is arguable that the fresh set of documents will be void if they simply state the new interest rate. If the original loan still had another year to run at the rate of, say, 8% and the new loan is to be for an identical amount for a period of 3 years at 9% it is arguable that the lender is getting a bonus, in that for the unexpired portion of one year he is getting an interest rate which is higher than the rate the borrower is legally obliged to pay for that year. To the extent that the new rate exceeds the old rate for a period of a year there is a bonus for the lender and because of the peculiar definition of the term "interest" which may be incorporated in our Act from the English Act, this bonus may be termed "interest" under the Statute and the new memorandum if it quotes the interest rate at 9% may be void and the repayment of the new loan unenforceable by the lender.

It is true that the rigour of the Act has been ameliorated to some extent by a provision which empowers the Court to validate the transaction notwithstanding a technical breach of the requirements of the Statute. This provision is, however, of little comfort to the lender. In the first place it might entail protracted litigation with an uncertain outcome and in the second place even though the transaction may be validated the lender may by that time have lost his security. It is not clear whether the validation operates retrospectively and by an analogy with holdings of the Court in other fields it is quite probable that it does not. Thus, a loan documented in 1964 and void for some technical breach of the requirements of the Statute may be validated by application to the Court in 1966 when the defect becomes apparent. By that time it might be too late. The borrower might have disposed of the security and the result of the validation will simply be that the lender can enforce repayment from the borrower but that the lender has

no security to enforce the loan. Furthermore, if the validation is not retrospective the lender will lose his interest on the loan from the date thereof until the date of validation.

The Act requires that a memorandum of the terms of the contract of loan be signed by the borrower which contains all the terms of the contract. Among the terms of the memorandum of contract of loan is a term requiring the borrower to give security which will in the usual case be either a mortgage of land, a debenture or an instrument by way of security. Each of these security documents contains a number of terms and obligations which the borrower must comply with. Thus, for example, it might be a term of the mortgage that the borrower repaint the house which constitutes the security at least once every five years. The security document will contain a number of like obligations designed to protect the security.

Logically, each of the obligations contained in the security documents must be considered a term or condition of the contract of loan and must therefore be set out in the memorandum in order to comply with the Statute. Similarly, the provisions implied by statute in various security documents must also be included. In the result, lenders are obliged to draw a memorandum which is an exceedingly complex document. It should have annexed thereto and forming part of the memorandum the actual security documents and a transcript of the implied statutory provisions. Thus, in the simple case of a husband and wife borrowing £500 on the security of their house there will need to be three memoranda of contract, a copy each for the borrowers and a copy for the lender, each of which has annexed thereto a copy of the mortgage, the implied terms and, usually, a bankers order. This memorandum is executed by the borrowers and immediately thereafter they execute the actual security documents. Because the memorandum must contain all the terms of the contract it must of course specify the date on which the loan is to be made. If some holdup occurs and the loan moneys cannot be advanced on the date named in the memorandum all the documents will have to be retyped and re-executed.

The complexity of the memorandum defeats the object of the Act. One of the purposes of the Act was to provide a simple memorandum of the terms of the loan which the borrower could consider before he bound himself by signing the security and taking the money. But in practice the memorandum is usually signed contemporaneously with the security documents and because of its length and complexity borrowers rarely read it before signing. It is just one further document which has to be signed. It therefore fails

utterly in its object of informing the borrower before he binds himself of the terms of the transaction and affording him the opportunity to reconsider it.

There is a great deal of uncertainty as to the type of transactions which are affected by the Act. A moneylender is defined as every person whose business is that of moneylending or who advertises or announces himself or holds himself out in any way as carrying on that business. There are certain exclusions from this definition and by virtue of those exclusions banks and insurance companies are not affected by the Act. Throughout the country there are hundreds of estates handled by solicitors which invest their funds by making private loans on first or second mortgages. Are these estates carrying on the business of moneylending? The fact that a similar question was recently taken to a Court of Appeal indicates that the point is open to argument. If such estates were held to be moneylenders there would be literally thousands of loans throughout New Zealand which would be unenforceable.

The types of transactions covered are also difficult to define. It has been held that the discounting of hire purchase paper does not amount to moneylending but on the other hand the purchase of cash orders has been held to be covered by the Act. There is a very real question as to whether commercial floor plan financing may amount to moneylending and there are a number of commercial transactions entered into every day where there is real doubt as to whether or not a moneylending deal is concluded.

Amendment to the Act is urgently required and it is suggested that the provisions thereof should have no application to loans to companies or to loans to individuals where the amount already exceeds £1,000 or to any lending transaction with an individual, regardless of the amount, where there is a solicitor acting for the borrower. This may be the most that is politically acceptable but it is suggested that the Act should, ideally, be repealed in toto and replaced by an Act which requires registration of moneylenders and empowers the appropriate authorities to revoke the licences to operate if the particular activities of a moneylender are unconscionable.

The Case for Reform:

It has been necessary in this paper to examine but a few of the matters in our commercial law which require the attention of the Legislature. The topics covered have been disparate and isolated. The case for reform rests not just on those items specifically referred to but on a host of others, embracing not or

the law of sales and the law relating to finance but also the law as to banking, negotiable instruments and contracts of carriage. Within the law of sales and financing itself the case for reform rests not on the items mentioned in this paper but on a host of others within those fields. It would be an immense task for this country to embark on a comprehensive revision of its commercial law if it was to undertake a review without the guidance of a comprehensive code enacted in another jurisdiction. No such code has been produced within the Commonwealth but fortunately we are provided with a magnificent example of what can be done.

The Uniform Commercial Code:

The United States is a common law jurisdiction, that is to say the laws regulating life in general in the United States are substantially the same as the laws which regulate us in New Zealand. There is in fact little more dissimilarity between the law of the State of Illinois and the law of New Zealand than there is between the law of New Zealand and the law of Australia. American law is based on English law in exactly the same way that our law is so based. Up until the 1950's American commercial law was very similar to our own and the statutes governing the same were closely modelled on the English Statutes which we have followed.

Just before the War, businessmen in New York indicated real concern over the state of commercial law in that jurisdiction. The parallel between the law of that jurisdiction at that time and the law of New Zealand now is startlingly similar and the defects complained of by the commercial community in the United States are substantially the same kind of defects we now suffer. An ambitious programme was embarked upon with a view to embodying the whole of the commercial law which had hitherto been splattered over a multitude of sources into one comprehensive code which not only consolidated the law but amended it so that it furthered rather than defeated the reasonable expectations of the commercial community. The magnitude of the project was such that some fifteen years passed before the Uniform Commercial Code was first enacted. During that period the Code had been drafted and redrafted, refined, changed, discussed and debated at almost inordinate lengths.

Of particular significance is the part which the commercial community played in the promulgation of the Code. Bankers and their associations, Chambers of Commerce and like commercial bodies were not only consulted in and during the development of the Code but played a very important part in formulating its con-

30 of the States of the United States and it is confidently expected by promoters that enactment in the remaining States will be effected within a few years.

The Code is divided into 9 parts. The first part deals with general principles of construction and interpretation and the remaining parts deal with sales, commercial paper (that is, negotiable instruments and the like), bank deposits and collections, letters of credit, bulk sale transactions (that is sales effected to defeat creditors), warehouse receipts, bills of lading and other documents of title, investment securities and finally the secured transactions.

It is interesting to note the way in which some of the problems mentioned in this paper are dealt with under the Code. Thus the concept of privity of contract between consumer and manufacturer is expressly modified so that the retail sellers warranty extends to members of the buyers family and the case law permits actions by consumers against manufacturers. The unhappy commercial buyer is given the right to call for an assurance of performance from the seller and if it is not forthcoming he can regard the contract as repudiated and is free to buy elsewhere.

The exemption clauses which deprive consumers of protection in our jurisdiction are dealt with by providing that words or conduct relevant to the creation of an express warranty and words or conduct intended to negative or limit a warranty shall be construed wherever reasonable as consistent with each other and, by and large, negation or limitation of warranties is inoperative to the extent that such a construction is unreasonable. The Code protects "a buyer from unstipulated and unbargained language of disclaimer by denying effect to such language when inconsistent with the language of express warranty and permitting the exclusion of implied warranties only by conspicuous language or other circumstances which protect the buyer from surprise". It will be remembered that the buyer's right of rejection of goods under our Statute depends on the technical distinction between condition and warranty and the technical issue as to whether the property has passed. The Code simply provides that if the goods on tender or delivery fail in any respect to conform to the contract the buyer may reject the whole or accept the whole or accept any commercial unit or units and reject the rest.

The 'firm offer' problem is dealt with in the Code by a provision which states that an offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not recoverable for lack of consideration during the time stated.

With regard to security instruments Article 9 of the Code deals comprehensively with the law relating to lending on the security of chattels and does so in a comprehensive fashion which is in no way dependent on the particular form that the borrowing takes, that is to say, it matters not whether the form of security is a chattel mortgage, a consignment plan, a conditional sale agreement, a pledge or an assignment by way of mortgage. The distinctions are not drawn on formal lines but rather between the different types of property which constitute the security. The Article, therefore, has particular provisions which relate to accounts and contract rights and others which relate to such items as chattel paper, general intangibles, consumer goods, equipment, farm products and stock in trade.

One of the problems mentioned with regard to our Chattels Transfer Act was the requirement that the chattels charged should all be specifically described and it was indicated how impractical this was, when the security was, say, stock in trade. Our Act also requires successive filing of documents when further property to be subject to the charge is later acquired by the borrower. The Code requires only that a general description of the type of goods covered be given and no successive filing is required to afford protection. All that is required under the Code is a financing statement signed by the borrower and lender which gives an address for the parties and contains a statement indicating the types or describing generally the items of the property charged or to be charged. Thus, the secured property can effectively secure later advances and an effective security interest can be obtained in after acquired property. Except as to consumer goods the fact that after acquired property is to be secured is disclosed in the filed statement and third parties are therefore protected.

Equally important is a provision which ensures that the security attaches to the proceeds of sale of items covered in the security agreement. If the security agreement is expressed to cover 50 sewing machines and the borrower sells the sewing machines proceeds may constitute cash, a debt, a tradein or goods taken in exchange. The lender's security interest attaches to those proceeds and if the proceeds are used to purchase further stock the security interest attaches to the new sewing machines purchased to replace those sold. The rights of third parties are protected by provisions which ensure that buyers in the ordinary course of business take free of the security interest and that other creditors are protected against security instruments which are not filed and available for inspection.

By comparison with a debenture the Code provides a security which is available whether or not the borrower

is a company and provides further that the charge is at all times crystallised over the assets comprised in the agreement. The priority of competing claims of purchasers and subsequent charges and creditors is dealt with in a simple and logical fashion without recourse to the artificial concept of crystallisation.

The emphasis throughout the Code is on commercial practice and cause of dealing while imposing on overiding obligation of good faith in the performance or enforcement of any contract or duty. It represents a tremendous advance.

Recommendations:

In a word, the trouble with our commercial law is that it has failed to move with the times. The changes which have been effected have been passed in a piecemeal fashion and the result is a confusing patchwork. The tendency seems to be to let well alone and to act in the legislative field only when the raw spots become unbearable. This is akin to leaving the patient with his pains and ailments until he is on his deathbed and then patching him up to enable him to survive, but only just. The result has been to bring the law discredit in the commercial community and to leave the legal profession to take the brunt of the expressed dis-satisfaction.

This paper recommends the adoption of the Uniform Commercial Code with such deviations as are required by local conditions. The course of commercial dealing in the United States and New Zealand is similar, at least in those areas to which the Code pertains and there is no reason why it should not be adopted in this country, notwithstanding that it would depart from English precedents. We have been slaves for too long to English initiative or lack of it! For reasons of history we have tended to confine our legal horizons to the United Kingdom. The time is well past when we should have recognised that the leading and most progressive common law jurisdictions are found in the United States. Mainly by virtue of their wealth of experience and the extent of their resources they are enabled to embark on programmes of law reform which are beyond the capabilities of law reformers in the United Kingdom. They have the added advantage of being free from the judicial straitjacket of slavish adherence to precedent. They have had the benefit of a diversity of holdings of Courts in 50 state jurisdictions and academics have been thereby offered the opportunity of choosing those lines of development which hold the most promise. The Uniform Commercial Code is a result of the advantages which the Americans enjoy.

We are now provided with an opportunity of capitalising on the most thoroughly scrutinised and carefully prepared Code known in recent legal history. The need for reform is pressing and what would otherwise be a colossal task is by virtue of the Code a task which is manageable within New Zealand resources.

It is the writer's view that this Conference should recommend to the Minister of Justice that machinery be set up to examine the Uniform Commercial Code and in particular Articles 2 and 9 thereof with a view to their enactment in New Zealand, with such changes and modifications as may be required by local conditions. It is the writer's further view that this Conference should recommend the repeal of the Moneylenders Act or its modification along the lines suggested in this paper.

C.J. Fernyhough

RECOMMENDATIONS

FOR

COMPANY LAW REFORM

BY

PROFESSOR J. F. NORTHEY

RECOMMENDATIONS FOR COMPANY LAW REFORM

The areas of company law where reform is called for are reasonably well delineated by recent reports. Some of the problems that are being discussed are not new. Some are in fact hardy perennials but they continue to agitate law reformers and bedevil the business community. In the United Kingdom, there have been two reports on company law reform in the past twenty years. The first, known as the Cohen Report,[1] lead to many changes when the Companies Act was passed in 1948. Indirectly, that Report was the inspiration for many of the changes made by our own Act of 1955. The second report, the Jenkins Report,[2] has met with little success. In New Zealand, provision is made in the Companies Act 1955, s.472 for the appointment of an advisory committee; such a committee was responsible for making recommendations concerning take-over offers which were given effect to by the Amendment Act of 1963. This committee made a further report to the Minister earlier this year, but unfortunately the report has not yet been made public and it may not in fact be issued.

A list of company law problems demanding the attention of the law reformer would include:

the doctrine of ultra vires;
investor protection
provision for the incorporated partnership;
disclosure in company accounts;
shareholder control;
pre-incorporation contracts;
the duties of directors;
protection of minority shareholders.

It is obviously impossible in a paper such as this to cover adequately any of these topics. Six subjects have been chosen; the paper does little more than introduce the problem and indicate the general approach of the author. It has been assumed that the discussion to follow the paper will cover other aspects of the problems and thereby assist the formation of a balanced judgment on the issues. The following topics have been selected for consideration in this paper:

(1) The doctrine of ultra vires;
(2) Disclosure in accounts;
(3) Flat-owning companies;
(4) Shareholder control;
(5) The director's duty of good faith; and
(6) Use of confidential information.

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1 Cmd. 6659 (1945).
2 Cmnd. 1749 (1962).

(1) The Doctrine of Ultra Vires

This is a hardy perennial which nonetheless remains a problem. The doctrine itself need not be stated. It is defended,[3] quite illogically, on the grounds that it protects the subscribers and shareholders on the one hand and the creditors on the other. It is obvious, of course, that the current drafting practice of including a lengthy objects clause in the memorandum diminishes the protection shareholders are thought to derive from the doctrine and that only intra vires creditors in fact secure the protection of the doctrine. The Cohen Committee summarised the legal position in these words:

> ... [T]he doctrine of ultra vires is an illusory protection for the shareholders and yet may be a pitfall for third parties dealing with the company.[4]

That Committee in effect recommended the abolition of the doctrine vis a vis third parties and would have retained it solely as a contract between the company and its shareholders as to the powers of directors. This recommendation was not acted on by the Legislature in the United Kingdom, but in New Zealand certain ancillary objects and powers were implied in memoranda registered after 1 January 1957[5] and a change was made in the law as to the effect of limits imposed in the company documents on borrowing powers of the company and its agents.[6] The Jenkins Committee saw difficulties in giving effect to the recommendation of the Cohen Committee and made a much more limited recommendation (similar in intention to the New Zealand amendment) which would have protected third parties from the operation of the doctrine of constructive notice.[7] A more liberal provision enabling the objects clause to be expanded to include any business in which the company decided to engage, coupled with an extension of s.34(3) to include ultra vires trading debts as well as loans, would probably meet the wishes of the commercial community and also satisfy the members of the company. A company rarely invokes the doctrine of ultra vires in relation to trading debts. It is more likely to be raised by a liquidator or receiver.

(2) Disclosure in Accounts

Despite the changes made as the result of the

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3 E.g., in Cotman v. Brougham, [1918] A.C. 514.
4 Cmd. 6659 (1945), para. 12.
5 Companies Act 1955, s.16(1) and Second Schedule.
6 S.34(3).
7 Cmnd. 1749 (1962), para. 42.

recommendations of the Cohen Committee, it is probably not an exaggeration to assert that company accounts remain almost unintelligble to the general public, including shareholders and intending investors, and that practices continue which are difficult to reconcile with the statutory obligations that full, true and complete accounts be maintained,[8] that balance sheets give a true and fair view of the company's affairs[9] and that the auditors certify that the accounts give a true and fair view of the company's affairs.[10] In saying this, I am fully aware of my lack of competence in the field of accounting; my assertion is based on the apparently unambiguous words used in the statute and my understanding of accounting practices. I am ready to be proved wrong about what I am about to say. Few will, I imagine, challenge the proposition that franker and fuller disclosure is now made to the Commissioner of Inland Revenue than to the shareholders.

I have chosen as an example of practices not consistent with the legislation the creation and disclosure of secret reserves. Such reserves may be created for a number of quite creditable reasons and lack of good faith need not be assumed. However, I adopt the words of Professor Gower who declares:

> "Provided that these reserves are disclosed this is unobjectionable, but if they are concealed the balance sheet becomes misleading and, as a means of assessing the worth of shares, even more unreliable than it always is. The profit and loss account is also falsified if the profit available for dividend is depleted by excessive provisions and this, too artificially deflates the price of the shares."[11]

It must be remembered that this passage was written subsequent to the changes made as the result of the recommendations of the Cohen Committee.[12] The practice apparently persists, despite the provisions of the new legislation and current teaching.[13]

As was shown in the Kylsant case,[14] there is a

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8 Companies Act 1955, s.151(1).
9 Ibid., s.153(1). As to group accounts, see s.156(1).
10 Ibid., s.166(1).
11 L.C.B. Gower, Modern Company Law (2nd ed., 1957), 424. Professor Gower argues that the practice is contrary to the provisions of the Companies Act and in particular to the Eighth Schedule.
12 Cmd. 6659 (1945), 56, 59 - 60.
13 E.g., T.R. Johnston & G.C. Edgar, The Law and Practice of Company Accounting in New Zealand (2nd ed., 1963), 88 et seq.
14 R. v. Kylsant [1932] 1 K.B. 442; [1931] All E.R.Rep. 179.

tendency for the Courts to adopt current practice as the legal standard. If the following statement correctly represents current attitudes, the changes sought to be effected by the amendments made in 1955 may not in fact (or in law) have been translated into practice:

> I am uneasy when I recognise the complacent if not eager way in which secret reserves are generally accepted by directors, auditors and the accountancy profession. Indeed secret reserves seem to be the goal of well-meaning directors.[15]

Essentially, the question is: are accounts where there has been an undervaluation of assets "true"? In addition to any liability under the Companies Act that may attach to accountants, directors and auditors who fail to present or certify "true" accounts, such persons may be liable to compensate those who have sold shares (either as part of a take-over scheme or otherwise) for less than their true value. The implications of the decision in Hedley Byrne & Co. Ltd. v. Heller & Partners, Ltd.[16] have not yet been determined, but it is quite conceivable that a liability may attach to those whose mis-statements cause loss to those who might be expected to rely on them.[17]

The reform needed here is not in the law which is clear enough. "True and fair" are unambiguous words. Practice needs to conform to the legal obligation.

(3) Flat-owning Companies

An example of the company form being used in circumstances where it was not appropriate is the flat-owning company which grants a lease or licence to, or confers some other right of occupation on, its shareholders. The Court of Appeal in Jenkins v. Harbour View Courts Ltd. (not yet reported) recently declared that this sort of arrangement involved a return of capital to shareholders, contrary to the provisions of the Companies Act. The effect of the

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15 Wallace, J., in a paper delivered to the Commonwealth and Empire Legal Conference, August/September 1965, at p.5.

16 [1964] A.C. 465; [1963] 2 All E.R. 575.

17 Admittedly the Hedley Byrne principle has not yet been applied in a contractual situation, but it is doubtful if it is accurate to describe the relationship between directors and auditors on the one hand and shareholders on the other as contractual.

agreements with shareholders left the company without the assets the shareholders' capital had purchased or created. Although the shareholders were obliged, in terms of the articles of the company, to provide funds to meet the claims of the creditors to whom such a company would be indebted, e.g., the local authority, tradesmen, etc., the sums provided to meet rates, maintenance and other costs are not paid as would normally have been the case, from its "capital".

To meet the situation created by the decision, an amendment to the Companies Act has been introduced which declares that flat-owning companies which grant rights of occupation to its shareholders in terms of its articles shall not be deemed thereby to have returned capital to those shareholders. Obviously, some amendment was necessary because so many companies had been established on the assumption that flat-owning companies, which granted shareholders a right to occupy a flat, did not involve a breach of one of the basic principles of company law. But the question remains: is this the best way of meeting the situation? Should some companies be granted exemption from compliance with one of the fundamental principles established in company law? Other countries have adopted legislation which permits strata titles to be issued to flat owners. Such legislation is consistent with our own system of land title registration and, if adopted here, would have made it unnecessary to press into service for an inappropriate purpose the company form.

(4) Shareholder Control

Though the Companies Act of 1955, embodied many of the recommendations made by the Cohen Committee[18] designed to improve shareholder control, the question remains: should that control be strengthened and if so, how? Those matters which are placed in the hands of a general meeting include appointment and removal of directors (but how often is the latter power exercised?) alteration of memorandum and articles, resolutions to wind up, and approval of payments of compensation for loss of office. Provision has also been made for the circulation of shareholders' resolutions, for shareholders to be able to requisition meetings and to have access to information held at the office of the company. In addition the Stock Exchange has imposed other requirements, requirements which are not as well known as those contained in the legislation.[19]

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18 Cmd. 6659 (1945), para. 124 et seq.

19 These requirements are seldom published. A note in [1965] N.Z.L.J. 337 gives details of present re-

The shareholder deserving of sympathy and a measure of protection is the minority shareholder who is being denied a voice in management and is being otherwise discriminated against, but who is unable to bring to an end the state of affairs or even terminate his membership, on satisfactory terms.[20] Provision has been made for cases of oppression,[21] a word yet to be exhaustively defined, but an effective barrier to relief is the doctrine laid down in Foss v. Harbottle[22] which the Jenkins Committee considered, but of which it did not recommend amendment.[23] A paper delivered to the Commonwealth and Empire Law Conference declared:

> "To go back to first principles, to what extent does the minority agree to accept the majority control?
>
> Any person who invests in a company is entitled to expect that:
> (a) The company will be managed honestly; and
> (b) Within the scope of its objects; and
> (c) That the management will be efficient; and
> (d) That the management will be adequately, but not more than adequately, remunerated; and
> (e) That proper dividends will be paid if the company can afford them.
>
> It is only the first two of these matters which can be litigated by a minority shareholder; as regards the others he runs up against the rule in Foss v. Harbottle, or the provisions of the articles. This seems unfair."[24]

But it is doubtful if a shareholder will always have a remedy in respect of breaches of the first

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20 Cf. Re Associated Tool Industries Ltd., [1964] A.L.R. 73, where an order for winding up was refused, but an order for the purchase of the petitioner's shares at a determined price was made.
21 Companies Act 1955, s.209.
22 (1843), 2 Hare 461.
23 Cmnd. 1749 (1962), paras 206 - 207.
24 R. Walton & C.H. Scott, Modern Problems of Company Law, 11. It is too late to urge that class rights should be unalterable without the consent of the class shareholders; decisions such as Dimbula Valley (Ceylon) Tea Co., Ltd. v. Laurie [1961] 1 Ch. 353; [1961] 1 All E.R. 769 and Fisher v. Fasthaven Ltd. [1964] N.S.W.R. 261, (cp. Crumpton v. Marienne Pty. Ltd. (1965) N.S.W.R. 240) show that consent is not always required. In the last two cases an attempt was made to deprive a shareholder in a flat-owning company of his rights of occupancy

proposition.[25] A recent decision, Pavlides v. Jensen,[26] has shown that Foss v. Harbottle will stand in the way of a shareholder who asserts that the property of the company has been sold at a gross undervalue, unless fraud can be established. There is no effective means of securing that management shall be conducted efficiently; the standard of competence demanded by such decisions as Re City Equitable Fire Insurance Co., Ltd.[27] is extremely modest. It is unrealistic to assert that inefficient directors will be removed at a general meeting; few members are sufficiently well informed or capable of rallying enough support to achieve such a result. It is almost impossible also to ensure that the rewards of management are in proportion to its efficiency and the contribution that has been made. To include within the oppression of the minority principle provisions which would enable a shareholder to challenge the directors to establish that there has been adherence to the last three of the five propositions advanced on p.44, supra, would be one means of removing the disabilities under which a minority shareholder suffers and indirectly to achieve a greater measure of compliance with those propositions.

(5) The Director's Duty of Good Faith

The common law position is that directors are in some respects trustees for the company towards which they must act in good faith. This duty has been extended by statute, e.g., as to compensation for loss of office[28] and loans to directors,[29] and it is also expressly provided that an indemnity in respect of liability cannot go beyond s.204.[30]

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25 An earlier part of this paper discusses the possibility of the operation of the principle of good faith being restricted by provisions in the articles.

26 [1956] Ch. 565; [1956] 2 All E.R. 518.

27 [1925] Ch. 407, 427 - 430, per Romer, J.

28 Companies Act 1955, ss.191 - 194.

29 Ibid., s.190.

30 The operative part of this section provides: ... [a]ny provision, whether contained in the articles of a company or in any contract with a company or otherwise, for exempting any officer of the company or any person (whether an officer of the company or not) employed by the company as auditor from, or indemnifying him against, any liability which by virtue of any rule of law would otherwise attach to him in respect of any negligence, default, breach of duty, or breach of trust of which he may be guilty in relation to the company shall be void ....

The first question to which attention is directed is the extent to which the common law duty of good faith can be defined or circumscribed by the articles and not amount to an exemption from liability within the meaning of s.204. It has already been recognised that the phrase "bona fide for the benefit of the company as a whole" does not mean that shareholders are expected to dissociate themselves altogether from their own prospects when considering what is thought to be for the benefit of the company.[31] Nor presumably need directors ignore their personal interests when exercising their rights as shareholders. But limitations do exist. A director cannot exploit confidential information that he possesses in his capacity as a director to make a profit at the expense of the "company". A most unusual illustration of the operation of this principle is Regal (Hastings), Ltd. v. Gulliver,[32] where the directors of a company took shares in a subsidiary in good faith and in terms of an arrangement approved by the controlling company, but when those shares were later sold to a purchaser at a profit of £2.16.1. per share, the House of Lords held that the directors had to account to the subsidiary company (which had changed hands as the result of the sale) for the profit. In effect, this reduced the consideration paid by the purchaser. Lord Russell of Killowen declared:

> "... I am of opinion that the directors standing in a fiduciary relationship to Regal in regard to the exercise of their powers as directors, and having obtained these shares by reason and only by reason of the fact that they were directors of Regal and in the course of the execution of that office, are accountable for the profits which they have made out of them."[33]

But provisions in articles which permit directors to vote on matters in which they have a personal interest are not unknown and are common in the articles of private companies.[34] Is the next step - the inclusion in the articles of provisions which in effect declare the director's interest or the governing director's interest to be identical with the interest of the company - likely to be treated as an exemption from liability within the meaning of s.204 or as a definition of his duty in such a way that the common law rules as to good faith cease to operate. A number

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31 See, e.g., Greenhalgh v. Arderne Cinemas, Ltd. [1951] Ch. 286; [1950] 2 All E.R. 1120.
32 [1942] 1 All E.R. 378.
33 Ibid., 389.
34 Cf. Companies Act 1955, s.199, Third Schedule, Table A, Art. 84.

of recent Australian decisions show that there is substance in the distinction I am attempting to draw.

In Levin v. Clark,[35] the facts were extremely complicated, so much so that the suitability of the company form of organisation (and the principles it carries with it) for certain business transactions can be seriously doubted. It was argued that the directors in exercising their powers had not acted in the interests of the company but to protect the mortgagee whose nominees they were. The relevant portion of the articles read:

> 81. (3) William Eric Addicoat and Augustus William O'Brien are hereby appointed jointly and severally as governing directors of the company and each shall be entitled to hold office as governing director until he resigns or dies.
>
> (6) A governing director for the time being of the company shall have authority to exercise all the powers authorities and discretions by these presents expressed to be vested in the directors generally or in the company in general meeting and all other directors (if any) for the time being of the company shall be under his control and shall be bound to conform to his directions in regard to the company and the company's business.

Clark and Rappaport had been appointed governing directors by the mortgagee in place of those named in the articles.

Jacobs, J., said at pp. 700 - 701:

> "I consider that Clark and Rappaport did act primarily in the interests of the mortgagee once they resumed the exercise of their powers as governing directors. However, I consider that it was permissible for them so to act. It is of course correct to state as a general principle that directors must act in the interests of the company. There is no necessity to refer to the large body of authority which supports this as a general proposition. However, that leaves open the question in each case - what is the interest of the company? It is not uncommon for a director to be appointed to a board of directors in order to represent an interest outside the company - a mortgagee or other trader of a particular shareholder. It may be in the interests of the company that there be upon its board of directors

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35 [1962] N.S.W.R. 686

> one who will represent these other interests and who will be acting solely in the interests of such a third party and who may in that way be properly regarded as acting in the interests of the company as a whole. To argue that a director particularly appointed for the purpose of representing the interests of a third party, cannot lawfully act solely in the interests of that third party, is in my view to apply the broad principle, governing the fiduciary duty of directors, to a particular situation, where the breadth of the fiduciary duty has been narrowed, by agreement amongst the body of the shareholders. The fiduciary duties of directors spring from the general principles, developed in courts of equity, governing the duties of all fiduciaries - agents, trustees, directors, liquidators and others - and it must be always borne in mind that in such situations the extent and degree of the fiduciary duty depends not only on the particular relationships, but also on the particular circumstances. Among the most important of these circumstances are the terms of the instrument governing the exercise by the fiduciary of his powers and duties and the wishes, expressed directly or indirectly, by direction, request, assent or waiver, of all those to whom the fiduciary duty is owed."

The last sentence of this extract can be taken to include the articles of association as a relevant instrument. The articles, taken together with the circumstances in which the governing directors had been appointed, made it clear that the duty of good faith, in the sense of being obliged to act in the interests of the company, had been varied and did not apply.

The second case is Savoy Corporation, Ltd. v. Development Underwriting, Ltd.[36] where again the fact situation was extremely complicated. The arguments presented by the plaintiff were:

(a) that in making a call on the shares the directors were not acting in the interests of the company but to protect their own position as directors and to frustrate the plaintiff's attempt to increase its shareholding; and

(b) that the call was made to facilitate merger proposals with a third company.

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36 [1963] N.S.W.R. 138.

The articles of association were so worded that the directors were not disqualified, by virtue of their shareholding, from voting on the resolution to make a call. Jacobs, J., would have declared the call invalid if it had been shown to have been made to secure the director's personal advantage or gain,[37] but this was not established. He was of the opinion that the directors could not be expected to ignore the infiltration of the company by persons whom they bona fide considered not to be seeking the best interests of the company. However, they were not entitled to identify their personal interests with the interests of the company, however much they considered the company to be dependent on their personal presence in its management. He concluded that, although the call had been made by reference to the merger proposals, it was a reasonable exercise of power.

The third case, Re Broadcasting Station 2GB Pty. Ltd.[38] introduces the element of oppression of a minority. The petitioner was a director and minority shareholder of the company operating Station 2GB Sydney. It was argued that the majority of the directors had voted to promote the interests of the company whose nominees they were. Jacobs, J., though recognising the principle that each director must govern his acts by his appreciation of the interests of the company as a whole,[39] nevertheless declared:

> "It may well be, and I am inclined to regard it as the fact, that the newly appointed directors were prepared to accept the position that they would follow the wishes of the Fairfax interests without a close personal analysis of the issues. I think that at the board meetings of early August that is what they did, but I see no evidence of a lack in them of a bona fide belief that the interests of the Fairfax company were identical with the interests of the company as a whole. I realize that, upon this approach, I deny any right in the company as a whole to have each director approach each company problem

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37 Ibid., 145.
38 [1964 - 65] N.S.W.R. 1648.
39 Ibid., 1662. A clear case where the principle was violated is Re Yorke Stationers Pty. Ltd., (in liq.), [1965] N.S.W.R. 446 where the two shareholders (who were also the directors) sold the assets of the company to themselves for a sum much less than the outstanding liabilities. The resolution approving the sale was declared invalid.

> with a completely open mind, but I think that to require this of each director of a company is to ignore the realities of company organization. [Italics inserted] Also, such a requirement would, in effect, make the position of a nominee or representative director an impossibility."[40]

As to oppression of the minority, he continued:

> "I do not think that there is any evidence that they have acted otherwise than in what they believe to be the best interests of the company. I do not think that it is sufficient that they have put themselves in a position where their interest and the duty which they have taken directly upon themselves may conflict. It would only be in the event that, on a conflict arising, they preferred their own interest that a situation of oppression could arise."[41]

In cases where a shareholder has a nominee on the board, it would seem that the nominee can vote according to the interest of the person whose nominee he is and those asserting a breach of his duty of good faith will have an extremely heavy onus of proof to discharge.

These cases approach but do not encompass the problem raised earlier. They show that the duty of good faith requires that a director should not exercise his powers to secure personal advantage, but it would seem that he may vote to improve the position of a company whose nominee he is and in which he is a shareholder. Such conduct is not necessarily a breach of his duty to act in good faith. He may clearly vote on issues in which he has a pecuniary or financial interest if the articles so provide. The duty of good faith has been emptied of much of its former content which could, it appears, be reduced still further by appropriate provisions in the articles. If this process is regarded in the abstract as objectionable (because it offends a basic principle of company law) legislation must be sought to curtail or reverse the present trend towards contracting out of the principle. Where members of the general public are minority shareholders, their interests could be sacrificied to the advantage of another company or business represented on the board.

(6) Use of Confidential Information

One particular aspect of the more general topic

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40 Ibid., 1663.
41 Ibid., 1664.

already discussed calls for comment. Persons holding multiple directorships are particularly liable to receive confidential information which they may be tempted to use for their private advantage. The principle applied in cases such as Regal (Hastings), Ltd. v. Gulliver[42] would not cover all cases where confidential information had been used. Even the recommendation of the Jenkins Committee which would make a director civilly liable for carrying on the business of the company in a reckless manner does not go far enough and would rarely cover the sort of situation being discussed. A clear statutory provision, perhaps associated with the one recommended on p.45 , supra, to ensure that directors receive only a reasonable reward for their services, is called for. Any private profit made as the result of the use of confidential information should be held in trust for the company as was done in the Regal Hastings case, supra.

The paper has raised a number of issues where reform is thought to be justified, but changes are not likely to be made unless those most affected, the shareholders and the business community, endorse proposals for reform. The Legal Research Foundation which has conducted this symposium is to be congratulated on its initiative in providing an opportunity for discussion of these issues.

J.F. Northey

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42 P. 46, supra. Even Byrne v. Baker, [1964] V.R. 443, where a director was charged with a breach of a statutory obligation to use reasonable diligence in the discharge of his duties, does not take the matter much further than the earlier cases.

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