COMPANY AND SECURITIES LAW AFTER THE MARKET CRASH

Papers presented by

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FOREWORD

by

The Honourable Mr Justice R.I. Barker
President, Legal Research Foundation Inc.

The Foundation’s major seminar for 1989 looks at “Company and Securities Law after the Market Crash”. The Foundation’s policy for its annual major seminar is to invite speakers of eminence from both sides of the Tasman to present papers dealing with many aspects of the subject. It is hoped that the presentations of both speakers and of the distinguished commentators will be of lasting benefit and record to the legal profession and the wider community.

This seminar is obviously timely in the aftermath of the share market crash. Recent corporate collapses and proposed legislative changes being considered by the Law Commission also contribute to its topicality. The input of the Australian speakers points to the desirability of harmonising New Zealand and Australian Commercial Law in the context of CER.

The panel of speakers is one of the most impressive assembled in New Zealand in recent times. The Foundation is grateful to them and to the commentators for their time and effort in preparing and presenting such scholarly papers. Participants and those unable to attend the seminar will benefit from this publication of the papers.

It would not have been possible financially to bring speakers from Australia without the support and encouragement of Qantas Airways; we thank Qantas and particularly its New Zealand sales manager, Mr Phillip Sims. Qantas’ practical help not only facilitates these seminars but enables the Foundation to assist deserving legal scholars wishing to conduct research overseas.

R.I. Barker

Judge’s Chambers,
High Court,
Auckland
2 March, 1989
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DUTIES OF DIRECTORS TO
SHAREHOLDERS AND CREDITORS

The Honourable Mr Justice B.M. McPherson C.B.E.
Judge of the Queensland Supreme Court
1. **The study of company law.**

Time was when company law was considered one of those dull but practical subjects studied by law students and taught by law lecturers because it was necessary to know, if not something about them, then at least that they existed. Attitudes changed after the publication in 1954 of Professor L.C.B. Gower's *Principles of Modern Company Law*. By presenting company law in a form that was intellectually challenging, he made it academically respectable and, in the years that followed, inspired a growing stream of texts, journal articles, theses, legal papers, and court judgments on company matters.

Perhaps Professor Gower did his work too well. What is surprising is how little those later publications have added to his original analysis of basic problems in this area of law. From this wholesale denigration of the efforts of others, based I suspect on an imperfect acquaintance with the range of modern legal literature, I hasten to exempt in particular the works of two authors. One is Lord Wedderburn's monumental two-part article on the rule in *Foss v. Harbottle* published in 1957-1958 in the *Cambridge Law Journal*; the other, two papers by Dr L.S. Sealy, one of which was published in 1967 and the second delivered at a recent conference of the Australian Universities Law Schools Association. On an occasion like this, one might have hoped for scholarship approaching the standards of those publications. However, for reasons which are self-evident and entirely discreditable, it is necessary to be content with something much less memorable.

2. **Character of shareholders' rights.**

For those whose efforts cannot impress, surprise is the natural and only refuge. The subject of this paper is the duties of company directors to shareholders and creditors. You will be surprised to hear me say both that there are no such duties, and also that there is very little, if any, place for them in modern company law. Of course, much depends on what in this context is
meant by "duty". What I mean by it is a duty that is legally enforceable by the person to whom it is owed against the person who is subject to it. A supposed legal duty that is not matched by a remedy is, as Dr Sealy has recently reminded us, "a nonsense". Duties imply correlative rights, and it is necessary to begin by segregating the rights of the corporate entity from the rights of its members or, as they usually are, shareholders. A shareholder whose individual rights as such are transgressed or disregarded by directors has his remedy; but, statute apart, it is a remedy against the company, and not, or only very rarely, against the directors themselves. A decision of directors that is contrary to the rights of a member may be void or may be voidable at the instance of that member. He may be entitled to have the decision declared invalid or restrained, or even - although this is much less clearly established - to have the appropriate decision substituted in proceedings against a company proposing to act upon that decision. But when you look at what actually happens, it is against the company and not the directors that the shareholder's right subsists and is enforced.

The problem is, like most others in the law, primarily one of definition and therefore of language. Having used the expression "individual rights" of members, I am bound to define it. What I mean by it are the rights a person acquires by becoming a member of a company. One day someone will, I hope, undertake a study of precisely what those rights are. I strongly suspect that a "right" on the part of members to have their interests considered by directors in making their decisions is not among them. But for present purposes it is enough to say that the rights of members are those that result from the twin statutory contracts: (a) between the member and the company; and (b) between the members inter se. The terms of those contracts are to be found primarily if not exclusively in the provisions of the articles of association, supplemented by statute and by various implications or additions introduced by judicial exegesis. A prominent instance of the latter is the supposed duty of members in general meeting to act "bona fide for the benefit of the company as a whole". That, according to Lord Evershed in Greenhalgh v. Arderne Cinemas Ltd., does not, "at any rate in a case such as the present", mean the company as
a commercial entity distinct from the corporators. It means "the corporators as a general body".

By confining it to "a case such as the present", Lord Evershed was careful to circumscribe the proposition he was stating. The case was one in which rights conferred by the articles, and thus forming terms of the member's statutory contract, were being altered. The proposition was therefore directed to defining the limits of members' powers in general meeting to alter those rights. Nothing at all was said on the subject of the duties of directors to members or to the company, whether considered as a corporate entity or otherwise. It is therefore an error to treat it as if it were a statement of general application to the exercise of directors' powers and the performance of their duties.

3. A duty to "the company".

Greenhalgh v. Arderne Cinemas Ltd., or what was said in it, nevertheless appears to be the principal source in recent times of the notion that directors owe a duty to the members. Dr Sealy introduces a section in his most recent paper with a reference to Lord Greene's formulation in Re Smith & Fawcett Ltd. Directors, said his Lordship in that case, "must exercise their discretion bona fide...in the interests of the company, and not for any collateral purpose". Having referred to it, the learned author is content to accept Professor H.A.J. Ford's exposition, which is that "the company" in this context is not "the abstract entity" but the associated membership - "the members as a whole in their capacity as associated persons". With respect, the judgment in Re Smith & Fawcett Ltd. gives no support to that hypothesis. On the contrary, concerned as it is with the discretion of directors to refuse registration of a share transfer in a proprietary company, Lord Greene's judgment is directed primarily to emphasising the limited extent to which corporate interests may be permitted to impede the exercise by a member of his individual rights represented by the proprietary interest he possesses in his shares. The notion that directors of modern companies owe enforceable duties to the members, in whose interests they are required to act, is a relic of the early history of company law; but, as was demonstrated by Dr Sealy in
the first of his two papers\textsuperscript{21}, such a conception of the fiduciary duties of directors is "an out of date assumption"\textsuperscript{22}.

The reason why the assumption is outmoded is that, considered from a legal rather than economic standpoint, the single most striking innovation of mid-nineteenth century companies legislation was not freedom to trade with limited liability but freedom to trade in corporate form. Despite some false starts\textsuperscript{23}, the independent corporate personality of trading companies was acknowledged\textsuperscript{24} well before \textit{Salomon v. Salomon & Co. Ltd.}\textsuperscript{25}, which, contrary to textbook tradition, did no more than illustrate its capacity to resist attempts to undermine it. Approaching 150 years after the first general Companies Act, it is scarcely necessary to be reminded that in law a corporation is a separate entity distinct from the individual members that constitute or comprise it\textsuperscript{26}. That is not only an elementary but the fundamental proposition of company law, to which all other rules are related and must conform. Because of it, the rule is that it is the company and not the members, either individually or collectively, that owns its property; the members themselves do not have even so much as an insurable interest in it\textsuperscript{27}. It is the explanation for the first aspect of the rule in \textit{Foss v. Harbottle}\textsuperscript{28}, which requires that, for a wrong done to the company, the only proper plaintiff is the company itself\textsuperscript{29}. Hence, too, comes the rule that liabilities incurred by the company attach to it and not to the members or directors\textsuperscript{30}. Just as corporate assets belong to the company, so do corporate liabilities.

Reduced to bare essentials, company law comprises little more than (1) a series of rules concerning corporate assets and powers, and the uses to which they may properly be put; and (2) a further and separate series of rules defining the structure that controls those assets and powers, in particular by ordering the internal distribution of authority between management and membership. In the course of the twentieth century the balance of power has moved emphatically to the board of directors. Directors are appointed by the general meeting; but, once in office, it is they and not the members who exercise the powers of the corporation.
4. Corporate powers and purpose.

Corporate powers are powers over or in relation to corporate assets. To everyone, whether member, director, employee or creditor, what matters most are the corporate assets and his particular rights or claims in relation to them. Textwriters and even judges continue to say that directors "are regarded as trustees...of the company's property". That is another out of date fallacy. Directors owe duties, some of them fiduciary, but they owe them to the corporation; it is only by using metaphorical and inexact terminology that they can be described as trustees of company property. Corporate assets are vested in the company and not in the directors as trustees, who in relation to those assets possess no more interest in them at law or in equity than do company members. The passage quoted above continues to appear in a section of the current edition of Gower's book that discusses remedies against directors for misappropriating company property; it is related to an earlier section of the same chapter on "Directors' Duties" previously subtitled "Other secret profits" but now "Use of corporate property". What at that point the author is engaged in analysing is Regal (Hastings) Ltd. v. Gulliver and other decisions about the duty of directors to treat as corporate property any assets or advantages that come to them in virtue of their office as directors. That is an area in which company law is deservedly expansive; but, the circumstance that company directors are in law bound to restore or account for company property and profits of office provides no justification in law for saying they are "trustees".

In any event, we are on this occasion less concerned to know what the corporate assets are than to know what may properly be done with them. In seeking an answer to that question, the first and critical consideration is that the assets are property of the corporation. It necessarily follows that they must be applied only for corporate purposes, or at least that they should not be applied for non-corporate purposes. At one time it was thought that, in order to identify corporate purposes, it was necessary and sufficient to look at the objects specified in the company's memorandum of association. To apply company property
to non-specified purposes was to act *ultra vires*. Acts of that kind would be restrained at the suit of a member, and the recipient of property, whether a director, member, creditor or complete stranger, could be forced to restore what he had received.

The decision in *Ashbury Carriage Company v. Riche* conceived of the matter as one of corporate capacity or power wholly divorced from a consideration of the good faith, knowledge or beliefs of those involved. In retrospect, it can be seen that the decision moved the law in the wrong direction. The result was to bring the doctrine of *ultra vires* into such disrepute as to make it for a time the only aspect of company law considered worthy of academic study. Despite attenuation of the doctrine in Australia and elsewhere, memories of its acknowledged evils tend to obscure the fact that some conception of corporate purpose is inherent in all powers exercisable on behalf of the company. Without it, there is no reason why corporate assets should not be freely dissipated. The underlying conception must, however, be understood as a measure only of the propriety of dispositions of corporate assets. It does not function as a test of corporate capacity to make the disposition; for that would mean the revival of the old doctrine of *ultra vires*. I do not know of anyone, at least in Australia, who wants that.

5. **Power to dispose of corporate assets.**

The conception of which I speak is capable of explaining some apparently disparate decisions concerning the misappropriation or misapplication of corporate property. Their underlying thesis is that there are purposes for which the assets of any and all companies may not properly be applied by those exercising power to dispose of them. Companies are incorporated with a view to using their assets for the purpose of carrying on business, and not, unless that is their business, for the purpose of making gifts of them to members or other persons. The most obvious illustration is paying dividends out of capital. The original companies legislation of the mid-nineteenth century said little on the subject. The prohibition was a judicial implication arrived at by generalising from particular statutory provisions that were seen as maintaining
company capital as a guarantee fund for creditors. To reach such a result required an expansive interpretation of the scheme and intention of early companies legislation. It was a further step, although a short one, for the House of Lords in *Trevor v. Whitworth* to hold that a purchase by the company of its own shares came within the implied prohibition. After that, judicial creativity seems to have dried up. Statute was needed to extend the prohibition to applying corporate funds to assist the purchase of shares in the company. No one who has had to grapple with it or its judicial offspring could account the legislation a success.

The speeches in *Trevor v. Whitworth* contain references to *Ashbury Carriage Co. v. Riche* and the ultra vires doctrine. But the fundamental objection was identified by Lord Macnaghten in that case when he said that, for a company to invest capital in purchasing its own stock, or to return any portion of its capital to any shareholder, was quite simply "contrary to the plain intention of the Act of 1862, and inconsistent with the conditions upon which, and upon which alone" Parliament had granted the right of trading with limited liability.

The notion that companies legislation embodies implied conditions that are fundamental to corporate activity is, I believe, not confined to dispositions of company "capital" in anything like its technical sense. No one supposes that *Trevor v. Whitworth* is limited in that way, or that a company is, without more, entitled to purchase its own shares from profits rather than capital. Likewise, when it is said that dividends may not be paid out of capital, the word "dividends" is not used only in its primary sense of a money payment but extends to dispositions of company property in specie. Standard textbook treatment of the topic nevertheless assumes that there exists, more or less in isolation, a series of special rules relating to company "capital" in an accounting or bookkeeping sense; and that the sole function of those rules is to preserve capital as a guarantee fund for creditors. Shareholders, however, seldom have the interests of creditors in mind when, as sometimes happens, they succeed in restraining payment of "dividends" out of "capital". Cases like that reveal the true function of those rules. They serve as a particular illustration of a
general prohibition against misusing corporate power to dispose of corporate assets. Because those responsible for such depredations are usually the majority or controlling shareholders, who nowadays are usually directors, improper dispositions of that kind tend to pass under the description "fraud on the minority". As such, they are treated in the texts as an aspect of "controlling shareholders' duties", where they are confusingly lumped together with the duties inter se of shareholders in general meeting. The truth is that in such cases "the majority" are practising a fraud on the company, which, as we all know, can, under an exception to the rule in Foss v. Harbottle, be redressed in a representative or "derivative" form of proceeding to which the company itself must be made a defendant party. Its presence is necessary in order to ensure that a successful judgment for restoration of corporate assets operates in favour of the company and not of those members who are plaintiffs. If it were not for this requirement, the effect of the judgment would in many cases be to distribute a dividend to the successful plaintiffs. That would be objectionable on two counts: in some cases the distribution might be effected out of a capital asset; invariably it would benefit only those of the shareholders who had elected to become plaintiffs. In this way, the procedural mechanics of the action demonstrate and confirm the rule of substantive law, which is that the assets belong not to the members but to the corporate entity, in whose interests alone they may be used.

The basis for allowing recovery in cases of fraud on the minority has not always been uniform nor has it been uniformly stated. Sometimes the ultra vires doctrine is invoked; sometimes it is rested on the traditional ground that a return of capital to members is involved; more commonly nowadays the transaction is likely to be struck down as an abuse of directors' powers. In whatever form it is expressed, the practical effect is to protect the assets from dissipation for improper or non-corporate purposes. This in turn suggests that an incidental purpose of preventing "fraud on the minority" is to maintain corporate assets as a guarantee fund for creditors. It is not only members who suffer if company property is misapplied or misused. It must surely be contrary to the "plain
intention" of the Companies Act that corporate powers should be used, whether with or without the assent or acquiescence of some or of all the members, to misappropriate corporate assets\textsuperscript{52}.

Something more fundamental is involved than the interests of members alone. That is why there can be no cakes and ale "except such as are required for the benefit of the company"\textsuperscript{53}. Lord Justice Bowen's famous aphorism to that effect comes close to encapsulating all that can and need be said on the subject of corporate assets and the power to dispose of them. It is at this point that attempts to identify "the company" as the "associated membership" rather than the corporate entity irretrievably break down. If benefit to members is the sole criterion, it is difficult to discover any limit in law to the quantities of cakes and ale that directors are justified in distributing. But the protection of corporate assets is not left to the mercy of the greatest happiness of the greatest number of members. Difficult though it may be to express with precision, the underlying principle is that corporate assets must be applied for corporate purposes, and not for the benefit of other persons, whether they are shareholders or strangers, and whether few or many. The functions and consequently the duties of directors take form and character from this paramount consideration.

6. Other corporate powers.

This "fundamental condition" or underlying principle of corporate behaviour is capable, with more or less facility, of being applied to all powers exercised by directors. In some instances, like issuing shares\textsuperscript{54} or approving share transfers\textsuperscript{55}, the interests of the company viewed as a corporate entity may be affected only at the periphery. That is because, objectively considered, it is for the most part a matter of indifference to the inanimate corporate entity who are the persons that hold its shares or control the voting in general meeting. But that is by no means always the case; and in any event it does not follow that, because corporate interests are not vitally involved, directors are justified in exercising corporate powers affecting shares for the non-corporate purpose of capturing or retaining control of the power structure of the company. Experience in
legal practice suggests that the major problem in advising directors intent on using new share issues as a response to takeover proposals is to elicit some plausible corporate-oriented reason, other than a subjective belief in the superiority of their own management skills, for the defensive measures they have in mind. If there is no corporate advantage to be had, it is seldom possible for directors to offer a legitimate reason for exercising their powers at all.

Exercising corporate powers of making contracts involves special legal problems of its own; in particular, the fiduciary character of directors' duties to the corporation attracts restrictions on their power to engage in transactions with the corporation, which, according to the current of contemporary authority, can be prospectively or retrospectively waived by a resolution of the company passed by means of the votes of those directors themselves. Such a result is a consequence of the indisputable character of voting power in general meeting as a species of property which as proprietor a shareholder may use as he pleases. It follows that a power that is exercisable in the hands of a director only for corporate purposes may in the end be used in the interests of a controlling majority. Such a state of affairs is frequently, and I think rightly, regretted; but it may be a consequence of the form in which the governing structure of companies is arranged. When the board is not free to act, power reverts to the general meeting where the directors resume the character of shareholders.

7. The interests of creditors.

If it is necessary in the interests of minority shareholders that corporate assets should be protected against the depredations of the majority, it must, as I have already suggested, logically also be necessary to preserve those assets in the interests of creditors, who have "no debtor but that impalpable thing the corporation, which has no property except the assets of the business." It is impossible to suppose that creditors lose their protection simply because the assent or acquiescence of all members is given for their application for improper purposes. That is demonstrably not so in the case of payments out of capital, for in Trevor v. Whitworth the articles
of association expressly authorised the purchase by the company of its own shares; and in Australia there is now clear authority for saying that directors may not properly apply the corporate assets of a company in paying the debts of another. In Walker v. Wimborne, Mason J, with the concurrence of Barwick C.J., spoke of "the fundamental principles" that each of the companies "was a separate and independent legal entity, and that it was the duty of [the company] to consult its interests and its interests alone in deciding whether payments should be made to other companies."

The claim in Walker v. Wimborne was determined in misfeasance proceedings in winding up. In the event of corporate insolvency, it is creditors who have the only legitimate interest in the assets. The difficulty is to find a remedy at a time before the ultimate failure of the company as a trading venture is demonstrated by its winding up. In the case of creditors there appears to be nothing resembling the shareholders' derivative suit for fraud on the company. That is surprising if it is the function of company capital to serve as a guarantee fund for creditors; but in Mills v. Northern Ry. Co. of Buenos Ayres persons claiming to be creditors of a company were refused an injunction to restrain payments alleged to involve misapplication of company capital in payment of dividends to preference shareholders. This attempt by a creditor to invoke the court's assistance on the ground that he was "about to be defrauded by reason of their [scil. the company's] making away with their assets" was peremptorily despatched by Lord Hatherby L.C. as "hardly capable of argument". It would, he thought, be "fearful" for the court to assume such an authority; "it would be called on to interfere with the concerns of almost every company in the Kingdom against which a creditor might suppose he had demands". A similar fate befell the application of a secured debenture holder in the later case of Lawrence v. West Somerset Mineral Ry. It is relevant to add that in the first of the two cases the plaintiff's claim to be considered a creditor was in dispute; and that in the second his debt was admittedly not yet due and payable. On proof of corporate insolvency, those plaintiffs might, in the capacity of a contingent or of a prospective creditor, now succeed in having
the company wound up, which adds contemporary force to the Lord Chancellor's remark in Mills v. Northern Ry. Co. that the only remedy of an unpaid creditor is judgment and execution or winding up.

It remains to be seen whether the development of the Mareva injunction is capable now of producing a different result in cases of this kind. It will not alter the fundamental proposition that the only duty owed to a creditor is to pay his debt, or that it is a duty owed by the company. That is the direct consequence of extending the privilege of incorporation to trading enterprises. Liabilities are incurred by the company and by no one else. Contrary to what is often said, it is necessary to emphasise that the companies legislation of the mid-nineteenth century did not in terms confer on company members the privilege of limited liability. What it did was to allow trading in corporate form but subject to the imposition on members of a liability to contribute to a fund for payment of corporate debts. Admittedly the liability imposed was limited, but it was and is nonetheless an imposition and not a reduction or limitation of liability; without it, there would be no liability at all. Debts incurred by the company remain debts of the corporate entity; absent the statutory duty to contribute, and there is no liability whatever on the part of company members for corporate debts.

8. Corporate power to incur liabilities.

It is profligate use of corporate power to incur liabilities that presents both courts and legislatures with the most pressing contemporary problem in company law. It would require bold interpretation of the underlying thesis of companies legislation for a court to condemn as legally improper the exercise of corporate power to accumulate liabilities once it was evident that the company could never succeed in discharging them. So far, no reported decision appears to go this length, and such authority as there is suggests that liability does not attach to directors for incurring corporate liabilities in the face of impending corporate insolvency. Legislation was needed to impose what is now known as fraudulent trading.

It may have been considerations like these that prompted
Cooke J in Nicholson v. Permakraft (N.Z.) Ltd.\textsuperscript{71} to say that, because the duties of directors are owed to the company, they may be required to consider creditors' interests before disposing of the assets in conditions of corporate insolvency or near-insolvency. I see no difficulty in regarding that as a species of misapplication or misfeasance; there is already authority for saying that authorising preferential payments to particular creditors before winding up may produce personal liability on the part of directors\textsuperscript{72}. But actions of that kind involve a disposition of corporate assets\textsuperscript{73}. It is not the question that is now being considered, which is the impropriety of continuing to incur corporate liabilities in the face of impending insolvency. That was, however, another of the matters referred to in Nicholson v. Permakraft (N.Z.) Ltd., where Cooke J suggested "an action by a particular creditor against the directors or company for breach of a particular duty of care arising on ordinary negligence principles"\textsuperscript{74}. The sentence following that remark makes it clear that His Honour's observations were directed to a liability for corporate indebtedness and not simply to the use of corporate assets for its discharge. The example given in the judgment is that of directors who "obtain credit for the company when they ought to know that the creditor incorrectly understood a valuable asset to belong to the company"\textsuperscript{75}.

The suggestion (which is by no means explicit in the remark made by Cooke J) that a general duty of care may be owed by company directors to creditors has not been received with universal enthusiasm\textsuperscript{76}. There are objections of principle to such a form of personal liability. One is that it contradicts the whole concept of limited liability trading. Until quite recently it was possible under the companies legislation to incorporate a company having directors whose liability was unlimited. It need hardly be said that in practice such companies were unheard of, and the Australian uniform Companies Code does not now trouble to refer to them. A more cogent objection is that the creditor trusts to the company and not to the directors to pay him. The work, said Lord Hatherby L.C. in Mills v. Northern Ry\textsuperscript{77} "is done simply on the credit of the company", with the consequence that the creditors of a company
must look for payment to their corporate debtor. To that objection it may be rejoined that it is the incurring of the indebtedness rather than its subsequent non-payment that attracts the duty of care. But that would be highly artificial. It is payment of liabilities that creditors look for, not duties of care in incurring them. In any event, the duty thus sought to be imposed on directors is not matched elsewhere in comparable areas of the law. If, acting as my agent, you incur liabilities on my behalf knowing I will probably not discharge them, you are not in consequence in breach of any general duty of care to the unpaid creditor with whom you have dealt. An agent impliedly warrants his authority but not his principal's solvency. The legal position of directors in this respect does not differ from that of an agent, no matter how much they or he may know about the principal's financial condition.

As a matter of principle it is difficult to identify any general duty of care in negligence on the part of directors, or any other agent or instrumentality, to refrain from using powers of incurring liabilities on behalf of others that are unlikely to be discharged. Except in respect of the statutory liability for fraudulent trading, company law proceeds on the acknowledged basis that corporate debts are liabilities of the corporation and not of anyone else. Protection for the creditor is left to free enterprise economics. It is commercially imprudent to extend credit to a company without better assurance than the bare promise of the company to pay. No legal duty of care is capable of protecting a creditor half as well as his own commercial judgment. It is a different matter altogether if corporate assets otherwise available for payment of creditors are diverted to non-corporate objects. That involves the directors in exercising corporate powers contrary to their duty to use them only for the proper purposes of the corporation. In that event they may expect to incur personal liability to the extent not of the unpaid debts, but of the assets improperly disposed of.


Considerations of the foregoing kind combine to show that directors owe enforceable duties only to the corporate entity of
which they are directors. The conclusion follows rationally and, I believe, inescapably from the fact that the law regards the company as an independent legal entity. As such, it owns the corporate property over which directors exercise their powers of management and control. There is nothing at all radical in the notion that a person's property may not properly be used for the benefit of others except with the consent of the property owner. Directors' powers and duties take their character from that elementary legal proposition. In the case of companies, the only difference is that, except as recognized by legislation, consent is irrelevant. In the exercise of corporate powers, corporate assets may properly be disposed of only for corporate and not non-corporate purposes. To say that company property may be dissipated with the assent of directors or members is inconsistent with "the plain intention" of the Companies Act and with the unstated but fundamental conditions on which Parliament permits corporate trading to be carried on. To adopt any other attitude would be to sanction wholesale thieving of company property.

If directors owe enforceable duties only to the corporate entity, it follows that they owe no such duties to members, creditors or others. It is impossible at one and the same time to owe and discharge similar enforceable duties to different persons whose interests in the assets are actually or potentially in competition. That is, however, not to deny that in making decisions affecting the corporation they are expected to take into account the likely impact of their decisions on shareholders, creditors, employees, and even the public in general. If they do not, the consequences for themselves, and ultimately for the corporation, are likely to prove detrimental. After acknowledging in Walker v. Wimborne the fundamental principle that the duty of directors is to the "separate and independent legal entity", and to it alone, Mason J continued -

"In this respect it should be emphasized that the directors of a company in discharging their duty to the company must take account of the interests of its shareholders and its creditors. Any failure by the directors to take into account the interest of creditors will have adverse consequences for the company as well as for them."

The supposed "duty" of directors to shareholders and creditors
extends so far, but it goes no further. It can scarcely be capable of legal enforcement by awarding damages, or even by the rather rudimentary means in which administrative or statutory discretion is controlled by the courts.

Social, political and economic considerations of all kinds exert conscious or subconscious influences on the attitudes of directors in making their decisions. Such factors ought not and, in any event, cannot be excluded. Personal considerations also play their part. I have yet to meet the director who believes that the interests of the company are not best served by leaving its affairs under his administration. That is why, in judging the propriety of exercising directors' powers, the composite "bona fide for the benefit of the company" offers only limited objective guidance. In the end, the paramount and only consideration capable of recognition by the law is the welfare of the company viewed as a corporate entity. Like guardians of human individuals, directors owe their legal duties to their charge and not to those others, numerous though they may be, who have an interest in its welfare. Some who adopt a different view of the duties of directors are troubled by images of the modern corporation as an artificial entity dedicated primarily to increasing its economic power, and devoid of those endearing sentiments that distinguish the human race. But that is exactly what companies are. It would be a mistake for the law to regard them as something else.
NOTES


4. L.S. Sealy: "Directors' 'Wider' Responsibilities - Problems Conceptual, Practical and Procedural".

5. Ibid, at 11.


13. [1951] 1 Ch. 286.


15. [1951] 1 Ch. 286.


17. [1942] Ch. 304.


21. Above, n.3.


28. (1843) 2 Hare 461; 67 E.R. 189.


34. [1942] 1 All E.R. 378.

35. (1875) L.R. 7 H.L. 653.


40. (1887) 12 App. Cas. 409.

41. Ibid, at 433.


43. Ibid.


46. Above, n.28.


49. Re National Funds Assurance Co. (1878) 10 Ch.D. 118, at 127.


52. Cf. Re George Newman Ltd. [1895] 1 Ch. 674.

53. Hutton v. West Cork Ry Co. (1883) 23 Ch.D. 654, at 673, per Bowen L.J. "The money which is going to be spent is not the money of the majority...It is the money of the company...": ibid, at 671.


55. Re Smith & Fawcett Ltd. [1942] Ch. 304.


60. See (1887) 12 App. Cas. 409, at 432-433.


64. (1870) L.R. 5 Ch. App. 621
65. Ibid, at 627.
67. [1918] 2 Ch. 280.
72. See Re Washington Diamond Mining Co. [1893] 3 Ch. 95; Re Yorke (Stationers) Pty Ltd. [1965] N.S.W.R. 446.
75. Ibid.
78. In any event, the extent of a tortfeasor's duty to those having purely contractual rights is, in Australia, not unlimited: see Caltex Oil Australia Ltd. v. The Willemstad (1976) 136 C.L.R. 529, at 544-556.
80. 137 C.L.R. 1, at 7.
PROTECTION OF MINORITY SHAREHOLDERS

The Honourable Mr Justice Meagher
Judge of the Court of Appeal of New South Wales
PROTECTION OF MINORITY SHAREHOLDERS

A feature of twentieth century company law has been the increased attention paid to the protection of minority shareholders. Fundamentally, two developments have taken place in this area. The first is the increased equitable limitations placed upon the powers conferred on the majority in general meeting. Coupled with this has been the relaxation of previously very rigid rules relating to standing. The second phenomenon has been the growth of statutory intervention to supplement and replace the general law in relation to protection of minority shareholders.

In regard to the first mentioned development the foundation of these equitable limitations is expressed to be that the majority must act for the benefit of the company as a whole. Although this language is reminiscent to that of directors' duties no fiduciary obligation is owed by the majority shareholders. Conduct which violates the majority's duty constitutes "fraud on the minority". The doctrine of fraud on the minority is intertwined with the topic of locus standi for actions regarding minority protection.

In relation to the equitable limitations on the voting power of the majorities two conflicting principles have sought supremacy. The first principle permits the complete utilization of the powers attached to the chose in action; the share. As Mellish L. J. in Menier v Hoopers Telegraph Works (1984) LR 9 ch app 350 at page 354 stated:

"shareholders of a company may vote as they please."
This notion is the consequence of the emphasis being focused on the share, devoid of considering its surrounding circumstances. The leading Australian statement supporting this view is to be found in *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457 at page 504. There Dixon J, as he was then, held:

"[the shareholders] vote in respect of their shares, which are property and the right to vote is attached to the share itself as an incident of property to be enjoyed and exercised for the owner's personal advantage."

The earliest English authority for this contention is contained in *Pender v Lushington* (1877) 6 Ch. D. 70 at pages 75-76.

The principle that collides with this unfettered freedom is contained in the statement of doctrine by Lindley MR in *Allen v Gold Reefs of Wester Africa Ltd* [1900] 1 Ch 656 at page 671. The Master of the Rolls held:

"[the power of the majority must] like all powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole, and it must not be exceeded".

The focus of this principle is wider than the first as it takes account of more factors, such as the effects of using the property rights on other shareholders.

The resulting friction generated by the competing principles has been the evidence for this century's struggle for protecting minority shareholders. The ascendancy of the second principle over the first has been reflected in the expansion of the doctrine of fraud on the minority. To take the analysis further the cases on this equitable limitation require
categorization. Various groupings have been suggested by various authors. The plethora of nominated sub-divisions is indicative of the ad hoc and uncertain nature of this area. The grouping utilized by Redmond in *Companies and Securities Law*, which is very similar to that suggested by Gower, is the one that is referred to here.

One category of cases dealing with equitable limitations applies to resolutions of the general meeting which expropriate corporate property or rights. The case of *Menier v Hooper's Telegraph Works* (1874) LR 9 CH App 350 illustrates this grouping. In that case the company directors decided to abandon proceedings which sought to regain valuable rights. In addition, the members in general meeting voted for the company to pass into voluntary liquidation. Arguing that the two decisions had been obtained by the majority shareholder pursuant to his own best interests a minority shareholder sued. James L.J. held at page 353:

"The minority of the shareholders say in effect that the majority has divided the assets of the company more or less between themselves to the exclusion of the minority. I think it would be a shocking thing if that could be done, because if so the majority might divide the whole assets of the company, and pass a resolution that everything must be given to them, and that the minority should have nothing to do with it."

The Privy Council decision in *Cook v Deeks* [1916] 1AC 554 supports the protection of minority shareholders on the basis of expropriation of corporate property. The High Court did likewise in *Ngurli Ltd v McCann* (1953) 90 CLR 425 at page 447. The difficulty with this grouping of cases is to ascertain
what the court will treat as an expropriation of corporate property. Both *Regal (Hastings) Ltd v Gulliver* [1967] 2AC 134 and *Furs Limited v Tomkies* (1936) 54 CLR 583 highlight this difficulty. Gower at pages 617 - 618 suggests that a reconciliation and understanding can be found in the cases by the distinction between misappropriating the company's property and merely making an incidental profit. The incidental profit, unless it flowed from a use of the company's property, is not itself company property, and thus no expropriation of company property can logically occur.

Resolutions to release directors from the consequences of their breach of duty to the company form the second category of cases in this area. *Bamford v Bamford* [1969] 1 All ER, 969 held that the general meeting has a wide power to ratify the actions of the directors who are in breach of their duties and to exonerate them from liability arising from such a breach. However, to understand where the protection of the court will be extended to the minority the various duties of the directors must be stated. These include the duty to avoid conflicts of interest and to act for proper purposes. The directors must also exercise a reasonable degree of care and diligence.

As a generalisation the general meeting is capable of ratifying a director's breach of his duty to avoid conflicts of interest. However, *North West Transportation Co. v Beatty* (1887) 12 App (as 589 does indicate limitations on this ability. The Privy Council stated:

"The general principles applicable to cases of this kind are well established. Unless some provision to
the contrary is to be found in the charter or instrument by which the company is incorporated, the resolution of a majority of the shareholders duly convened, upon any question with which the company is legally competent to deal, is binding upon the minority, and consequently upon the company, and every shareholder has a perfect right to vote upon such a question, although he may have a personal interest in the subject matter opposed to, or different from, the general or particular interests of the company. On the other hand, a director is precluded from dealing, on the behalf of the company with himself, and from entering into engagements in which he has a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound by fiduciary duty to protect; and this rule is as applicable to the case of one of several directors as to a managing or sole director. Any such dealing or engagement may, however, be affirmed or adopted by the company, provided such affirmance or adoption is not brought about by unfair or improper means, and is not illegal or fraudulent or oppressive towards those shareholders who oppose it."

On the question of whether the general meeting can ratify a breach of the duty to exercise the powers for a proper purpose Nguri Ltd v McCann (1953) 90 CLR 425 held that where the directors have acted in their own interests rather than in the interests of the company ratification is open to challenge by the minority. Bamford v Bamford (supra) should be noted on this point. It held that the majority can ratify an improper exercise of powers by the directors where the directors honestly believed their actions were in the best interests of the company. The case of Winthrop Investments Limited v Winns Limited [1975] 2NSWLR 666 held that the majority is capable of prospectively ratifying a breach of directors' duties unless it can be shown that the majority in ratifying failed in their duty to act bona fide for the benefit of the company. Once again the test is vague and so leaves the court with much discretion.

The possibility of ratification of a director's breach
of the duty to exercise reasonable care and diligence was considered in *Pavlides v Jensen* [1956] Ch 565. In that case the court found that the majority could release the directors after they had acted negligently. However, this should be contrasted with *Daniels v Daniels* [1978] 2 WLR 73 where no release was allowed as the directors negligence resulted in a benefit to themselves. Thus a distinction must be drawn between where a benefit is a consequence of this breach.

The third grouping of case law recognised as constituting fraud on the minority is the power of the majority to vote for alteration of the *articles*. *Ford*, at page 467, considers whether or not this grouping now, as S.73 allows the memorandum to be altered, applies to alterations to the memorandum. As S73(8)(10) only allows the Supreme Court to cancel such an alteration to the memorandum on the application of persons with an interest of not less than 10 percent, it would appear logical that this grouping could be appropriate to any attempts to alter the memorandum.

In *Brown v British Abrasive Wheel Co. Ltd* [1919] 1 Ch 290 an attempt was made to alter the articles so that the majority could acquire the shares of the minority. Ashbury J. held that the proposed alteration would be invalid, and an injunction to prevent the alteration was granted. Jacobs J. in *Crumpton v Morrine Hall Pty. Ltd* [1965] NSWR 240 allowed relief where alterations were proposed in a home unit company to restrict sub-letting of a shareholder's unit as it was fraud on the minority. However, when the High Court considered this
matter in Peters' American Delicacy it upheld an alteration which had the effect of depriving holders of partly-paid shares to the advantage of holders of fully-paid shares. Therefore, Fort at page 472, suggests that discrimination is not a sufficient test in this area, but because of lack of consistency shown in the cases no suitable test of a concrete nature can be supplied.

At this point the case of Phillips v Manufacturers' Securities Ltd (1971) 116 LT 290 should be noted. It held that a company may, from its inception, have valid articles capable of discriminating against the minority. It would be interesting to speculate what would the result be if this was litigated today. It could be argued that the minority shareholder knows of the unfavourable articles and it is their responsibility if they should purchase the shares. This is analogous to the notion of freedom of contract. The reference to contract law is also instructive in the likely outcome of such litigation. As the scope of freedom of contract has been narrowed and the court been exercising an increasing remedial role, likewise it might be presumed with original discriminatory articles.

After an examination of the equitable limitations on the power of the majority and an attempt at categorization it must be stated that the area of general law protection of minorities is unclear. It's lack of clarity is the function of two factors, of which the second is really a consequence of the first. This initial point is that two opposed principles are in direct conflict within this area. The second point is that with
the ascendancy of the concept of the protection of the minority that the delineation between the two principles has been, and continues, shifting. Thus, close legal analysis of the case law to determine relatively specific legal tests is less than fruitful. Thus, Jacobs' J. statement in Crumpton v Morrine Hall Pty Ltd [1965] NSWR 240 is relevant. At page 244 His Honour stated that:

"It seems to me that the truth is that the courts in each generation or in each decade have set a line up to which shareholders have been allowed to go in affecting the rights of other shareholders by alterations of articles of association and beyond which they have not been allowed to go. It seems to me that no amount of legal analysis or analytical reasoning can conceal the fact that the decision has in the past turned, and must turn ultimately, on a value judgment formed in respect of the conduct of the majority - a judgment formed not by any strict process of reasoning or bare principle of law but upon the view taken of the conduct."

Foster J. in Clemens v Clemens Bros Ltd [1976] 2 All ER 268 at 282 stated it would be:

"unwise to try to produce a principle, since the circumstances of each case are infinitely varied."

Indeed, Ford at page 465 compares this area of law to that of negligence which relies heavily on the hypothetical reasonable person for the application of a broad formula to diverse factual situations. Uncertainty of result is the outcome of the court's attempt to reflect changing social and business views on the protection to be afforded to minority shareholders.

Logically connected with these equitable limitations is the power to litigate. Standing is an essential element for the minority to obtain the court's protection. An easing of previously strict standing rules has been evident this century, which has allowed for greater minority shareholder protection.
Generally, the directors' duties are owed to the company, and only in exceptional circumstances to individual shareholders. Further, the power to litigate in the company's name resides in the directors. This is clearly the result of Regulation 66 of Table A which gives powers of management to the board. Dicta in Marshall's Value Gear Co. Ltd v Manning Wardle & Co. Ltd [1909] 1 Ch 267 suggest that the general meeting itself may authorise the commencement of proceedings in the company's name. But where neither organ will enforce a duty or sue for the company in cases such as Ngurli v McCann and Mills v Mills (1938) 60 CLR 150 the court has permitted a shareholder to sue for a wrong done to the company. This derivative suit occurs where fraud on the minority has taken place. This action requires two elements, "fraud" and "control". In these cases the cause of action belongs not to the shareholder but rather to the company. The derivative suit operates as an exception to the rule in Foss v Harbottle (1843) 67 ER 189 which stands for the proposition that the company is the proper plaintiff to bring an action if the wrong is done to the company. The Foss v Harbottle rule was, according to Boyle in his article "The Minority Shareholder in the Nineteenth Century" (1965) 28 MLR 317, a major impediment to the nineteenth century minority shareholder seeking redress for a wrong. The derivative suit lessens this problem. In this suit the member sues on behalf of themselves and all other members. The company is joined as a co-defendant, and so any judgment will bind it. Wallersteiner v Moir (No.2) [1975] QB 373 has further assisted
the minority shareholder by finding that if the derivative suit is properly and reasonably brought then usually the company will be ordered to pay the plaintiff's costs.

Another exception to the strict standing rule of *Foss v Harbottle* was mooted in that case by Wigram V-C at pages 202-203. This possible exception is where justice requires. This notion has received further support in *Edwards v Halliwell* [1950] 2 ALL ER 1064 and in *Hodgson v NALGO* [1970] 1 WLR 130. Such an exception must be seen as assisting the minority shareholder. However, the English Court of Appeal in *Prudential Assurance Co. Ltd v Newman Industries Ltd (No. 2)* cast doubt on this exception by considering it impractical.

Ford, at page 479 and following, has an intersection of the common law developments resulting in the protection of minority shareholders and the statutory intervention to the same end. This common ground occurs in the member's personal action. In cases such as *Ngurli v McCann* (supra) and *Howard Smith v Ampol Petroleum* [1974] AC 821 the High Court recognised wrongs done to the shareholders personally, and not to the company. As these cases dealt with the capital structure of the companies it may be suggested that Australian actions relating to the capital nature of the company will give rise to a personal action by shareholders. In this way the minority shareholder is not confined or restricted by the *Foss v Harbottle* rule as it has no ambit of operation.

A further area in which the proper plaintiff rule,
stemming from Foss v Harbottle ceases to be relevant is in the statutory contract contained in the memorandum and articles. Hickman v Kent or Romney Marsh Sheep Breeders Association [1915] 1 Ch 881 held that the memorandum and articles of association constitute a statutory contract. Section 78 declares that the memorandum and articles have the effect of a contract between the company and each member, between the company and each officer, and between a member and each other member. Ford at page 483 suggests that the language of this new s.78 may mean that a member can enforce an obligation such as that involved in Eley v Positive Life Assurance Company (1874) LR 9 CP503 where the articles required the member to be appointed the company's solicitor.

A fetter upon the minorities reliance upon the statutory contract is, as Ford details from page 483 onwards, is the presumption of ratification by the majority. Thus, another flaw is evident in the protection of minorities. The importance of statutory modifications to the general law protection of minorities becomes increasingly relevant.

The protection offered by the general law to minorities is although it has been extended, haphazard and less than comprehensive in its coverage. The initial point is that the cases in this area articulate no single test, and thus the scope of the protection is uncertain. This imprecision is a function of the application of ever changing views of what behaviour of the majority will and will not be tolerated. Further, a strict application of Foss v Harbottle would often make it impossible...
for minorities to seek protection. The severity of this standing rule has been mitigated by the introduction of exceptions and the expansion of the availability of personal actions. The statutory provisions for protecting minorities fulfil two functions; a supplement to the general law and a wide expansion of the protection of the minority shareholder.

The two primary statutory remedies which avail themselves to minority shareholders are the compulsory liquidation remedies and the provisions for oppression. Standing is given to the individual in these cases. The problem associated with *Foss v Harbottle* is thus avoided.

The oppression remedy was inserted to the English Companies Act following the recommendations of the Cohen Committee [Cmnd 6659 of 1945]. Section 186 was introduced to the Australian Uniform Companies Legislation of 1961. The initial English provision, S.210 of the Companies Act (UK), was comprehensively reformed in 1980 and is now contained in ss 459-461 of the Companies Act 1985 (UK). The Australian section was expanded and became S.320. This was amended in 1983. The overall effect of these changes has been to overcome some of the judicial limitations placed upon the protection of minority shareholders.

Nothing in s.320 prevents its application to any type of company. The court may make remedial orders if it is of the opinion that the affairs of the company are being conducted in a manner that is "oppressive", "unfairly prejudicial" or "unfairly discriminatory" against a member. The concept of "unfairly" in
the latter two grounds is an essential element as demonstrated by Wayde v NSW Rugby League Committee Ltd (1985) 59 ALJR 798.

The notion of "unfairly prejudicial" is a result of the Jenkins Committee's [Report of the Company Law Committee, Cmnd 1749 of 1962 at paragraph 202] desire to lower the threshold of conduct, from "oppression", that must be met for a remedy to be available. Therefore, the new ground for relief makes it easier for minority shareholders to seek redress. "Unfairly discriminatory" is the product of the recommendation of the Macarthur Committee [final report of the Special Committee to Review the Companies Act (1973) (NZ)]. Once again this new ground provides greater scope for relief to the shareholder. Although S.320 has been expanded so as to provide a remedy to members in a wider range of circumstances, the cases appear to suggest that S.320 does not permit a minority shareholder to force a purchase of his shares simply because he is "locked in". Nor does it apply merely because the member is disgruntled with the way the company is being run. The Victorian case of Re G. Jeffrey (Mens Store) Pty Ltd (1984) 9 ACLR 193 and the New Zealand Court of Appeal decision in Thomas v H.W. Thomas Ltd (1984) ACLC 610 support these contentions.

By s.320(2) where an application is made under the section the court has wide powers to make an order it sees as fit. Possible remedies include the winding up of the company (s.320(2)(c)), an order regulating the future conduct of the company's affairs (s.320(2)(d)), an order for the purchase of shares of any member by other members (s.320(2)(e) and an order
that the company institutes or defends legal proceedings or authorise a member to institute or defend legal proceedings in the name of the company (s.320(2)(g)). The width of the court's discretion to make the appropriate order and so protect the minority shareholder is illustrated by two cases. In *Re Overton Holdings Pty. Ltd* (1984) 2 ACLC 777 the Supreme Court of Western Australia granted an order authorising a member to institute legal proceedings on behalf of the company. In this way the *Foss v Harbottle* limitation to actions by minority shareholders can be circumvented. The other case is *Re R.H. Harmer* [1968] 3 All ER 689. In that case a father and two sons were the directors of the family company. The father was chairman and governing director, and with his wife he had control over three quarters of the shares. He ignored the wishes of the sons, the other directors and resolutions of the board. The court found that these actions constituted oppression, and it ordered that the father should not interfere with the valid decisions of the board of directors. Further, the court ordered that the father enter into a contract with the company as a consultant at a specified salary. These two cases give a brief glimpse of how the court can now make very precise orders to remedy any action that is "unfairly prejudicial", "unfairly discriminatory" or "oppression".

The compulsory liquidation remedy available to the members permits the court to make an order for the winding up of a company if the court is of the opinion that it is just and equitable that the company be wound up (s.364(1)(i)), the
directors have acted in the affairs of the company in their own interests rather than in the interests of the members as a whole, or in any other manner whatsoever that appears to be unfair or unjust to other members (S.364(1)(f)), affairs of the company are being conducted in a manner that is oppressive or unfairly prejudicial to, or unfairly discriminatory against a member or in a manner that is contrary to the interests of the members as a whole (S.365(1)(fa)), or an act or omission, by or on behalf of the company, or a resolution or proposed resolution of a class of members of the company, was or would be oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member or was or would be contrary to the interests of the members as a whole (S. 364(1)(fb)). By simply examining the language of this section it is apparent that the legislature has attempt to provide a comprehensive remedy to the shareholder.

Re Tivoli Freeholds [1972] VR 445 is a case involving winding up under the just and equitable ground. Here a company whose main objects were to carry on an entertainment business with associated activities and to acquire land on which theatres were to be erected came under the majority shareholding of a corporate raider. The company sold off its links to the entertainment business, and subsequently lent money to other companies to finance corporate raids. A minority shareholder petitioned for winding up under S.186 UCA (now S.320) or S.222(1)(h) UCA (now S.364(1)(j)). Menhennitt J. ordered winding up as it was just and equitable.

These two primary statutory remedies reflect the desire
to provide protection to members, which includes minority shareholders. The remedies available, especially S.320(2)(j) and (k) which allows the court to order requiring a person to do or not to do a specified act or thing, have given the court much discretion. These remedies are not automatically available. However, the tests that must be satisfied do appear sufficiently elastic to allow changes in what the court will and will not permit the majority shareholders to do. Although these are the primary statutory protective devices extended by the legislation they are not the totality of the statutory remedies available. Under S.574(1) any person whose interests are affected by the conduct of a person which constitutes a contravention of the Code, may apply to the court for an injunction restraining that person from engaging in the conduct. The court may also order that the person acting in contravention of the Code be required to do any act or thing. Section 241 requires the directors to convene a general meeting on the requisition of not less than 200 members in company not having a share capital, not less than 100 members holding shares in a company with a share capital on which there has been paid up an average sum per member of not less than $200, or members holding at least 5 per cent of the paid capital, or who are entitled to at least 5 per cent of the voting rights.

In this brief overview of the protection afforded to minority shareholders three central features have become apparent. The first is that much of the general law has been
confused by the search for highly specific tests relevant to each grouping of cases. It needs to be recognised that such searching is futile, and indeed, irrelevant. A general test of the act being bona fide for the benefit of the company as a whole should be stated, and the individual application of this should be made by the judge in the particular case, utilizing its own facts to a great degree to determine the outcome. (1)

The second main feature has been the advent of large scale and important legislation dealing with this area. The final observation has been the noting of the vast increase, by the greater availability of common law remedies, the easing of standing requirements and the extension of statutory remedies, in the protection of minority shareholders.

(1) Legal principle should remain at high abstract level.
Inquiries [into fraud and abuse should be undertaken] promptly by some public functionary and enforced by law:

Lord Penzance, 1887
Introduction

In Hugoe'sque terms, this is the best of times and the worst of times to prepare a paper on this topic. The law is in flux. At the time the topic was allocated, there was considerable public debate on the subject of corporate investigations. After I began to prepare a paper, the government introduced certain measures bearing on this subject. The Bill which is of greatest significance to this paper was then referred to a Parliamentary Select Committee. It has not reported back at the time of writing. Its deliberations and the submissions made to it are subject to parliamentary privilege. It is not known what view the Committee will take of the Bill, or how the government might choose to proceed thereafter.

In the result I have prepared a relatively broad paper, which will I hope provide an over-view of the sort of issues which arise in this subject area. My hope is that this will stimulate some discussion of the present law, the practical difficulties with it, and where the law might go. However, there is no evidence the present administration has a closed mind on the subject. I should think that constructive suggestions would be most welcome, and could still be forwarded to those responsible for advancing reform of the law in this difficult subject area.

A Sketch

Suppose an extraterritorial visiting earth wants to know how things are in the world of commerce. ET is handed a selection of the business pages of several of the leading newspapers in the western world from the last twelve months or so.

ET might conclude that there is a depressingly similar pattern to things, world-wide. In the Times he would find despair over the Guinness affair. In the Toronto Globe and Mail he could read how the directors of Nova Scotia Savings and Loan, in the words of an investigating judge, functioned as "a sort of benevolent junta, paying formal respect to the shareholders, but operating the company in their own way." And further west, the same newspaper has two major companies (Southam and Torstar) being told bluntly in Toronto by the relevant authorities that there had been an "unacceptable arrogation to directors
of unlimited powers to do with a company as they deem appropriate...[and that such behaviour leaves]...little chance of creating fair and equitable markets in which the investing public can have confidence." 2 At the same time attempts by a prominent Canadian business family to exclude non-voting shareholders from a takeover of a major retail chain are said to have amounted to "an abusive transaction...which if it is allowed to proceed...will destroy confidence in our capital markets." 3 The business section of the New York Times, in the jargon of corporate America, has been preoccupied with concerns over two-tier offers, leveraged buyouts, greenmail, poison pills, white knights, deposit scams, and insider trading. Newspapers from the pacific region would offer no light relief. There are similar allegations of mismanagement and misfeasance associated with the failure of companies such as Registered Securities, Landbase, Kinetic, and Equiticorp. The New Zealand Herald has reports that thirty companies were under scrutiny by the Reserve Bank in New Zealand at the beginning of February 1989 on its "prudential" surveillance list. 4

And ET might detect a similarity in response by the sectional actors in this large scale drama.

Commerce continues to insist that a few bad apples are not a barrel full, and that a free market will allow it to lead us all to a land of prosperity and economic justice for all, if only we will all leave it alone. Of course corporate abuse is a bad thing commerce concedes, but the market itself or self regulation will deal with behaviour which is too predatory or venal.

Governments wonder whether there is anyone or anything that can realistically address the unleashed spectre of finance corporatism on an ex ante basis. They nervously ponder the advisability of being a lender of last resort; bailouts in particular cases; at what point of time the trigger should be pulled on statutory investigatory schemes; and how they will deal with the inevitable complaints from investors and the derisory cries of opposition parties. And when the statutory trigger is pulled, and investigators sent in, every effort is routinely made to derail the inquiry. Thus, for example, in the course of the inquiry into the collapse of the Principal Group in Canada, under the Alberta Companies Special Investigations
Act, it was said the investigator might attempt to bring down the equivalent of criminal law findings of fraud and the course of the inquiry was side tracked by collateral legal proceedings.

The technical control agencies and government departments are resource constrained, and find holes exist in legislation which was supposed to give them the ability to effectively intervene as and when required. Publicly they cannot afford to diminish public confidence further, and a brave face is put on things.

The lawyers and accountants who prepared the deals look nervously at their indemnity policies as another group of professionals beavers away at the fine print on the transaction and reviews their handling of it. Too often it turns out that some infringement of some section of some piece of legislation has taken place. And scornful fingers are pointed at the professions on ethical grounds. These transactions could never have taken place but for the firms who advised on and certified them, it is said.

Judges faced with individual claims by disgruntled investors struggle with whether what was involved was simple gullibility and greed by individual investors who deserved to get burnt, or whether (particularly) equity causes of action should be increasingly pressed into action to control the worst excesses of corporate entrepreneurs. The result is serious distortion in legal doctrine. To shamelessly rephrase Lord Templeman in *CBS Songs v Amstrad* "these...[fashionable pleadings] assume that we are all in a [fiduciary relationship] now, Pharisees and Samaritans alike...that that relationship is a function of hindsight and that for every mischance in an accident prone world someone solvent must be liable in damages." 5

Academics and law reformers ponder solutions to problems which have already happened. Their prescriptions tend to assume a causal connection between law and street behaviour which is not always self evident. If x is done then y will follow they say. Perhaps. Life, as it should, asserts itself and rolls remorselessly on regardless of all prognostications.
I do not intend by this sketch to convey cynicism, or despair or to downplay matters of real significance. The sketch is over-drawn to convey the nature of the problems. They are contentious, complex, and matters on which thoughtful people could reasonably disagree. My aims are twofold.

First, things should be put in context, and a balanced perspective maintained. There has been much comment of a particularly partisan and non-analytic variety on this subject in recent months. At one extreme there have been calls to leave the market alone. At the other it has been suggested that corporate misfeasance is out of control. My own position is that the sky has not yet fallen, nor do I think it will. But there are serious atmospheric disturbances, and I do not by any means think we have seen the last of them. We need to try and understand better the cause of those disturbances.

Second, we should review the state of our law to deal with them - both on an ex ante and ex post basis - and proposals which have been made or are proceeding for reform of that body of law. And we should do this with all due humility as to the limits of law. Thievery and knavery are everyday concerns for lawyers, and traditional techniques still serve us well enough when such things need to be dealt with. But we lawyers routinely make fools of ourselves when we try to apply legal techniques to macro-economic policy. And foolish investors should not expect the law to save them from themselves.

Finally, by way of introduction, I should make it plain that my concern in this paper is with "external" reviews (generally after the event) of corporate behaviour and crashes. I will not be addressing ex ante accounting or securities controls or the existing law relating to "internal" or individual investor challenges to corporate misfeasance. Accounting standards are urgently in need of attention in New Zealand and our law very badly needs over-hauling in the dimension of investor challenges. However I am not sanguine about the ability of the investing public in New Zealand to mount effective challenges even under improved derivative remedies. The cost is simply prohibitive to the small investor and shareholder. In New Zealand, the growth of professionally managed investments may - and should - ultimately lead to closer scrutiny of the finance markets and achieve as
much as prolonged and expensive lawsuits. A critical economic press is also very important. And legal culture should not be underestimated. At the end of the day, a long tradition of egalitarianism and collective inquiry through the state dies hard in a small country, as the present administration has detected and is endeavouring to foster.

The Context of the Times

How far, if at all, our law should provide investigatory and remedial powers of an extraordinary character must be gauged against the prevailing mode of commerce, the public policies of the day, and the collective sense of justice of society of the time.

In contemporary society this is a matter of great complexity. The financial world has changed more dramatically in the last five years than in the whole of the preceding century. We do not like, but at least have become accustomed to, the traditional problems of over-leveraged property companies, finance companies borrowing short and lending long, nasty inter-group dealings that leave shells for some lenders, and so on. What has vastly complicated matters is that all the various countries in the Western world have lived through, to a greater or lesser extent, their own particular form of Big Bang financial deregulation in the last several years. This has resulted in the blurring or the outright abandonment of traditional or policy maintained demarcation lines with respect to markets, or institutions and sometimes both. In England the deregulation was with respect to markets. In Canada deregulation was with respect to institutions. New Zealand seems to have experienced a mixture of both approaches.

The pressures for the Big Bang built up over the last decade. Successively, there were problems in the early 1970s over floating exchange rates, then the reliance on monetary policy and battling inflation. On top of these global macro-economic problems there were the powerful forces of new technology and an increased ideological focus on competition.

As David Walker noted, it would be futile to suggest that these very large forces
can be arrested. One should not try to put the toothpaste back in the tube. Innovation, strongly driven by technology and competition, is with us in respect of financial services. I used to be able to tell clients and students that raising money through borrowing could be accomplished by two distinct techniques: either securities were issued to the public or funds were borrowed on a "private" basis from a lender. But of course any process by which non-tradable financial assets are effectively converted into tradable securities may not unreasonably be termed "securitisation". The attraction of repackaging assets as securities and creating new markets in them has become an irresistible new force in the financial world. We have everything from "junk bonds" to "mortgage backed" securities appearing all around the world. Innovation is both more novel and global. There has been a move towards merging the more conventional forms of debt and equity borrowing in a way which provides investors with a quite complex package in most cases and one which, moreover, takes into account not merely the traditional creditworthiness, or business acumen of the borrower, but also likely developments in exchange rates, and so on. Markets, forms of financing, and geography are becoming less distinct.

If this is so, attempts to regulate both markets and the legal form of transactions will be increasingly difficult in the future. And efforts to unravel "what happened" in commercial crashes will become increasingly complex.

It may be as well to deal here, upfront, with the argument that in this new climate a hands off or minimalist approach to law reform and legislation is appropriate. This requires much more than the simple assertions about "intervention" versus "non Intervention" one hears from some members of the Bar, and sees in financial journals. Again I agree wholeheartedly with Walker that the real issue is: What are the welfare implications of a minimalist approach? His views on that, to which I have added one or two points, go like this.

There are many people (and they include many astute old hands who have passed something like this way before) who think there is a serious imbalance between finance and what they would regard as real production in contemporary western economies. The financial whiz kids and middlemen, seen through such
eyes, are sterile in terms of their contribution to overall economic wellbeing. Things, it is said, have got out of kilter. The new markets and forms of financing are merely adding to opportunities for speculation and financial arbitrage, and then of course, it is said, crashes will occur.

More informed opinion tends to be suspicious both of the older point of view and of the new. Consider first the benefits that this large change in society and corporate behaviour brings with it. First, it does seem clear already that the greater competition that deregulation allows reduces the costs of doing business in capital markets, improves efficiency by allocating capital to a greater extent on the basis of competitive merit rather than regulatory influences, and by increasing the variety of available financing techniques enlarges the portfolio choice available to investors.

Second, a wider variety of financial instruments and markets enables market participants to protect themselves against interest and exchange rate fluctuations as well as against uncertainties with future liquidity. Risks are shifted to others. That in turn means that risks are more widely dispersed and in some degree reduced. The use of hedging devices increases the overall robustness of the financial system.

Third, the influence of greater dynamism in securities markets and corporate developments forces the pace of development in other parts of the economy. This can be a bad thing. Many regard merger mania and its consequential concentration as a bad thing. On the other hand, oligopoly may be an inevitable fact of life in a country as small as New Zealand. And our existing company and securities law tends to be pretty protective of existing management. But at least in the new climate companies have to stay awake and this is surely a good thing.

The down sides to deregulation - now all too obvious - are that of increased fragility in the whole financial structure and the opportunities for irresponsible or unduly venal behaviour.

As to increased fragility, any competitive process tends in any industry to involve
more or less continuous change with those enterprises (products) which are unable to compete or adapt being wiped out. The question which is not often asked, but ought to be, is whether this process is more or less acceptable in the financial sector.

The answer is that there ought to be concern about this fragility. First, financial intermediaries and investors may on occasions make very large losses. Some of these will be of the chain variety evident in the Equiticorp crash. These shock waves may be big enough to derail a whole economy. Second, *ex ante* detection of these big shocks is much more difficult than is commonly supposed. Third, the increased dependence on capital markets will accelerate the transmission of shocks to final investors without the traditional buffer of financial regulation. We will have to get used to, and cope with, some very sudden, very nasty surprises. In Henry Ford terms, when the wheels come off they will all come off at once, and the engine will explode at the same time, instead of a gradual deterioration. The ability of a financial system to cope with this phenomenon is problematic.

As to "bad" corporate behaviour, there is clearly the opportunity for greater corporate abuse. Around the world, where such has occurred, it has historically followed familiar patterns: money is taken in and either badly invested or a kind of shell game played (routinely to the greater advantage of the promoters). I am not in a position to say whether things have got worse in this dimension in the recent past in this country. Certainly the evidence in North America as enquiries have proceeded, has revealed some very unhappy events. This has led to a climate of suspicion with respect to investment, and calls for reviews of laws relating to investment and greater controls on the ability of those in charge of corporations to direct them in a position which will prefer their own position.

The point of this excursion is entirely practical. Government, government agencies, and courts have to formulate some response to the new footloose chameleon of ever expanding financial services and the incidents which such a phenomenon will inevitably bring. The alternatives are a classic law reform dilemma. They range all the way from essentially no regulation or investigative
powers, through encouragement of self regulation, a mix of self regulation and statutory intervention, to outraged judicial activism or labyrinthine statutory schemes. 7

My own views on the way forward are diffident, to say the least. I am too newly returned to New Zealand from North America to have any unusual insights into the domestic scene. For whatever it is worth, I doubt that there is much (if anything) to be said for short circuiting the problem by treating government as a guarantor of last resort. There should clearly be an encouragement of a greater understanding of the problems involved in the brave new capital world, and the need for ethical behaviour in the market place. In the long haul a culture that condemned corporate depredations for what they are - a fraud on us all, and the system we live under - would be the most transformative. However I was a legal practitioner for too long for the educator's idealism to have entirely overwhelmed me. There does, I think, need to be some prophylactic measures to avoid the risk of chain reactions of difficulties and possible failure. And there does need to be a mechanism or mechanisms - state generated - which can be employed to investigate and supervise in appropriate cases. I am not sanguine about the prospects for enlarged judicial supervision - a sort of revenge of the common law - with equity based causes of action in effect over-riding deliberately constrained statutory schemes. And last but not least we should not forget the sense of justice of the common person, who will say - with some justification when burnt - "these people were at least damned careless, and at worst downright dishonest, with my money." If the criminal process and penalties should only be employed as a social sanction of last resort (as I believe) but commerce has not collectively smartened up its act (as it has not) then there is every justification for sterner criminal measures.

The Existing Law

The existing statutory provisions for investigation of a companies affairs in New Zealand follow more closely on the British model than the American. In Britain, provision for official investigations was built into the earliest company legislation on the thesis that the government has a duty to investigate serious cases of abuse
or fraud on behalf of shareholders or the public at large. Those provisions fall into (very broadly) two categories. First, those requirements which require the provision of information to somebody else, so that in effect a watching brief can be maintained. Other action may then of course follow. Then there are a second, more powerful set of provisions which enable actual "investigations" to take place.

**Reporting Requirements**

There is one preliminary point I should make. Under the Reserve Bank Act that Bank operates what has fashionably come to be referred to as a "prudential" system of supervision of financial institutions. The Bank is entitled to demand quarterly information from registered banks, foreign exchange dealers and other financial information that the Bank considers to be of sufficient significance to the country in the financial arena. Balance sheets and "off-balance" sheet items may be requested. However these powers to intervene can be exercised only for the purpose of maintaining public confidence in the financial system or for the purpose of avoiding damage to the financial system.

As to the Companies Act, the existing Section 9A contains provisions allowing the Registrar of Companies (or any person authorised by him) "for the purpose of ascertaining whether a company is complying or has complied with the Act", to require the production of *(inter alia)* the records and books of the company. If the Minister or the Secretary so requests, the Registrar must make a request. There is also provision in section 67 of the Securities Act for the Securities Commission to trigger a power of inspection by the Registrar.

There are real difficulties with the Companies Act provision. Its ambit is narrow. The Registrar cannot get information about the management of the company. The penalties are derisory. A fine of $1000 is far preferable to the action which might follow on disclosure. The Registrar has no powers of entry and seizure. There is no power to compel cooperation from the companies officers. The position will be much improved in some cases by the Corporations Investigation and Management Bill, if enacted, which will be dealt with, *infra.*
Powers of Investigation

There is power, in sections 168 and 169 of the Companies Act, to investigate a company's affairs. In the case of a company with share capital there must be 200 concerned members or members holding not less than ten percent of the shares, and the High Court, to whom application must be made, must be convinced there is "good reason for requiring the investigation". In other cases the Court can order an investigation if there are "circumstances that suggest" that the business is being conducted with intent to defraud creditors, for a fraudulent or unlawful purpose or in a manner oppressive of its members, or that members "have not been given all the information with respect to its affairs which they might reasonably expect." Sections 170 to 174 detail the powers of an inspector, and what is to happen to the Report when made.

There are provisions of this kind in legislation throughout the British Commonwealth, although the precise terminology employed, and the powers conferred vary slightly from one jurisdiction to another. This type of proceeding can serve various purposes: it can provide evidence which will provide grounds for winding up a company; inform Parliament and the public as to why a company failed; provide evidence for civil or criminal proceedings; and it can provide a case study for improvements in the law or accountancy or business practice.

There have however been some concerns as to the basis on which Courts should be prepared to grant orders for investigation and how they should exercise their discretion with respect to the powers under the Act. The standard New Zealand authority is *Re Holeproof Industries Limited* 10 This case involved an application for directions as to whether an Inspectors report should be published. T.A. Gresson J. accepted a submission that inquiries under these provisions are non-judicial, and inquisitorial in nature. But it did not follow that the public interest could not, and should not, be considered in deciding whether to publish the report. His Honour held that the Court should consider all factors, including the public interest, before making an order. Canadian caselaw, by way of contrast, appears to have been more ambivalent on the equivalent provisions. There are some cases in British Columbia and Ontario which suggest that these provisions amount
to an extraordinary remedy to be used only where there is no other remedy, and this in effect requires an exhaustion of any other remedies before the sections can be employed. 11

In the United Kingdom the issue of the proper approach to the jurisdiction, and how, mechanically, investigations should be triggered, has been addressed in a manner which has found its way to some extent (whether by accident or design) into the Corporations (Investigation and Management) Bill in New Zealand, and therefore warrants some comment.

Under the British company law provisions, the Department of Trade and Industry can appoint inspectors. To avoid the expense and delay involved in a full scale inspection there are powers which can be exercised in advance of an appointment, and which may even obviate the need for it. 12 But there have been criticisms of and problems with the English approach which will likely also surface in New Zealand on enactment of the Bill. 13

First, there is the problem of departmental reluctance to order an investigation. A government department never has all the personpower and resources it would like. Unless a high profile case in which it is forced to act comes along it can be very wary of intervention. The news that a company is under investigation sends shock waves, or at the very least a message, into the financial community. Departments will likely be very cautious to avoid that kind of effect. And pressure can be brought to bear on Ministers to tell their departments to "back off" if an issue of this kind becomes politicised. I have seen English editorial criticism of the English departments refusal to go toe to toe with, particularly, public companies on this issue. It appears to have been thought that the financial establishment was able to influence Ministers in some cases.

Second, once a department or official is put in this position there tends to arise collateral issues of procedural irregularity, and natural justice. In Britain, in Re Permagon Press 14 inspectors were required to act fairly and to give an opportunity to those involved to respond to criticisms. This may suggest that Courts will be more inclined to review departmental action where the methodology
of the statute is to use the departmental process. There may, in short, be some judicial distrust of the bureaucracy exercising these kind of functions. The distrust is not bias. Under the old regime the inspector is still basically within the control of the Court. With departmental initiated action the judicial concern is a proper one - who will police the policemen?

In the result, in practice, applications for investigation (whether via a departmental route, or the Courts) are not made as frequently as they could usefully be in the British Commonwealth. Potential applicants are deterred under a judicial process by a narrow conception of the remedy and known judicial caution over the possible effects of an order on the company in the marketplace. It is quite possible that a department will be even more conservative than Judges have been. Hadden is of the view that this has in fact happened in the United Kingdom. This is unfortunate. American law has tried to address this problem by allowing more liberal access to information, particularly if the applicant will bear the costs involved. Doubtless that is useful in particular kinds of cases, particularly where there is a major shareholder, but the lot of the small investor is not improved. There is a real need to find better mechanisms to fund and assist small investors on a collective basis. Reform of class action laws, either generally, or in this subject area, are one possibility.

*The Corporations (Investigation and Management) Legislation*

In addition to these traditional kinds of investigatory powers, in 1958 New Zealand enacted the Companies Special Investigations Act, which replaced a 1934 Act.

The Act makes provision for the appointment of statutory receivers where desirable for the protection of shareholders or creditors of the company, "or it is otherwise in the public interest".\(^{15}\) The Act only applies however where those interests cannot be protected under the Companies Act "or in any other lawful way."\(^{16}\) Hence, whatever the jurisdictional basis of "normal" investigations, this Act clearly provides an extraordinary remedy. This is reinforced by the manner of the appointment - it is made by Order in Council, on "the advice of the Minister [of Justice] given on the recommendation of the Securities Commission".\(^{17}\) Once
subject to the Act, the company can only be released by Order in Council or the High Court. The Court can not however release the encumbered company unless the conditions that had caused the enrolment in the first place have ceased to exist.

The Act gives the receiver/manager very wide powers, and the court can, if necessary, confer further powers. It is also possible to order an investigation under the Act, by "competent inspectors" and certain of the Companies Act provisions then apply. There is power, under section 26, to appoint an advisory committee to assist the receiver or inspector, and that power has been exercised for the first time recently in relation to the Equiticorp case.

In practice, as the Schedules to the existing Act confirm, the Act has been used predominately in "group failure" situations. That is, where the affairs of a number of companies were hopelessly intertwined, and a series of individual liquidations or investigations would have been a most impractical way of proceeding. In short, the statute, whatever it says on its face has really been a multiple death statute, leading to a mass grave. The statute is a not a conventional insolvency provision, which contemplates "trading out" as at least a possibility.

On the 13 September 1988, the administration of the day introduced a Bill to repeal this statute and substitute a revised and extended measure. The Minister of Justice, The Hon. Geoffrey Palmer, conceded that "the Bill arises from a review of the Act that I asked my department to undertake urgently in the light of recent company failures and the corporate fraud debate that has occupied so much of the Houses's time in recent months".

The essential scheme of the Bill is as follows. First, the jurisdictional reach of the Act is widened. The Act would continue to apply where its application is necessary for the purpose of preserving the interests of a corporations shareholders or creditors, or in the public interest. But a new prophylactic jurisdiction is created: the Act would also apply to any corporation that is, or may be, trading fraudulently or recklessly. This jurisdiction would extend to foreseeable as well as actual occurrences. Under Part II of the Act, the Registrar
would have power, where he has "reasonable grounds" to believe that a corporation "may be" a corporation to which the Act applies, to declare it a corporation "at risk". He is then given certain powers and certain duties of co-operation are cast on the corporation. At the same time, the Registrar of Companies, who is thus given a greatly expanded role, is expressly not made a watchdog. He has no general duty to supervise any corporation. Investors, in short, cannot regard the Registrar as any kind of pocket, deep or shallow. A risk is still a risk.

Given the central importance of the terms "fraudulently" or "recklessly" it is important to note that a corporation contracting debts (at the time they were contracted) without an honest belief on reasonable grounds that they would be met when payable, as well as all its other debts (including future and contingent debts) is within the Act. I have emphasized the word contingent because it may well be overlooked in practice, and could well cause the same kind of difficulties in practice as those which have arisen under section 62 of the Companies Act in relation to guarantees and other forms of contingencies.

As to the meaning of the two critical words, the then Minister of Revenue, the Hon. Trevor de Cleene - a lawyer - suggested that "I think it would be reckless behaviour if people who invested in trustee securities invested beyond the two thirds limit, or if they invested without regard to the proper valuations or, perhaps, to valuers who are registered and of merit within the valuing community. That is the kind of recklessness I think the Registrar of Companies would consider." In practice I would doubt that Courts would have any difficulty with these terms.

Second, the entities to which the Bill applies would be much wider than under the existing law. Indeed the Bill has as wide a definition of a corporation as I have ever seen, anywhere. It means "any body of persons, whether incorporated or established in New Zealand or elsewhere." Hence this Bill would bring incorporated societies, partnerships - indeed on its face any enterprise by two or more people - within its reach. That, coupled with the powers actually given the Registrar of Companies, would make this a very intrusive statute. And it is only by implication that one can read into the statute that it is aimed at commerce and
Third, the Bill gives the Registrar greatly enlarged powers to obtain information, carry out investigations, and manage the affairs of the corporation. For instance, not only can the Registrar require information, he can require it from auditors and trustees, and he can require information to be supplied to him to be audited.  

Fourth, the offence provisions are now significant. If a statutory manager is appointed, transferring assets out of the country without consent could involve jail terms, or fines up to $50,000 in the case of an individual or $250,000 in the case of the company. Destroying documents or records could attract a wide range of penalties - a clear reference to the problems some receivers and liquidators have had in reconstructing records.

The introduction of the Bill was welcomed by both sides of the House. The oppositions principal concern appears to have been that it should have been introduced sooner. The Bill has been referred to a Select Committee.

Reported professional comment at the time the Bill was introduced was adverse. The Bill was said to be "philosophically confused - a kneejerk reaction, cobbled up to to fill a gap in the political rather than the legal market." Some accountants apparently think the at risk provision to be a certain kiss of death, with liquidation the only possible outcome. The very wide powers which would be given the Registrar were said to have evoked considerable concern. And the Bill gives unsecured creditors and shareholders rights not previously available, and arguably improves their position at the expense of secured creditors. This was criticised.

The Bill could usefully be reviewed under four heads: First, do we need an extensive jurisdiction of this kind? Second, if so, who should exercise it? Third, what powers should the persons charged with such a jurisdiction have? Fourth, what is the likely impact of the Bill on third party interests, such as secured creditors?
As to the first matter, that is essentially a question of social and economic policy. Commerce, and I would imagine the professions as professional groups, will likely resist the conferring of such long arm jurisdiction. They will ask - as did some members of the opposition on the introduction of the Bill into the House - what happened to government's avowed commitment to having the market place sort these things out for itself? There is some force in the comment. But there have always been clear exceptions to the broad principle of the market. For instance, patent law is a clear exception to anti-trust or monopolies provisions. At some point, the purity of the market has to yield to other considerations. In this area for instance, fraud is fraud and notions of common justice then take over. At the macro end of the scale, the opportunities for large scale harm to the economy are such in the brave new world of financial services that it is possible to conceive of the market itself being destroyed, or at least severely impaired or damaged. Hence the argument can be made that provisions of this kind are necessary for the integrity of the marketplace itself.

The first question inevitably spills into the second question. Can it be done, and if so by whom? I am surprised there has been no reported comment on the conferring of this jurisdiction on the Registrar of Companies (which includes a Deputy).30 Unless some reorganisation of the Commercial Affairs Division of the Department of Justice that I know nothing about is contemplated, I do not see that that office has the person power or the expertise to do the job. And there is a point of principle - Registrars are essentially administrators. It is desirable that administrators not be regulators and adjudicators. Some regulators recognise this, whether it is because they do not want the enforcement end of things, or for reasons of principle. Sir Kenneth Berrill, the Chairman of the Securities and Investments Board Ltd in England recently said, "I am a regulator, a watchdog and a policeman - in that order."31 My own experience of company law reform in Canada was that Registrars consistently resisted having matters at the investigatory and enforcement end of the scale thrust upon them. I would be surprised if things were otherwise in New Zealand.

As to the question of the breadth of powers to be conferred, this too relates to the fundamental justifications for such jurisdiction. If it is appropriate that there be this
kind of jurisdiction, the powers are probably necessary. It would appear that the range of powers under the English provisions are very wide, but the Courts have had no difficulty in reviewing the conduct of investigations, where necessary, on review applications. The Halsbury summary of the legislation and caselaw in that jurisdiction records what appears to be a sensible set of rules, and I am not aware of any criticism of that aspect of the English company law provisions. 32

As to the suggested alteration to the rights of the various parties interested in a company, some of the provisions in the Bill seem to have come out of other statutes or proposals. Their appropriateness in this measure seems questionable. The moratorium notion for instance, is in the Reserve Bank Amendment Act, but should it be in this Bill? And the rights of secured creditors do seem to have been downgraded. Is that desirable?

I would offer these further thoughts, or lines of inquiry, for whatever they are worth.

Philosophy of Commercial Law Reform

How does this proposed legislation relate to other projected reforms in commercial law - and particularly company law - in New Zealand? The trend of modern corporate law reform has been to treat a companies act as being a largely neutral vehicle. That is, it merely provides a vehicle to enable registration of a business form. Improper corporate activity is controlled elsewhere, to the extent that it needs to be. In other words, the uses to which a corporation may be put are, by and large, not the concern of a registration statute. This is the philosophy which underpinned the Model Business Corporations Act evolved by the American Law Institute which was eventually adopted in the United States and Canada. The Canadian federal variation of that model is clearly influencing our Law Commission to some extent, if the Commission's Working Paper is any indication of the direction it intends to recommend. 33

I could put this another way. What do we want from our company law? Do we want an English style approach, with many "bright light" substantive provisions in the statute? Such an approach, conceptually, sees a company as much more like
a trust, and all sorts of consequences flow from that vision. Or, do we want the controls to which corporations are subject to be determined by reference to how far they serve identified social and economic ends? In that case, a companies act is not the place to express those controls. Or do we want the market to run free, with only an occasionally outraged judiciary between the investor and the predators - which inevitably leads to a marked escalation of equity causes of action, as in present day North America?

The Minister of Justice has repeatedly, and in a variety of contexts, said that he does not want piecemeal law reform. He is, with respect, quite correct in that approach. But the corollary is that there must be a thought through philosophy of commercial law reform if we are not to fall between several stools. I do not discern a cohesive philosophy, as opposed to strategy, in the measures introduced or published or announced as intended to be undertaken, to date. In particular, where does this jurisdiction stand by way of a response to modern corporatism? We have surely passed through the age, identified by Berle and Means in their famous work, *The Modern Corporation and Private Property* (1932), as that of the separation of ownership and control, to a new age of finance corporatism, which in the case of large entrepreneurial companies is characterised by the professional manager and large pools of capital seeking to maximise short term advantage.

I am not sure that even the existence of these kind of issues has yet been firmly grasped by departments and our lawmakers in New Zealand. What seems to have happened in New Zealand is that we have got into the very situation the Minister did not want: entering via the back door into a dim room of very large proportions, without too much of an idea of what we would do once we got in there, and how we would arrange things inside.

*The Enforcement Problem*

If we are persuaded, as I would hope we might be in such a new age, to put investigation and enforcement out of the Registrar's domain, new or extended organisations are needed.
There are two aspects of this problem. One concerns the detection of corporate wrongdoing. The other aspect concerns enforcement. I have already said I think good public administration should keep the two functions separate. The Minister of Justice has been adamant that there is now no problem with resources to staff the existing Corporate Fraud Unit. That came as something of a surprise to me, given the very large resources these sort of inquiries routinely require, and difficulties encountered overseas. In England it has been said that it has "proven extremely difficult for the new Director [of the Serious Fraud Office] to recruit lawyers of the right, or for that matter any calibre." The Minister is entitled to have his assurance respected. However there is still a need for more cohesive standing enforcement machinery in relation to corporate wrongdoing.

There are two ways, outside the Registrars office, of approaching this. Either we extend or reinforce an existing organisation or we set up a new one. For instance, there could be set up a new Corporate Affairs Enforcement Commission, or such-like body, to undertake these and perhaps enforcement related functions under other statutes, or the Securities Commission could be given an expanded role. At least in theory, an independent, across the board enforcement arm has some attractions. It keeps regulators out of the trenches. And it formally makes difficult the sort of coziness that can creep in between an industry and the regulators thereof. But if that were to be done it would need to be subject to the usual caveats. It is very difficult to get street-wise people to join this sort of enterprise, and we should not underestimate the resources required to get the job done. Unless the administration is prepared to treat such a body as a significant national enterprise, we would not be much further ahead. Indeed, the outcome could simply be public cynicism at "yet another useless Commission" and calls eventually to do away with it. If, on the other hand, (say), the Securities Commission is to be beefed up in this dimension, it will need a higher profile, and it will face the problems the SEC has traditionally faced in the United States, staff-wise.

I am not in a position to offer definitive views on this issue of the most appropriate machinery. There are very real policy and organisational difficulties involved. I
am merely pointing to a serious issue for this country which has had inadequate attention and has not yet been the subject of sufficient public debate and scrutiny. It is one thing to bring in a raft of new commercial law legislation. My own experience of commercial law reform is that making it work, and enforcing it, is actually the hardest part of the job. Stamina, a readiness to go back and amend if necessary, but above all putting in place an organisation which will advance the cause are critical. Given the present Minister's experience, I should think that he is not unaware of this general problem. And it may be that one of the absolute priorities for the Chief Executive of the new "super ministry" of Commerce (which to some extent straddles Justice and Commerce) could be to see that matters are advanced under this head. The sort of enforcement fragmentation that is already apparent in statute law development in New Zealand has to be questionable, and at the very least needs a thorough review.

Conclusion

In present circumstances it is unrealistic to argue that corporate investigations are neither necessary nor desirable in principle. And the more complex and ever expanding range of corporate financing means that there will likely be more opportunities for, and instances of, predatory behaviour and deviousness of a particularly venal kind. It would be a mistake to assume that what we are having to deal with at the moment is merely a by product of the sharemarket boom and that "the wave has rolled through." The need for adequate investigatory machinery has grown, not diminished, in importance in contemporary circumstances.

The attempts by the present administration to strengthen the law must therefore be welcome. The question is whether what has been put before us is the best that can be devised. The much wider jurisdiction and powers are important. The real problem however is in relation to detection and enforcement. The proposals, at least on what is publicly available to this point of time, seem weak and incomplete on that side.
CORPORATE INVESTIGATIONS - FOOTNOTES

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1. *Globe & Mail*, editorial, 25/2/88

2. *Id.*

3. *Id.*


5. [1988] 2 W.L.R. 1191, at p. 1208, G.


7. See Gower, note 6, supra.


12. Companies Act 1967, c.81, s.109


15. S.3(4)

16. Id.

17. Id.


20. Cl. 29

21. Id.

22. Cl. 8

23. Cl. 7

24. Hansard, note 18 supra, p. 6499

25. Cl.2(1).


27. Cls. 42, 69.


29. Id.

30. Cl.2 (1)


32. See note 9, para 973.

33. Preliminary Paper No. 5
34. It is one thing for a government to parcel out the work it wants done in commercial law reform to various sources - the department itself, the Law Commission, the Securities Commission and so on. It is quite another to have a clearly thought through philosophy of commercial law reform which will inform all that work. And the statutory introduction of commercial law reform in the last several months has not exactly been tidy or schematic.

35. See Note 31, supra.

36. The SEC, for all its high profile in the United States and overseas, still has staffing difficulties. And the more recent revolving door rules, which may make it difficult for bright young lawyers to peddle their Commission won experience could exacerbate this problem.
THE REGULATORY FRAMEWORK FOR COMPANY TAKEOVERS IN NEW ZEALAND

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I The Statutory Framework and Regulatory Institutions

(a) Introduction

Company takeover law in New Zealand is presently in the melting pot. Following its earlier report on insider trading, the Securities Commission has now published a comprehensive report to the Minister for Justice on company takeovers. Parliament has recently enacted changes to the Securities Act which regulate insider trading and also the controversial futures industry. The Minister has promised legislation to enact the major recommendations of the Securities Commission on takeovers. In particular, a person who passes the 30 per cent threshold of ownership will be required by law to bid for the whole company at a price that is not less than the highest paid for acquisitions in the preceding 12 months or the market price immediately before the bid is announced, which is the higher.

The Law Commission is due to report to the Minister on Company Law reform, following publication last year of its Discussion Paper. That report is likely to recommend the strengthening of the duties of company directors and may go so far as to impose specific duties on the directors of offeree companies.

All of these changes are being considered in a commercial and economic environment that is far from healthy. The stock market crash of October 1987, the subsequent collapse of large public companies, including most recently and most notably Equiticorp, the public revelation of secret transactions of doubtful legal validity and commercial propriety and the failure of many
high-flying company directors to observe fundamental notions of fiduciary obligation have all contributed to a feeling that New Zealand financial markets are completely lacking in integrity and that regulatory controls are either non-existent or at best totally inadequate. Added to that is a current political and economic environment that has such features as high unemployment, a multitude of corporate and individual insolvencies, concerns about foreign ownership and a degree of political instability resulting from the dismissal or resignation of high-ranking Government Ministers.

Commercial law reform, including changes to takeover laws, is being considered therefore in an atmosphere that does not lend itself to rational and considered debate. Much emotion, some of it justified but some not, has been engendered by particular transactions. Take for example the various moves made during 1987 in relation to what used to be the largest company in New Zealand - NZ Forest Products Limited: the establishment of Rada Corporation by NZFP, its public flotation, the purchase by it of a substantial part of NZFP as a defensive mechanism to an unwelcome suitor in the form of Fletcher Challenge Limited, the refusal by the Commerce Commission to authorise a takeover of NZFP by the Australian Amcor Corporation, the subsequent insolvency of Rada, the Justice Department Report on the incestual financial transactions occurring between NZFP and Rada and the eventual reverse takeover of NZFP effected by Elders and buy-out of the Fletcher holding in return for important forestry and wood product assets. Little wonder that this led to a conviction by many that minority shareholders were but pawns in the corporate world and that they lacked proper protection under existing corporate and securities laws.
Concern for the position of minority shareholders was also behind the decision of the Securities Commission to hold a public inquiry into the Lion Corporation merger with L.D. Nathan & Co Limited, following a purchase by Lion of 35 per cent holding which was held by Fay Richwhite & Co Limited in Nathan at a price substantially above the value of the public offer made by Lion to the remaining Nathan shareholders. The inquiry before the Commission was lengthy and was accompanied by High Court proceedings brought by a minority shareholder in Lion seeking to frustrate the merger. Some of the comment that accompanied and took place within the Inquiry was ill-informed and unconstructive but the exchanges between the Chairman of the Commission and Professor John Pound, a United States economist brought to New Zealand for the Inquiry by Fay Richwhite, raised the debate on shareholder equity to a level that was more worthy of the disappointing recommendations later published by the Commission.

What the Lion-Nathan inquiry did heighten, however, was the tension that exists between economic efficiency, on the one hand, and shareholder equity, on the other. Not surprisingly, economists such as Professor Pound and Mr Peter Gorringe from the Treasury argued forcefully that great benefits result from takeover activity, that it promotes corporate efficiency and increases shareholder wealth. \(^7\) By contrast, minority shareholder advocate Mr Max Gunn and former Attorney-General Dr Martin Finlay QC emphasised that securities rank pari passu and that holders should therefore receive equal treatment not only on a winding up but in a takeover situation as well. \(^8\) The resolution of this conflict determines the kind of takeover laws that a country has. New Zealand appears to have chosen the equal treatment solution and to have rejected the case for economic efficiency and increased shareholder wealth, tempered by the strengthening of the
fiduciary duty to prevent abuse, so elegantly advocated by Professor Pound.

(b) The Existing Law

Company takeovers and mergers in New Zealand are regulated under statute by the Companies Amendment Act 1963, by the Commerce Act 1986 and, where the offeror is an overseas person (including within that term a foreign corporation), by the Overseas Investment Act 1973. While not concerned specifically with company takeovers, the Fair Trading Act 1986 is also of relevance. In addition, it is necessary to refer to the Takeover Code contained in the Listing Requirements of the New Zealand Stock Exchange, although those provisions are strictly speaking contractual in nature notwithstanding that the Exchange is created by statute.

The statutory institutions charged with administering these various provisions are the Registrar of Companies (Companies Amendment Act 1963), the Commerce Commission (Commerce Act 1986 and Fair Trading Act 1986), the Overseas Investment Commission (Overseas Investment Act 1973) and the New Zealand Stock Exchange (Takeover Code). Although not given any specific enforcement powers, the Securities Commission, which is established by the Securities Act 1978, has however proved to be a highly influential and significant body in this area. Relying on its "law reform" recommendatory powers, the Commission, as will be seen below, has investigated takeovers during their currency, by way of both public and private inquiry, in order to satisfy itself that there is no irregularity or unfairness emerging that requires legislative attention. Ultimately, however, its lack of statutory enforcement powers has rendered it far less effective than its Australian counterpart, the National Companies and Securities Commission.
Prior to 1963 there had been no specific controls on takeover offers contained in the Companies Act, though there were (and are) provisions by which an offeror which had succeeded in acquiring nine-tenths of the company (excluding shares already held by the offeror) within a period of 4 months could compulsorily acquire the shares of the dissentient shareholders subject to the right of the latter to object by application to the High Court.\textsuperscript{11}

The Companies Amendment Act of 1963 introduced what has been referred to as a "takeover code". The inappropriateness of that description was demonstrated by a number of Court decisions, beginning with that of the Court of Appeal in 1966 in \textit{Multiplex Industries Limited v. Speers}.\textsuperscript{12} In that case, it was held that the Act only applied to offers that were made in writing and did not extend to oral bids. There later followed in 1983 the judgment of Mahon J. in \textit{Carter Holt Holdings Limited v. Fletcher Holdings Limited}\textsuperscript{13} in which it was held that an initial purchase of a substantial shareholding, made pursuant to a verbal offer and intended to give the offeror a "toehold" in the target company, did not come within the statutory definition of "takeover scheme",\textsuperscript{14} notwithstanding that it was made immediately before the formal written statutory offer was made.

The ambit of the Act was further reduced by the judgment of Quilliam J. in \textit{Tatra Industries Limited v. Scott Group Limited}.\textsuperscript{15} The Court there held that the Act had no application to purchases on the Stock Exchange even although the brokers acting for the bidder had given notice to the Exchange to stand in the market, as required by the Rules of the Exchange. Reference should also be made to \textit{Carr v. New Zealand Refrigerating Company Limited}\textsuperscript{16} where the High Court took a generous approach to
what was regarded as "substantial compliance" with the Act, notwithstanding a number of procedural contraventions.

Finally, there is an express statutory exemption in the case of offers that are made to not more than 6 members of a company. In practice, this provision has been used on occasion to circumvent the Act by using a broker to collect together a large number of small parcels into the confines of a single nominee company to which the offer is then made.

Not surprisingly to practitioners in this field, the Securities Commission (in its Report Company Takeovers) had little compunction in describing the 1963 Amendment Act as "an inept piece of legislation that should be repealed in any event." It further pointed out that the Act had the opposite effect from its apparent policy objectives:

"One remarkable feature of this is that the 1963 Act itself operates to induce offerors to make personal approaches to selected shareholders with substantial holdings to the exclusion of other shareholders with relatively small holdings. Certainly the 1963 Act has failed to achieve the purpose, if such it was, of giving all shareholders the opportunity to respond to a takeover offer. On the contrary, it has induced discriminating treatment by leaving open the way to takeovers by agreement with some substantial shareholders, and impeding an approach to all shareholders that is feasible only by written offers with the formality and disclosures required by the 1963 Act. If the object to the Act was to improve the position of the general body of target shareholders, the object has not been achieved. On the contrary, the promoters of this legislation succeeded in scoring a remarkable 'own goal' against them. The Act promotes the very kind of takeovers, partial, sudden, secret and by word of mouth, that the promoters intended to inhibit."
(ii) Stock Exchange Rules

Take-over activity or potential takeover activity is regulated in two ways by the Rules of the Exchange. First, there is the "substantial shareholding" requirement that obliges a member of the Exchange who has received instructions to purchase more than 10 per cent of the voting shares in a listed company to bid for not less than one-fifth of the proposed purchase at a trading meeting after prior notice has been given to the Exchange at least 20 minutes before the beginning of that meeting. Secondly, there is the Take-over Code.

The Take-over Code is directed towards:

(1) establishing duties on directors of both offeror and offeree to act in the best interests of shareholders, to make full disclosure to the Exchange and to all shareholders and not to allow insider trading to develop where a possible takeover exists;

(2) requiring sufficient information to be given to shareholders of the offeree company to enable them to make an informed decision on whether to accept the offer;

(3) preventing the Board of the offeree company from engaging in defensive takeover tactics "unless it honestly believes that acceptance is not in the best interests of shareholders" and in any event foreclosing the issue of unallotted voting shares without the sanction of a general meeting as a defensive measure;

(4) guaranteeing equal treatment for offeree shareholders.
Consideration of this last objective dominated the Report of the Securities Commission into Company Take-overs and, more specifically, the Lion-Nathan Inquiry. It therefore deserves closer examination. Rule 612 provides that all holders of the same class of security are to be "treated similarly" by the offeror except that allotments of small parcels of shares may be satisfied by cash. It is to be observed that in a note to the rule the Exchange says that an offeror is entitled to make a partial bid provided that every offeree who accepts has the same percentage of his shareholding taken up. The subject of partial bids has been a highly controversial one, particularly in recent times in Australia. The effect of the recommendation made by the Securities Commission to the Minister for Justice (and adopted by him) requiring persons who have acquired by any means 30 per cent or the company to offer to purchase all the voting securities issued by the company will be to outlaw partial bids in New Zealand over the 30 per cent threshold level.

Rule 613 provides that where a takeover or merger transaction is reasonably in contemplation and shares are purchased from one or more shareholders of an offeree company, any subsequent general offer made by the same offeror (or person acting in concert with it) within 3 months to the remaining holders of the same class of security must not be on less favourable terms. Similarly, increases in consideration or price within a 3 month period must be passed on to all offerees, whether or not they have already accepted the offer.

In the Lion-Nathan merger, the first of these rules had not been observed in that Fay Richwhite was offered a cash price by Lion of $9.20 per share for its 35 per cent holding in Nathan whereas the offer to the remaining Nathan shareholders was for scrip and valued at about two-thirds of the Fay Richwhite price. The Stock Exchange,
however, waived compliance with the requirements of rules 612 and 613, under a general power which it had to dispense with the observance of any of its Rules, on condition that the offer was accepted by a majority of Nathan shareholders excluding those with a particular interest in the merger. That condition was satisfied. In announcing the grant of the waiver, the Exchange acknowledged that the 3 month requirement could all too easily be circumvented by the simple expedient of delaying the general offer. The Exchange called for the enactment of "effective takeover law", arguing for equality of treatment of all shareholders and concluding that any other course would harm the international appreciation of the New Zealand market and render harmonisation of trading with the Australian market impossible.

(c) Commerce Act and Fair Trading Act

As is well known, the 1986 Commerce Act introduced into New Zealand a radically different regime of competition law and policy. In accordance with the dictates of the Closer Economic Relations Treaty Agreement, the New Zealand Parliament adopted the model employed in Australia in the form of the Trade Practices Act 1974, though with a number of detailed differences. One of the more significant of such differences was in the area of regulation of takeovers and mergers. The Australian provision simply prohibited any takeover or merger that had the effect of substantially lessening competition in a market. When enacted in 1974, the Act contained a prior clearance system but this was removed in 1977. Accordingly, since that time the Australian Act has relied on powers of divestment and on the power of the Trade Practices Commission to seek injunctions from the Court against the implementation of takeovers that appear to infringe that statutory prohibition. In practice much informal prior consultation occurs.
By contrast, the New Zealand Act imposes a legal obligation to obtain clearances or authorisations to takeovers or merger proposals before they are implemented.\textsuperscript{34} Section 50(2) of the Act prohibits any person, either by himself or jointly or in concert with any other person, from implementing a merger or takeover proposal to which the section applies unless a clearance or authorisation to the proposal is implemented in accordance therewith. The prohibition only applies where the threshold levels as to proportion of shareholding (20 per cent)\textsuperscript{35} and aggregate value of assets of participants in the proposal\textsuperscript{36} are exceeded.

The Commerce Commission, when receiving an application for clearance to a merger or takeover proposal, is required within 20 working days thereafter either to grant a clearance if it is satisfied that the proposal, if implemented, would not result or would not be likely to result in any person\textsuperscript{37} acquiring a dominant position in a market or strengthening a dominant position in a market or, if not so satisfied, by notice to inform the applicant accordingly and thereafter to give a clearance or authorisation or decline to do so.\textsuperscript{38} The distinction between a clearance and an authorisation is that the former is granted where the Commission is satisfied that no dominance problem arises whereas the latter may be granted, notwithstanding a dominance problem, so long as the Commission is satisfied that implementation of the merger or takeover proposal "would result or would be likely to result in a benefit to the public which would outweigh any detriment to the public which would result or would be likely to result" from the acquisition or strengthening of a dominant position in a market.\textsuperscript{39} The Act gives the Commission a period of 100 working days to consider authorisations,\textsuperscript{40} a matter which has been the subject of much criticism in that it may adversely affect the ability to effect a successful takeover, morale among
staff and customers of the target company and also the costs of acquisition where financial markets are changing rapidly.

The whole scheme contained in Part III in relation to merger and takeover proposals is currently under review and various aspects are debated in the Discussion Paper on the Commerce Act published by the Department of Trade and Industry in 1988. A number of specific questions warrant consideration, the major two of which are:

i) Is the pre-transaction clearance system appropriate?

As noted above, a similar system was abandoned in Australia, although undoubtedly much informal notification and consultation with the Trade Practices Commission takes place by companies wishing to avoid the potentially very detrimental effects of injunction or divestment proceedings. There is acknowledged to be a considerable resource cost to the Commerce Commission in vetting the large number of proposals that fall within the Act, even although only a very small number of such proposals are declined (2 out of 332 in the first twelve months of operation of the Act). The Department nevertheless recommended the retention of the present system, although advocating procedural reforms designed to achieve some simplification. The question of alternative measures is discussed further below.

(ii) How satisfactory are the twin tests of market dominance and public benefit?

It is somewhat odd that Part III of the Act should erect a barrier of market dominance per se when Part II merely legislates against the use of a dominant position in a market for stated anti-competitive
purposes. It is submitted that this apparent policy anomaly requires addressing. The concept of "public benefit" is intended to provide a balance against the undesirable consequences of too slavish an application of the market domination test. The difficulty that exists, however, is that the Act nowhere lays down any definition or provides any criteria or principles by which public benefit is to be measured. It is a matter of legitimate criticism that the 1975 Commerce Act defined "public interest" in terms that were vague, inherently contradictory and lacking in any central principle. The 1986 Act has gone to the opposite extreme in that it fails to give any guidance whatsoever to the Commission or to the Courts. This has, not unnaturally, led to a certain inconsistency in the decisions of both bodies, including the Courts of Australia where a similar problem exists under the Trade Practices Act.

The criticism of inconsistency in the approach to public benefit has been taken up recently by the New Zealand Business Roundtable which suggests that both the Commerce Commission and the High Court have failed "to recognise economic efficiency as the objective underlying, but not specified in, the Act, or to interpret competition as a means to efficiency (and hence consumer welfare) rather than as an end in itself." The consequence, the Business Roundtable concludes, is that there exists in New Zealand "a bias towards intervention, imposing significant economic costs which might be avoided under better designed antitrust rules."

In terms of the adoption of central concepts of competition policy that have international acceptance, the Commerce Act of 1986 as a whole undoubtedly represents a major step forward from earlier trade practices.
legislation in New Zealand but the part of the Act that regulates mergers and takeovers is far from satisfactory. It is bureaucratically clumsy and costly, not only to the regulatory body that administers it but also to commerce and industry. It lacks a clear policy objective and, to the extent that one can be gleaned, it is inconsistent with the policy applicable to restrictive trade practices. The Departmental Discussion Paper correctly poses the choice for future policy as being between economic efficiency and a broader, better defined, public benefit principle that takes specific account of social considerations that may conflict with efficiency criteria. The Paper comes down in favour of a view of public benefit that facilitates "the achievement of efficiencies which would not be achievable if the parties to the application were required to comply with the Act." That sounds reasonable but its translation into clear legal criteria may be more difficult.

It is important to appreciate that there are other limitations on the pursuit of economic efficiency as the desired goal. These are to be found in the Fair Trading Act 1986 which has incorporated, with no real change of principle, the provisions of Part V of the Australian Trade Practices Act 1974. In particular, it has adopted the Australian prohibitions against misleading and deceptive conduct in trade and misrepresentations of numerous stated kinds, together with the wide range of legal remedies in respect of such conduct. There is a clear intention therefore on the part of the Legislature that the competition and economic efficiency objectives of the Commerce Act are to be tempered by an overriding requirement that what is done is done honestly and according to standards of conduct that are reasonably protective of the consumer. The point was made clear by the High Court of Australia by Mason J. (as he then was) in Parkdale Custom Built Furniture Pty Limited v. Puxu Pty Limited in the following way:-
"In a collision between one of two different statutory policies and plain words giving effect to the other statutory policy the plain words will prevail. To my mind the words 'misleading' and 'deceptive' as applied to conduct in trade and commerce are reasonably plain. And in a collision between the general policy of encouraging freedom of competition and the specific purpose of protecting the consumer from misleading or deceptive conduct it is only right that the latter should prevail. It would be wrong to attribute to the Parliament an intention that the indirect and intangible benefits of unbridled competition are to be preferred to the protection of the consumer from the misleading or deceptive conduct which may be an incidental concomitant of that competition. Given the statutory context here it is more likely that Parliament intended to promote free competition within a regulatory framework that prohibits the trader from engaging in misleading or deceptive conduct, even if it means that one trader cannot in particular cases compete with another trader because the opposite view would give a paramountcy to freedom of competition not accorded to it by the statute."52

It is of interest and significance that the Courts of both Australia and New Zealand have been willing to consider the application of Part V (of the Australian Act) and the Fair Trading Act respectively to takeover situations. In particular, in *Bell Resources Limited v. BHP Co Limited*53 (Australia) and in *CBP Industries Limited v. Bowker Holdings No.16 Limited*54 (New Zealand), the Courts appeared to accept that statements made during the course of contested takeovers could be measured against the standards laid down in section 52 or section 9 respectively, although on the facts of each case no substantive remedy was granted.

II Policy Objectives in relation to Takeover Controls

(a) Inter-relationship between Competition Policy and Securities Market Regulation

It has been suggested above that competition policy in relation to mergers and takeovers needs to be re-thought
both with regard to substantive content and to administration. There is also the question of the inter-relationship between the regulatory regime imposed by the Commerce Act and the controls on markets for securities that are laid down in companies and securities legislation and in Stock Exchange rules. This is a matter that was addressed by the Securities Commission in its Report on Company Takeovers. The Commission challenged the view that "effective government intervention in the markets for goods and services may require government intervention in the markets for the control and ownership of the entities that participate in the markets for goods and services." The "case for such intervention ('upstream') and removed from the markets for goods and services," the Commission said, "seems to be weak if there is an open and competitive market for securities and the control of those entities." More than that, the Commission thought the Commerce Act to be positively disabling in that it:

(1) affected securities markets by requiring public notice of a bidder's proposal to acquire shares and by impeding the presentation of a competing proposal;

(2) made it possible to "lock up" a target company by entering into a contract with some shareholders to buy their holdings subject to consent of the Commerce Commission but including provisions designed to prevent acceptance of a competing bid.

The Commission accordingly recommended the total repeal of Part III of the Commerce Act. It is respectfully submitted that there is much merit in these views and that Part III does not in any event stand as a monument to successful public interest legislation.
(b) Policies for Securities Markets - the pari passu principle and Lion-Nathan

The Securities Commission addressed this matter at some length. Ultimately, it recommended that statutory reforms be enacted to the following effect:

"(a) a person who, by any means whatsoever, acquires relevant interests in more than 30% of the voting securities of a listed company should be required to offer to purchase each and every one of the voting securities in the company for a consideration equivalent to the highest consideration for any voting security acquired by the person within the preceding 12 months, or the price on the market immediately before the announcement of the offer, whichever is the greater (...the 'mandatory offer'):

(b) prior notice of the offer should be required except where it is an unconditional offer of cash for each and every one of the voting securities that is open for acceptance by each offeree for a reasonable period, say three weeks.

(c) an administrative authority should be established with the powers and resources necessary to administer and enforce the legislation."

The Minister for Justice has publicly announced that these measures will be enacted during 1989.

As has been noted above, the debate before the Commission during the Lion-Nathan Inquiry centred on whether a shareholder in the position of Fay Richwhite - with, say, a 35 per cent holding - should be entitled to bargain for a "premium for control" in a takeover situation or even to stipulate the best negotiable price to a purchaser who is
content to deal with it and it alone. The key to the rejection by the Commission of the solid consensus of most economists that the premium for control was not only a natural market phenomenon but had positive economic benefits for all shareholders and was in the public interest lay in this footnote to its Report:

"In our opinion, the pari passu principle stated in the text is a major premise, usually inarticulate, of existing company law and practice. We think it is implicit in the concept of a 'share'."61

The Commission thought that if the pari passu principle were "perfectly implemented" and share prices set in "perfect markets", market forces would ensure price equality at any given time for the reason that:

"A rational and efficient market would expect that identical benefits would accrue in future to every ordinary share in the same company, would attach identical present values to those future benefits, and would therefore set identical prices for each of the shares."62

In those circumstances, the Commission said, there would be no significant premium for control "because control would not be regarded as conferring any benefit, valuable in terms of money, significantly disproportionate to shareholdings".63

Of course, as the Commission itself acknowledged,64 the New Zealand market does not conform with this expectation. The recommendations propounded by the Commission and accepted by the Minister therefore constitute an attempt to force the market to behave differently from its natural dictates, so that the sanctity of the pari passu principle is not endangered. Professor Pound had rejected these proposals in his submissions to the Securities Commission during the Lion-Nathan Inquiry.65 It is submitted that, even if one
looks at the issue from a narrow legal perspective, the
principle relied on by the Securities Commission cannot be
regarded as providing a universal directive by which all
corporate conduct must be guided. It is true, as the
Commission says, that the law seeks to ensure that
contributors to the corporate funds share in
"distributions by the company and in the residual assets
of the company" simultaneously and pro rata. It is true
also that it is reasonable to give "distributions a broad
meaning, that is, to include not only dividends but also
any gratuitous payment which is tantamount to gifting the
assets of the corporation". However, while generally
discouraging distributions that advantage directors or
particular shareholders at the expense of the assets of
the corporation, the Courts have allowed distributions
that satisfy these tests:

"(i) Is the transaction reasonably incidental to
the carrying on of the company’s business?

(ii) Is it a bona fide transaction? and

(iii) Is it done for the benefit and to promote the
prosperity of the company?"

Where a distribution is made shortly before a company goes
into liquidation, the Courts have had little difficulty in
giving full rein to the pari passu principle because a
gift of corporate assets is hardly likely to ensure any
lasting benefit for an entity that is moribund. However, where the company is a going concern, the
business management rule dictates that so long as the
above requirements are met, the Courts should not
interfere. This is not to say that the Courts cannot
examine the reasonableness of the transaction. As was
said by Bowen L.J. in Hutton v. West Cork Railway Co:
"Bona fides cannot be the sole test, otherwise you might
have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly bona fide yet perfectly irrational."

Nevertheless, the Courts have been reluctant to second guess management decisions, while preserving the residual ability to strike down decisions that could not, by any objective criteria, be regarded as for the benefit of the company as a whole.

The board of Lion Corporation thought that an initial purchase from Fay Richwhite at a cash price for which the latter was prepared to sell was the only means by which Lion could achieve a takeover of LD Nathan through the allotment of its own scrip. It thought that there were valuable synergies to be achieved by the merger of the Lion and Nathan business operations. The acquisition of the Fay Richwhite parcel was conditional on the approval of the Lion general meeting. That approval was given. The offer to Nathan shareholders (other than Fay Richwhite) was conditional on 90 per cent acceptances. Nathan shareholders accepted beyond that level, presumably therefore signifying that they too saw advantage in the merger, irrespective of what Fay Richwhite received for its parcel.

Notwithstanding these facts, and while rejecting the suggestion that the pari passu principle be enacted as a legislative norm, the Commission advocated that the principle should govern the nature of statutory controls on takeover bids by the enactment of the proposed measures referred to above. The premise upon which these views were based is that the market requires an "assurance ... that corporate contracts constructed on the pari passu principle will be observed."
Hence, said the Commission:

"Where the corporate contract requires pari passu distributions, there should be no substantial differences between the contemporary prices of shares ranking pari passu. The monetary value of voting power impounded in the prices of parcels or tranches would be governed by the pari passu requirement. In a takeover situation, there could be a 'premium', representing the value of the potential to increase the profits of the company under a change of control, should attach rateably to all shares that rank pari passu, whether or not those shares are acquired by the new controller."73

It is submitted with respect that this analysis ignores the fact that shareholders do not necessarily place equality ahead of a good deal. If that were not so, the Nathan shareholders would have rejected the Lion offer on the grounds that they were not being paid as much as Fay Richwhite.

(c) Matching Legal Machinery and Policy Objectives

How best to enforce laws having a strong public interest component has been much debated by jurists, economists and other social scientists.74 In New Zealand, the most recent discussion - in the context of anti-trust regulation - is the paper published by the New Zealand Business Roundtable, Antitrust in New Zealand - the Case for Reform.75 That discussion draws on well-known writings of Posner and others as well as on a lengthy submission76 by Professor Baxt and Stephen Franks to the Law Commission in relation to its current reference to reform Company Law. That submission, although not directed to takeover laws, contains some interesting observations as to the structure which commercial laws ought to achieve. The authors argue that "the law should be oriented to achievement of objectives ranked in priority". To that end, the law should be "clear, capable
of a fair and strict enforcement, and so enforced."77 This view is adopted by the Business Roundtable paper which then however turns away from the certainty that specific, detailed legal rules provide both for judges and for the commercial community in favour of the necessarily vaguer general standard, although supplemented by detailed guidelines (such as those issued by the United States Department of Justice) published from time to time by the appropriate regulatory authorities.78

The use of broad, legislative rules or standards, which effectively confer a greater discretion on Courts and other enforcement agencies to meet and deal more effectively with attempts to circumvent the policy objectives upon which the law is based, was rejected on grounds of principle by the Securities Commission in its Report on Insider Trading, made to the Minister for Justice in December 1987.79 In making recommendations to deal with the problem of insider trading, the Commission said of section 10(b) of the Exchange Act 1934 (U.S.), which makes it unlawful "to use or employ, in connection with the purchase or sale of ... securities ... any manipulative or deceptive device or contrivance in contravention of "rules published by the U.S. Securities and Exchange Commission:

"We think this is too sweeping for use as a precedent for New Zealand. Under our constitutional tradition, it is regarded as necessary for legislation to designate with precision the mischievous act that is prescribed."80

One wonders, if this is so, how section 9 of the Fair Trading Act 1986 ("No person shall in trade engage in conduct that is misleading or deceptive or that is likely to mislead or deceive") was ever enacted.

The point concerned is reminiscent of the debate that occurred in the United Kingdom when the Restrictive
Practices Court was established in 1956. Notwithstanding that the Court was to be composed not only of a High Court Judge but also economic experts, it was felt by many that the legislation - the Restrictive Trade Practices Act - did not define legal rules with sufficient particularity to leave to the Court for determination issues that could be properly regarded as being justiciable. Rather, it was said, the Court was being asked to determine matters of economic policy through the judicial process - a mechanism that, because of its emphasis on adversary procedures, was said to be unlikely to promote the public interest.  

Clearly enough, these comments are pertinent to the lack of any precise definition of the criteria which are to guide the Commerce Commission and the High Court in determining whether or not a merger or takeover proposal, if implemented, would result or would be likely to result in a benefit to the public which would outweigh any detriment to the public resulting or likely to result from some person acquiring or strengthening a dominant position in a market. They are equally pertinent to the legislative jumble of contradictory criteria that were thrown into the public interest sections in the earlier 1975 Commerce Act.  

It is submitted that, in the area of economic and public policy, the optimum solution is not legislation that is characterised by detailed and highly specific rules that, while having the virtue of apparent certainty, also encourage circumvention by participants in the market or industry and lack the required flexibility to encompass new situations, new problems and new issues not necessarily fully envisaged when the legislation was enacted. Nor is the best solution legislation that is so general and vague that the adjudicating bodies are able to give full rein to their individual idiosyncratic philosophies and prejudices and to current fads in
economic and commercial thinking. Clearly, discretion must be entrusted to the regulatory agencies and to the Courts but, as Professor K.C. Davis has urged in the United States, the discretion should not only be structured but should also be controlled by the publishing of rules and guidelines (as suggested by the Business Roundtable above) as well as by observing the principle of openness in all matters of decision-making and administration.84

Equally important is the type of enforcement and adjudicative machinery that is established to administer legislation that is policy-based in the economic and commercial area. It is now generally accepted that High Court Judges, at least sitting unaided by persons having economic or other relevant expertise, and High Court procedures do not provide the best and most efficient means of adjudication of issues arising under such legislation. At the other extreme, decision-making by administrators trained in the ways and attitudes of the Public Service engenders not only concern about the quality of the decisions made but also a high degree of distrust. Hence the development during the twentieth century of specialised administrative tribunals, observing the fundamental principle of hearing parties affected upon which the judicial process is based but adapting rules of evidence, procedure and precedent so as to deal more effectively with the issues before them.85

Administrative tribunals have, however, not been an unqualified success. Bodies such as the Commerce Commission which exercise decision-making powers that are determinative of the rights of parties and that affect their commercial interests do sometimes fall into error, either procedural or substantive, and it has been felt necessary to provide rights of appeal to the High Court (in its Administrative Division, sitting with experts) and
to retain the normal powers of review that superior Courts have always exercised in its supervisory jurisdiction over inferior tribunals and administrators. The power of review also extends to bodies such as the Securities Commission, whose powers are almost entirely recommendatory, it being recognised that the inquiries conducted by such a body and the findings and recommendations made by it can adversely affect the interests of parties whose conduct is the subject of inquiry.

There is also a certain unhappiness about bodies such as the Commerce Commission who under the same statute are given enforcement and prosecutorial functions, on the one hand, and judicial functions, on the other. For example, the Commission may take action as plaintiff in the High Court to seek an order requiring the parties to a merger or takeover proposal that has allegedly been implemented in contravention of the Act to make a retrospective application to the Commission for a clearance or authorisation of the proposal. If an order is granted requiring a retrospective clearance to be sought, it is the Commission which then removes its policeman's helmet and puts on its Judge's wig. It is submitted that such a situation is highly unsatisfactory.

III Conclusion

When making submissions to the Securities Commission during the Lion-Nathan Inquiry, Professor Pound summarised the existing regulatory position in New Zealand in the following terms:

"New Zealand stands at a crossroads in the development of its corporate law. It has embarked on a process of broad-based review that could usher in dramatic change. The debate has been spurred in large part by recent
developments in mergers and takeover transactions. These transactions, representing billions of dollars of shareholder wealth, have grown in importance worldwide in the past decade. They have strained the adequacy of existing regulations governing relations between management and various classes of shareholders.\textsuperscript{89}

As has been noted at the beginning of this paper, the review of New Zealand commercial laws that is currently underway is taking place in an unhealthy current commercial environment that is unlikely to lead to rational reforms. There are considerable pressures on the Government to be seen to be "doing something" about the unscrupulous and the incompetent (of whom there are certainly many). The danger is however that the reforms will swing too far in favour of "shareholder equity" at the expense of sound economic policy that acknowledges the benefits, both to shareholders as a body and to the economy as a whole, that takeover activity generates.\textsuperscript{90}

The decision by the Minister for Justice to introduce legislation enacting the principal proposals of the Securities Commission on Company Takeovers justifies these fears.

No one doubts that there is an important need to recognise that those who are entrusted with company assets must observe the fiduciary duties of care and trust that the common law has always required. Although the Courts have never held that controlling shareholders are fiduciaries,\textsuperscript{91} they have however been prepared to intervene by imposing equitable limitations (for example, through the doctrine of fraud on a power\textsuperscript{92}) on the abuse of the powers of such shareholders where minority interests are being sacrificed to an unacceptable degree.

The legal criteria by which the Court does intervene to correct the actions of controlling shareholders are difficult to define. That is not however necessarily to be regarded as a weakness but rather as a strength to the extent the supervisory powers of the Court are thereby

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better able to be tailored to meet the facts of any particular case.

It is likely that the Law Commission will seek to strengthen the duties of directors, either generally or in specific situations (notably where there is a takeover bid). Professor Pound argued before the Securities Commission that majority shareholders should be subjected to fiduciary duties as a means of preventing coercion in takeover transactions - for example, by the acquisition of a majority shareholding and then using the voting power accorded to the majority to "squeeze out" or otherwise harm the interests of the minority. That view is however potentially destructive of the traditional principles upon which company law is based and it is submitted that a combination of the equitable limitations which the Courts have imposed on the abuse of power, taken with such statutory remedies as section 209 of the Companies Act that have been enacted specifically for the protection of minority shareholders, is sufficient.

Recognition of the role that the Courts can play in that respect should facilitate the provision of a system of statutory regulation that is better attuned to the correct economic policies. That leaves however the necessity to ensure that the Securities Commission is established as an enforcement agency, equipped with adequate resources to carry out more effectively its functions as a public watch-dog and hopefully in appropriate cases as the initiator of legal action. It would seem essential also that minority shareholders are not dissuaded by high legal costs from taking Court action to remedy oppression and in that respect measures such as class actions and contingency fees must be given serious consideration.
1. (December 1987): see below
2. (October 1988): Report to the Minister of Justice on Company Takeovers
3. Securities Amendment Act 1988
5. Loc.cit., pp. 52-54, para. 191-199
10. See City Realities Limited v. Securities Commission [1982] 1 NZLR 74 (C.A.); Lion/Nathan merger (below)
11. Companies Act 1955, s.208
12. [1966] NZLR 122
13. [1908] 2 NZLR 80
14. A "takeover scheme" is defined as meaning "a scheme involving the making of offers for the acquisition of any shares in a company which, together with shares, if any, to which the offeror is already beneficially entitled, carry the right to exercise or control the exercise of more than one-fifth of the voting power at any general meeting of the offeree company": section 2(1).
15. [1983] 1 NZCLC 95-079
16. [1976] 2 NZLR 135
17. In addition, the Act does not apply to offers relating to shares in a private company, where all offerees have consented in writing, before the date of making the offer, to waive the requirements of the Act: section 3(a)
18. Report, op.cit., vol.1, p.139, para A.121
19. Ibid, p.139, para.A.119
21. See Take-over Code, rules 601-606
22. Ibid, rules 607-608 and 611
23. Ibid, rules 609-610
24. Ibid, rules 612-613
27. See rule 613(4) for definition of acting "in concert".
28. Rule 613(1)
29. Rule 613(2)
32. Trade Practices Act 1974, s.50
33. See, for example, TPC v. Australian Meat Holdings Pty Ltd (1988) ATPR 40-876
34. Part III, Commerce Act 1986
35. S.50(3)
36. First Schedule to Act
37. Whether or not that person is a participant in or otherwise a party to the proposal: s.66(3)(a)
38. S.66(3)(a) and s.66(6)
39. S.66
40. S.66(9)

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43. Loc.cit., p.48

44. S.36

45. See Farmer, loc.cit.


47. Antitrust in New Zealand - The Case for Reform

48. Ibid, p/vii

50. Trade Practices Act 1974, s.52 et seq.; Fair Trading Act 1986, s.9 et seq.

51. (1982) 149 CLR 191

52. Ibid., 205

53. [1986] ATPR 40-702

54. (1987) 3 BCR 257


56. Ibid, pp 173-174, para D9

57. Ibid, p 174, para D9 and vol 2, p 169, note D37

58. Ibid, vol 1, p 174, para D10

58a. Ibid, p 75, para 11.2

59. Ibid, section 4, pp 76-95

60. Ibid, pp 83-84: and see pp 87-95

61. Ibid, vol 2, p 4, note (1.1)(f)

62. Ibid, vol 1, p 5, para 1.3

63. Ibid, pp 5-6

64. Ibid, p 6, paras 1.4-1.5

65. See NZCIS Occasional Paper, infra, p.5
66. Loc.cit, vol 1, p 5, para 1.1


70. Ibid, 671

71. Loc.cit, vol 1, p 56, para 7-10

72. Loc.cit, p 76, para 12.2

73. Loc.cit, p 72, para 10.1


75. (September 1988), Section 6, pp 43-53 (The Economics of Law Design and Enforcement).

76. March 1988 (commissioned by the New Zealand Business Roundtable)

77. Ibid, p 4, para 9.

78. Loc.cit, pp 43-44, para 6.1.1

79. And see now Securities Law Reform Bill which, inter alia, will enact comprehensive reforms in the area of insider trading.

80. Loc.cit, vol 1, pp 38-39, para 4.9.5

81. See Farmer, op.cit, pp 28-33

82. Commerce Act 1986, s.66(8)

83. Commerce Act 1975, ss 2A and 80; and see Farmer, loc.cit, fn 31 above

84. K.C. Davis, Discretionary Justice (1969); Farmer, op.cit, p 197
85. See Franks Committee Report on Administrative Tribunals and Enquiries (1957) Cmnd. 218; Farmer, op.cit, chapter 8

86. See City Realities Limited v. Securities Commission, supra

87. Commerce Act 1986, section 67

88. Ibid, s.83


90. See Pound, loc.cit, chapter 1


92. See, for example, Ngurli v. McCann(1953) 90 CLR 425, 438-440.
TRADE PRACTICES — A TRANS-TASMAN VIEW WITH SPECIAL REFERENCE TO TAKEOVERS

Professor R. Baxt
Chairman of the Australian Trade Practices Commission
As you will know July 1 1990 is a very important day in the development of CER. By this date it is anticipated that a number of things will have happened in the harmonisation of the commercial laws of Australia and New Zealand. You will be aware of the Memorandum of Understanding that was signed between Australia and New Zealand in 1988 which highlights the areas that are regarded as appropriate for harmonisation.

It is my view, and this is purely a personal view, that the 1990 date will have to be varied with respect to some of the areas under consideration because of significant differences in approach that are to be taken by Governments and because of impending elections in both countries. I should indicate that I applaud the move towards harmonisation for I see it as essential recognition of the existence of a common trading environment which knows no artificial boundaries.

The area that I have been asked to concentrate on is that relating to Trade Practices, with special reference to Takeovers. In this paper I will comment not only on the area of Takeovers but also on other areas in which harmonisation of law between Australia and New Zealand will have to be worked
at fairly hard if we are to see a fairly uniform approach to
the administration of our respective Trade Practices laws - in
Australia the Trade Practices Act (referred to as TPA); in
New Zealand the Commerce Act (referred to as CA), and the
separate Fair Trading Act (FTA).

In a paper which I delivered on "CER - Towards One Market" at
the Conference of the Australia-New Zealand Business Council
held in Wellington in 1988, I indicated that there were a
number of problem areas which would make it difficult for
harmonisation of the commercial laws of our two countries to
take place with certainty and without difficulties. I will
not discuss these in this paper.

The more important difficulties I identified are as follows
(and there are probably others):

1. Australia is a Federation of six States (with two major
Territories), whilst New Zealand is a unitary nation.

2. There are, in most cases, two Houses of Parliament in
the various Australian governments, including the
Federal Government, whilst New Zealand has a unicameral
Government. The importance of this will not be lost to
those of you who have studied Australian politics.

Just to give you one example of the kind of difficulty
that can arise, with special reference to Trade
Practices law, one is referred to the vigorous lobbying
that went on at the time that the present Australian
Government tried to remove from the TPA the secondary
boycott provisions. The Australian Democrats, who
control the balance of power in the Upper House (the
Senate), were persuaded to maintain the current
legislative provisions and the Bill which would have
removed the secondary boycott provisions which had been
passed by the Lower House was defeated in the Senate.
3. There is a significantly different stance taken in the interpretation of statutes and relevant law in Australian courts than that taken in New Zealand. This is a matter which has not yet been highlighted in any great detail by courts but already one or two interesting developments have occurred which I will comment on in this paper to highlight this particular matter.

In addition to this difference, one needs also to make reference to the fact that we have both State and Federal Courts of Australia. There are different philosophies that govern the approaches taken by various State Supreme Courts, as well as an emerging difference in approach taken by the Federal Court when compared with the State Supreme Courts. These differences are subtle in many cases but in some others are becoming more definite – this will create problems in the interpretation of laws, especially as the State Supreme Courts are now given a role to play in the area of Trade Practices law.

The question of interpretation of statutes and the attitude of the courts is one that will play a vital role, in my view, in ensuring that harmonisation is effective.

4. Part of the difficulty we face in Australia in the area of Trade Practices law (and this applies to other areas of business law such as company law), is the fact that the Commonwealth Government in Australia has limited power to enact legislation. So, for example, the Federal Government must seek co-operation from the State Governments or face legal challenges in a number of areas of business law. This includes Trade Practices law. I want to comment about the problems of the universality of the TPA when compared with the CA in this paper.
There are obviously other areas of difficulty - the different philosophical stances of political parties; attitudes of governments to issues of internationalisation etc.

Before turning to specific areas of law I want to spend a few minutes talking about the courts and the way in which they interpret Trade Practices law.

Under the CA the New Zealand courts have the ability to add to the court lay assessors who will assist, or can assist, the court in dealing with the particular problem which faces the court. This particular issue is one that has certainly been taken advantage of in particular cases, and I refer in particular to the Trutone case (judgement delivered on 19 September 1988 by the New Zealand Court of Appeal). The Australian legislation makes no allowance for the addition of lay persons to the court.

The question of who should sit on cases dealing with competition law is one which has clearly concerned not only Australian and New Zealand law makers, but also law makers in other countries.

Indeed one of the critical matters that has been a factor in the operation of Trade Practices law in Australia has been the question of whether judges, drawn traditionally from the legal profession, are best equipped to handle matters relating to Trade Practices law.

Very early in the history of modern Australian Trade Practices law it was suggested by the then Attorney-General, Sir Garfield Barwick (who later became the Chief Justice of the High Court of Australia and a principal proponent of the literal interpretation of statutes which in itself poses problems for Trade Practices), that it would by inappropriate to leave to lawyers the task of interpreting economic
legislation such as Trade Practices legislation. This warning was repeated by a number of commentators at the time the 1974 legislation was enacted when the Tribunal oriented Restrictive Trade Practices Act 1967 was changed for a more court oriented Trade Practices Act 1974. I would like to quote from a judge in the United States of America who suggested that even their courts had difficulty in coming to grips with the economic base of the Anti-Trust laws of that jurisdiction many years after those laws had been enacted. Judge Wyzanski, in the famous case of United Shoe (U.S. v. United Shoe Machinery Corp 110 F Supp 295 at 347-348 (1953) made these comments:

"Judges in prescribing remedies have known their own limitations. They do not ex officio have economic or political training. Their prophecies as to the economic future are not guided by unusually subtle judgment....In the anti-trust field the courts have been accorded, by common consent, an authority they have in no other branch of enacted law."

These comments were echoed in different ways by a number of commentators, such as Richard Eggleston the first President of the Trade Practices Tribunal, who noted:

"It will be ... another generation [from 1974] before [lawyers] are relieved of the task of translating into English [the economic concepts of the Act] for the benefit of the judge."
[see Hambly & Goldring, Australian Lawyers and Socialist Change (1976) p.500]

Others attending that conference supported this view. One of these is now playing a significant role in the interpretation of the current statute - notably Mr W. Deane QC (now Deane J of the High Court of Australia).

I for one share the concerns that have been expressed by these persons. I stated them, together with my colleague Maureen Brunt, at the time when we reviewed the TPA in 1975 in the Australian Business, and having served now for about a year as Chairman of the Trade Practices Commission am still not convinced that the traditional courts are the best equipped
forae for the handling of these matters - and this is still my view after the Queensland Wire case. I will be commenting on this case orally. It will be necessary for us to provide a change in attitude by judges towards the interpretation of legislation if the full implementation of Trade Practices law is to be effected. Will this occur in New Zealand? This remains to be seen, but is a matter that I would welcome discussion on at this forum.

In enacting the new competition legislation, the legislature conscious of the specific problems of having lawyers sitting in Courts dealing with economic law (and they are not unique problems, they have been stated elsewhere), chose to establish a specialist Tribunal rather than to rely on the work of the courts.

In Australia we have the Federal Court which one can say is almost a specialist Tribunal dealing with these matters, but because of the Cross-Vesting legislation that was enacted in 1987 it is not certain that all Trade Practices matters will be handled by the specialist courts. Should we not go one step further and have a specialist division of the Federal Court? The Cross-Vesting legislation makes it possible for Family Court judges to hear Trade Practices matters in appropriate circumstances. Is this desirable?

The rather complex and unusual concepts of competition, the market, notions of substantial lessening of competition and dominance, and other concepts, do not lend themselves easily to traditional legal analysis. As I have noted earlier, the Commission has been critical of the interpretation of the TPA by judges. Its most trenchant criticism was of the decision in the Tradestock case (TPC v. TNT Management Pty Ltd (1985) 58 ALR 423; see in particular the Annual Report of the Commission 1984-85 at p.14.)

The TPC had expressed its concerns on this issue to the Griffiths Committee (the House of Representatives Committee
established to review Trade Practices law in Australia) but this will be reassessed in the light of what appears at first reading to be a most encouraging decision of the High Court of Australia in the Queensland Wire case (judgment delivered 8 February 1989).

It is true that the TPA has only been in place for fifteen years but the question is, how long do you wait before one gets the right forum to deal with these matters? In one sense it may be regarded as too late already to do anything about it in the context of rationalisation and concentration in Australian industry. Indeed one might be cynical enough to suggest that no courts are likely to handle the questions of divestiture and the break-up of industries and organisations that have accrued dominance or misuse their power. There has been little success with the divestiture remedy in any jurisdiction and certainly none as yet in Australia. Whether New Zealand courts would handle these matters better in the light of the existence of a lay assessor on the relevant court hearing the matter, and in the light of the different approach to the interpretation to which I referred previously, remains a matter of some doubt. Again, I would welcome comment from participants on this issue.

**Takeovers and mergers**

In the first place it is important to note that as yet New Zealand does not have a comprehensive Takeover Code (in the context of companies legislation). This is a matter that is the subject of other papers at this Conference.

There are a number of marked differences between the TPA and the CA. Our Takeover (or Merger) Law is different, not only in the context of the threshold that has to be "reached" before a relevant merger is liable to be "caught" by the legislation, but also in the administration of the legislation. To date we have only seen two reported decisions on s.50 of the TPA and I do not believe that there are many
cases in New Zealand either before the Commission or the Courts.

When Bill Coad, the recently retired Deputy Chairman of the TPC, and I visited New Zealand in August 1988 we were rather surprised at the number of mergers that were being examined by the Commerce Commission. This, we understood, was required by the nature of the legislation and by the processes under which mergers (or takeovers) were to be assessed. The compulsory pre-notification of most mergers over a certain benchmark is something that we have never had in Australia. The only parallel I can draw is the fact that when we had the clearance provisions in the Australian TPA the Commission was under a similar workload to that faced by the New Zealand Commerce Commission today. With the removal of "clearance" from the TPA in 1977, the whole attitude of the Australian Commission towards mergers and takeovers changed. I understand that the recent discussion paper on New Zealand legislation calls for a retention of the pre-notification mechanism, but allowing for some mergers to fall through the gateway (as it were) rather than require detailed evaluation by the Commission.

Perhaps I can explain briefly the process that we follow in Australia in relation to mergers or takeovers to illustrate the difference. If companies are concerned that a particular merger (or takeover) might run into trouble from the context of s.50 of the TPA they seek what is known as an informal clearance from the Commission. They will approach us on a confidential or non-confidential basis (we would always prefer the latter), set out the details of the proposed merger, and then get our assessment of the particular transaction. In very few cases will we have to do a great deal of market research because of the high threshold that is set by s.50 of the TPA. We have available to us a good deal of information which we use in assessing the relevant merger. Whilst we will make market inquiries in many cases, this will be done fairly quickly and it is only in a couple of dozen cases a year where we will have to go into detailed investigation of the
particular merger. By "detail" I mean (usually) work lasting more than a week. It has been very rare for us to throw up doubts in relation to a particular merger and we have only gone to Court on a very few mergers, and on many occasions these Court proceedings are quickly "terminated" by the agreement of the parties. There has been, as I have indicated above, only two decided cases, whilst a third case is now in the Courts i.e. Arnotts' Biscuits.

We have taken the view in Australia (which you may gather from the Merger Guidelines that were issued by the Commission in 1986) that very few mergers will trouble the Commission. As a rule of thumb as long as there are at least two well matched competitors left in the relevant market the Commission is rarely troubled by a particular merger. Whether this should or should not be the position is, of course, another matter - an issue which is presently being assessed by the Griffiths' Committee set up to look into Australian Merger and Monopoly Law in February 1988. That Committee is about to report on its findings and I will be commenting orally on these.

It is safe to say that neither country has yet developed any jurisprudence that we can speak about with confidence. The decision of Wilcox J in the Australian Meat Holdings case decided in 1988 [(1988) ATPR 40-876] is not very satisfactory, and his decision has been made less satisfactory by the way in which he handled the question of the orders to be made. That case has gone on appeal to the full Federal Court. It's decision is reserved. It is my guess that the case could go all the way to the High Court.

In discussions held in Wellington between the two Commissions in August of 1988 it was recognised that there are a number of difficulties in dealing with the problem of how Australian and New Zealand laws could be harmonised, or whether the administration could be harmonised in an effective way.
It is safe to say that we agreed to disagree on what might be the best approach. The Trade Practices Commission has indicated to the Griffiths' Committee that it did not wish to have a pre-notification system introduced. We are satisfied that the present voluntary informal notification system does bring to our attention most mergers that are likely to cause problems. There has been, to our knowledge, only one or two situations where mergers have been consummated or attempted to be consummated "behind the Commission's back". The existence of a sophisticated financial press, and legislation which regulates takeovers in the context of company law (the Companies (Acquisition of Shares) Act and Codes) means that we have "a kind of notification system" (not directly relevant to operations) which does give the TPC an opportunity to review those mergers which might come within the broad ambit of the legislation.

The approach taken in New Zealand to the question of notification will no doubt be the subject of a report to be issued shortly and could be influenced by the fact that your Government has now chosen to introduce Company Law Takeover legislation.

**Trans-Tasman mergers**

The problem of mergers and takeovers which have trans-Tasman implications is quite a difficult one. It can create a number of interesting tensions. Indeed there is a matter that is presently before our Attorney-General which raises the very issue of what happens when mergers are being discussed between Australian and New Zealand companies.

The matter can become quite complicated if the parties approach both Commissions for a "clearance": how do we handle the matters? Do we look at each other's acquisition? Do we only examine those that are relevant to our particular jurisdiction? What power do we have to involve ourselves in the other country's acquisition? How do we assess the overall
takeover in that context? What relevance is there in the fact that the Australian process is informal whilst the New Zealand process is formal? How do we identify markets in this situation? What public benefits could be taken into account if authorisation is regarded as necessary? What enforcement can be relied on in appropriate cases? Will the Courts adopt the kind of approach taken by Hodgson J in the New South Wales Supreme Court Rainbow (Woolworths) case?

The Commissions agreed to try to work on this matter but regrettably time has prevented a great deal of progress being made. A working party was established to look at the question of the definition of market. This is an issue which is yet to be resolved. All I can say at this stage is that when the Trade Practices Commission considered the Fletcher Challenge merger (joint venture) in 1988 it took a rather unusual position of what was meant by "market". Despite the fact that there was nothing in the legislation to allow us to do so, we chose to look at the market in question (for the purposes of determining a number of issues) as being a trans-Tasman market.

We have recommended the creation of joint working groups between the two Commissions, the appointment of Associate Commissioners to each others Commission, and other matters, but these have yet to be acted upon by the relevant Ministers.

It is vital that the two Governments and the two Commissions formulate some clear sets of guidelines as to how trans-Tasman mergers are to be looked at. If this is not done then we could find ourselves facing many difficult situations.

Let me take one hypothetical situation. Company A, operating in Australia, wishes to merge with company B (a New Zealand company). Company A is the only supplier of a particular good in Australia, and company B is the only supplier of that good in New Zealand. Imports from other areas are virtually non existent for various reasons. Company A and company B, for
financial and other reasons, form a joint venture company in New Zealand. A number of restrictions that have previously operated in the New Zealand market at the behest of Company B are to be removed as a "sweetener" to permit the joint venture company to be formed and operated. What if the merger is not opposed by the NZ Commerce Commission? The Australian Commission, when faced with a similar situation some years previously, had questioned whether the merger or takeover should be allowed to go ahead.

The consummation of the merger would make it less important for the two companies to compete in either market. In the Australian context in this situation there is the removal of a potentially well-matched competitor; in the New Zealand market one has achieved economies of scale which might be regarded as very important. On the other hand, the potential for competition by one company against the other in either country is very much blunted. The two pieces of legislation (TPA and CA) do not provide for official exchanges of views and other interaction between the two Commissions; we will have to be circumspect in the way in which we handle a merger and inquiries flowing from it. If authorisation is the relevant route in either country, then again the fact that the relevant legislation does not contain any guidance on such issues as the market and public benefits (in a trans-Tasman context) is a considerable hurdle faced by the parties and by the Commissions.

I should say that I have raised this specific matter with the Federal Attorney-General and I am hopeful that he will be discussing the matter shortly with his New Zealand counterpart.

**Misuse of market power and the anti-dumping regime**

Sections 46 and 36 of our respective pieces of legislation will have received a considerable boost as a result of the High Court of Australia's decision in the *Queensland Wire*
case, to which I have referred previously. There are significant differences in the language of the two pieces of legislation and if we are to see harmonisation of our laws in relation to the developments in anti-dumping (to be effective from 1 July 1990) then a considerable amount of work has to be done. I am pleased to say that some work is already being done on this particular issue, and it is one that must and does cause concern to the business community generally. In the paper that I delivered last October to which I have referred previously I commented more specifically on the questions relating to monopolisation but, as I think you will appreciate, the Queensland Wire case may make some of those comments of less significance.

Some concluding comments

The Griffiths' Committee, which has conducted a fairly detailed inquiry into the operation of the TPA in the area of mergers and monopolisation, is unlikely to come down with any major recommendations relating to s.50 of the Act. There may be some recommendations which relate to its administration (for example calling for a user pay approach to work done by the Trade Practices Commission in dealing with mergers). My guess it that it will not call for any significant lowering of the threshold in s.50. This means that there will have to be some analysis of just how the two countries will rationalise their laws in this area.

The Griffiths' Committee will no doubt be encouraged to take this view by the fact that we now appear to have a fairly strong s.46, as a result of the Queensland Wire case. But as I have indicated in my oral presentation on the Queensland Wire case, it still leaves a number of questions unanswered. It does not in any way deal adequately with the problem of potential misuse of market power on a continuous basis by a corporation that happens
to be in a dominant position. It will not affect dominance which may have been created by mergers (or as a result of effluxion of time etc). There is little doubt, however, that where such dominance has resulted from mergers where the conduct complained of is against the spirit of s.46 that the dominance should not be condoned. If we are to continue to encourage a high degree of rationalisation with oligopoly and monopoly being the order of the day, then we must be satisfied that we have not only adequately resourced Trade Practices and Commerce Commissions reviewing cases, but also must be satisfied that the Courts will deal with cases of misuse of market power by such dominant firms in a way that recognises the approach to issues of market taken in Queensland Wire. Failure to adopt a pragmatic approach to definitions of market (in contrast to the Full Court's decision in the Queensland Wire case) will lead to frustration and quite considerable concern in the business community in Australia at least. I cannot judge whether the same concerns will exist in New Zealand.

Any unwillingness or inability of the Governments of the two countries to recognise the fact that offshore transactions will be utilised to overcome jurisdictional and other limits of each others Trade Practices law is another matter that needs to be emphasised. Lawyers are of course very adept in organising their clients' activities in such a way as to take full advantage of a loophole that may exist in the law. Approaches by the Courts to this type of activity will vary from jurisdiction to jurisdiction, and whilst there may be some short term successes in overcoming the operation of the law, one imagines that the cure which will be imposed if these successes become too blatant may be much harsher than would otherwise have been necessary.

There are significant changes facing the two Governments
on the question of whether we should identify markets on the basis of a trans-Tasman market. Whilst this may be very sensible in certain situations, it may result in rather unfortunate situations in other cases. The challenges that face both the Governments on the one hand, and the Commissions and the professions (legal, economic and other) on the other hand is indeed a most interesting and challenging one. I look forward to being involved in meeting the challenge and to assist in helping find some of the solutions to the problems that may arise.
REFORM OF DIRECTORS' FIDUCIARY DUTIES

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The object of this paper is to examine two aspects of directors' fiduciary duties - basic self dealing and the obligation of care and skill. The Law Commission is currently considering the codification of directors' duties and a similar rather complicated attempt has been made in Australia. Before one codifies the law it seems appropriate to consider whether the law to be codified is satisfactory. In my opinion both aspects of this law are very unsatisfactory and should not be codified in their present form. I, therefore, consider not only the causes of dissatisfaction but also certain reforms of the law.

However, a threshold question must be considered and that is whether it is appropriate to refer to a director's obligation of care and skill as a fiduciary duty. There has been an increasing tendency in recent years to regard all obligations of care as capable of being subsumed under the tort of negligence. This is a great mistake. Not only is the tort of negligence one of the least satisfactory areas of the law - the late Julius Stone for instance aptly referred to the duty of care as a category of illusory reference - but also such a tendency negates important legal distinctions. A director's obligation of care and skill is part of his/her fiduciary obligations in Equity. There is no question of establishing a duty of care because of the underlying equitable relationship between the director and the company. Equitable defences are available. A director's obligations of care and skill have more in common with a trustee's obligations of due diligence although there are still some important differences. This reason above any other provides justification for the apparently low standard of care required of company directors. However, I shall have more to say about this later.
Basic Self Dealing

I take as a paradigm case of basic self dealing a director contracting with his company. The law on this in both the Commonwealth and the U.S.A. has undergone a complex development. By the middle of the 19th century in Commonwealth countries and the United States it had become recognised that directors were in a position analogous to trustees and thus any contract entered into by them with the company was voidable. This was clearly established by the House of Lords sitting in a Scottish appeal in Aberdeen Railway v Blaikie. In that case a company entered into a contract with a partnership which included one of its directors. The House of Lords held that the contract could be avoided by the company notwithstanding that its terms were fair. Lord Cranworth LC said:

"...This, therefore, brings us to the general question, whether a director of a railway company is or is not precluded from dealing on behalf of the company with himself or with a firm in which he is a partner. The directors are a body to whom is delegated the duty of managing the general affairs of the company. A corporate body can only act by agents, and it is, of course, the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such an agent has duties to discharge of a fiduciary character towards his principal, and it is a rule of universal application that no one having such duties to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect. So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into. It obviously is, or may be, impossible to demonstrate how far in any particular case the terms of such a contract have been the best for the cestui que trust which it was possible to obtain. It may sometimes happen that the terms on which a trustee has dealt or attempted to deal with the estate or interests of those for whom he is a trustee have been as good as could have been obtained from any other person; they may even at the time have been better. But still so inflexible is the rule that no inquiry on that subject is permitted."
The position in Equity was that the contract was voidable and any profits made by the directors could be recovered by the company. The position was thus similar to a promoter. However, whereas a promoter could escape liability by making full disclosure of material facts to an independent board of directors or, in certain other cases, all the members, a director was in a more difficult position. It was not possible for the directors to disclose to themselves as some judges thought that the company had a right to the unbiased voice and advice of all its directors. The only way in which the directors could proceed was to make full disclosure to the members of the company and have the contract approved or ratified in general meeting. This was expressly provided for in section 29 of the Joint Stock Companies Act 1844 but the relevant provision did not appear in the Act of 1856. Instead there was a provision in the model articles, article 47 of Table B, that any director, directly or indirectly, interested in any contract with the company (except merely as shareholder of another company) should be disqualified and vacate office. Articles to this effect continued in the model articles under the legislation until the 1948 English Act. However, the practice developed of inserting articles which excluded or modified the standard form. Since 1948 in the United Kingdom and the Companies Act 1955 in New Zealand, Table A has omitted such a clause and instead provided that directors are not disqualified by contracting with the company. Indeed many articles have attempted to modify directors' duties. There are various ways in which this is done in the case of self dealing transactions. Articles regularly provide for disclosure of interest and some provide for exclusion from the quorum and voting. However, others provide for an interested director to be both counted towards the quorum and able to vote. The Greene Committee in 1926 was concerned by the growth of such clauses and recommended provisions for mandatory disclosure of a director's interest. The present New
Zealand provisions are now contained in section 199 of the Companies Act 1955. There are similar provisions in force in section 228 of the Australian Companies Code although these contain certain amendments which I shall discuss shortly. Sections 228-9 of the Australian legislation are set out in the Appendix to this article. Section 199 of the 1955 Act provides for disclosure of the nature of a director's interest at a meeting of the directors. However, under section 199 (3) it is sufficient to give a general notice to the effect that the director is a member of a specified company or firm and is to be regarded as interested in any contract with that company or firm. The sanction for breach of the section is a fine not exceeding $200, which is now much lower than overseas jurisdictions, and section 199(5) provides that nothing in the section shall be taken to prejudice the operation of any rule of law restricting the directors of a company from having any interests in contracts with the company. In other words the contract is voidable and profits can be recovered under the equitable principles. There is a conflict of Australian and English authority on whether there is separate liability in tort for a breach of statutory duty.\textsuperscript{16}

A signal weakness of this section, but one which no doubt facilitates business, is that disclosure is to the board and not to the company in general meeting. Indeed, on the face of the section it appears that disclosure is only required if the contract is brought before the board.\textsuperscript{17} On the other hand it has recently been held in England that disclosure to a committee of the board is not sufficient and will render the director liable as a constructive trustee of the benefits transferred.\textsuperscript{18} The declaration need not be recorded in writing.\textsuperscript{19} There is uncertainty surrounding the meaning of the word "interested" for the purpose of section 199. It is arguable that "interested" only means having a pecuniary interest. On the other hand Professor Gower\textsuperscript{20} argues that this would be too restrictive an
interpretation and it does not seem to have been the intention of the draftsman of the Act. Thus a more remote connection through a network of companies and in the capacity of an officer of the company will be sufficient.

The Jenkins Report made recommendations in connection with the English section which was the counterpart of our section 199. The report recommended that disclosure should be limited to material interests but should cover all contracts irrespective of whether they came before the board. In all cases the nature and extent of the interest would require to be stated and although a general notice would be allowed this would not be sufficient if the nature of the interest was greater than that stated in the general notice. These reforms have not been enacted but Section 199 of the English 1948 Act was amended in 1980 to extend to transactions and arrangements and the wording modernised in the consolidation in 1985. The corresponding provision in Table A has been substantially revised. The Australian provision now contained in section 228 of the Companies Code adopts the Jenkins idea of material interests although the wording of section 228(2) is badly drafted. Certain matters, which need not be disclosed and are in the new UK Table A, are set out in Section 228(3). In Australia it is now impossible to read section 228 in isolation from section 229 of the Companies Code, which appears to codify directors' duties but whose relationship with section 228 and the caselaw is obscure. Section 229(3) prohibits the improper use of information argued by virtue of a directorship to gain a personal advantage or to cause detriment to the company. This in turn overlaps with section 229(1) (duty to act honestly), and section 229(4) (duty not to make improper use of one's position). There are criminal and civil sanctions under section 229. Section 229(10) provides that the section is in addition to and not in derogation of any duty or liability by reason of the office or employment in relation to the company. Again I find the meaning of this obscure. Last year I had the
privilege of participating in the Sydney Law Review Conference on Company Law with a number of distinguished judges, practitioners and academics. I was particularly struck by the lack of agreement on the meaning of section 229 and its relationship to the caselaw.

On the whole the best drafted section is section 132 of the Ontario Business Corporations Act 1982 which

(i) does not use the wording "directly or indirectly" but spells out clearly who is covered;
(ii) requires disclosure in writing or minuting of contracts and transactions, even those not requiring approval;
(iii) spells out clearly the consequences of non disclosure;
(iv) provides expressly for confirmation by shareholders in certain circumstances;
(v) provides a procedure for setting aside the contract for breach of the section. This gives express locus standi to a shareholder.

The wording of section 132 is set out in the Appendix to this article. The relationship of this to the codification provision in section 134 is clear. Section 134 is more general (much more general than section 229 of the Australian Companies Code) and is subject to section 132 by virtue of section 134(2).

In addition to section 199 the New Zealand and other Commonwealth legislation contains provisions requiring specific disclosure and formality in connection with different types of contract. The English provisions now contained in the U.K. Companies Act 1985 are more extensive than those of the New Zealand Companies Act 1955. However, we will not concern ourselves with these detailed provisions but concentrate on the question of basic principle. Before we do so, however, I will briefly mention the course of development in the U.S. case law as this helps to understand certain aspects of the Ontario reforms. As I have mentioned the U.S. courts in the 19th
century recognised a rule similar to that laid down in *Aberdeen Railway v Blaikie*. In doing so they saw themselves as adopting a sound principle of trust law and were no doubt influenced by the number of railway frauds in the 1860s and 1870s. However, in 1910 a second stage had developed where the general rule was that a contract between the director and his company was valid if it was approved by a disinterested majority of his directors and was not found to be unfair or fraudulent by the court, if challenged. By 1960 a third stage was reached whereby contracts with directors are generally valid unless found to be unfair by a court, if challenged. An American commentator on this development in 1966 was at a loss to provide convincing explanation of the changes in judicial policy. The rationale for the change, where professed, was technical and based on a trustee's ability to deal with a cestui que trust provided he made disclosure and took no unfair advantage. A possible fourth stage was reached in 1975 when California adopted legislation which is capable of the interpretation that contracts properly ratified by shareholders are immune from judicial inquiry into the fairness of their terms. Professor Robert Clark of Harvard in his *Corporate Law*, after mentioning the possible fourth stage discusses a number of possible reasons for the changes. One is the influence of management on the courts and legislature. However, Clark thinks that there are a number of difficulties in this explanation and evidence is lacking. The second explanation is that the changes mark a shift to more flexible rules which was part of a change in judicial attitudes in a faster moving society. Clark finds this more convincing. A further explanation is the legal profession's influence on reform. It was to their professional advantage to have less certain rules. Another interesting explanation mentioned by Clark and which is based on detailed research in the American case law is that by the turn of the century the number of self dealing cases involving close corporations became greater than those involving public
corporations. In such cases it is easier to see how the courts could favour a more flexible attitude since in close corporations there may only be one vendor or source of credit. However, no such research has been done in respect of Commonwealth case law and the matter remains something of a puzzle.

The American Law Institute in its Principles of Corporate Governance favours a conjunctive test for self dealing transactions. The director must make full disclosure and the transaction must be fair to the corporation. In an article "Self-interested Transactions in Corporate Law" about to be published in the Summer 1988 issue of the Journal of Corporation Law, Professor Melvin Eisenberg, general reporter of the project, explains the reasoning behind the adoption of this conjunctive test. First, disclosure is not enough. Where for instance the board consists of three members, two of whom are interested in the transaction they could easily approve the transaction over the objections of the third in spite of the fact of it being unfair. Conversely, fairness of price without full disclosure may not be enough either. First, the transaction is with a person who is in a relationship of trust and confidence. Secondly, to raise the matter of fairness alone would be to remove the matter from the company to the hands of the court. Disclosure of the contracting party and the facts may affect the price to be paid. Obviously this would be irrelevant in the case of a homogeneous commodity. However, for a non-homogeneous commodity the matter can be crucially relevant to the determination of what is a fair price. To eliminate disclosure would be to prejudice the company as a contracting party. The director contracting with the company is, by virtue of his position, not only aware of all the material facts concerning the item to be bought or sold but also of the material facts about the company as a seller or buyer. The transaction in those circumstances can only be fair if the company is put in the same position. Another related reason is that fairness is
not only concerned with price but also with the process of negotiation. Because of the difficulty of establishing fairness of price the law necessarily has to seek refuge in intense scrutiny of the fairness of the process as a substitute. Unfairness of process may, therefore, be evidence of unfairness of price. The question then arises as to whether this can be countered by approval by disinterested directors. Professor Eisenberg argues that approval by disinterested directors should not insulate a self-interested transaction from judicial review for fairness. However, in the flexible way in which United States law and law reform approach corporation law it is suggested that approval by disinterested directors should shift the burden of proof. In other words, where the transaction has been approved by disinterested directors the burden of proof is on the complainant; otherwise it is on the disinterested director to show that the transaction is fair. Secondly, approval by disinterested directors changes the standard by which the self-interested transaction is to be measured. The complainant has to show that disinterested directors could not reasonably have believed that the transaction was fair. This is easier for the director to satisfy than a pure fairness test. On the other hand it is harder than the Business Judgment Rule.

The Ontario Business Corporations Act 1982, section 132(7) links disclosure with fairness in a conjunctive test and also links fairness with reasonableness. Provision is made in section 132(8) for ratification by a special resolution provided the director acted honestly and in good faith and there is adequate disclosure in the notice calling the meeting. It is suggested that the Ontario section represents a useful model of reform for New Zealand and Australian law. A rationalisation of the law in these terms is definitely called for.
The obligation of care and skill

Unlike a professional person, a company director is not required to have any special qualifications for his office. All that the law requires is that he should exhibit in the performance of his office the care and skill that may reasonably be expected from a person of his knowledge and experience. Unless the articles or a service agreement provide otherwise the director is not obliged to devote the whole or indeed any particular part of his or her time to the company. Failure to attend board meetings does not necessarily amount to negligence. In the absence of grounds for suspicion a director is entitled to rely on the information and advice given him by the trusted officers of the company. The basic rules are stated in these terms by Romer J in *Re City Equitable Fire Insurance Co Ltd*:

"(1) A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. A director of a life insurance company, for instance, does not guarantee that he has the skill of an actuary or of a physician. In the words of Lindley M.R.: 'If directors act within their powers, if they act with such care as is reasonably to be expected from them, having regard to their knowledge and experience, and if they act honestly for the benefit of the company they represent they discharge both their equitable as well as their legal duty to the company': see *Lagunas Nitrate Co. v Lagunas Syndicate* ([1899] 2 Ch. 392 at 435). It is perhaps only another way of stating the same proposition to say that directors are not liable for mere errors of judgment. (2) A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is not, however, bound to attend all such meetings, though he ought to attend whenever, in the circumstances, he is reasonably able to do so. (3) In respect of all duties that, having regard to the exigencies of the business and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly..."
A common criticism is that the standard of care is too low. An attempt has been made in some overseas jurisdictions to introduce a more objective element into the basic obligation. Thus section 229(2) of the Australian Companies Code provides "an officer of a corporation shall at all times exercise a reasonable degree of care and diligence in the exercise of his powers and discharge of his duties". The odd thing about section 229 is that breach of this gives rise to a criminal penalty of $5,000 as well as civil compensation. Section 134 (1)(b) of the Ontario Business Corporations Act 1982 provides that a director shall "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances". The 1978 United Kingdom Companies Bill contained the following clause:

"In the exercise of the powers and the discharge of the duties of his office in circumstances of any description, a director of a company owes a duty to the company to exercise such care and diligence as could reasonably be expected of a reasonably prudent person in circumstances of that description and to exercise such skill as may reasonably be expected of a person of his knowledge and experience."

The U.S. Revised Model Business Corporation Act which is a model for state legislation codifies the law as follows:

8.30 General Standards for Directors
(a) A director shall discharge his duties as a director, including his duties as a member of a committee:

(1) in good faith;
(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
(3) in a manner he reasonably believes to be in the best interests of the corporation.
(b) In discharging his duties a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:

(1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented;

(2) legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person’s professional or expert competence; or

(3) a committee of the board of directors of which he is not a member if the director reasonably believes the committee merits confidence.

(c) A director is not acting in good faith if he has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.

(d) A director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section.

It is interesting that this provision avoids the use of words like "diligence", "care" and "skill". The argument in the official comment is that skill in the sense of technical competence should not be a qualification for the office of director and the concept of diligence is sufficiently subsumed within the concept of care. The reference to a "ordinarily prudent person" focuses on the basic attributes of common sense, practical wisdom and informed judgment. The use of the phrase "in a like position" recognises that the care is that which would be shown by the "ordinarily prudent person" if he or she were a director of the particular corporation. The reference to "similar circumstances" emphasises the relativity of the responsibility. The nature and extent of the
responsibility will vary depending on factors such as the size, complexity and urgency of the activities carried on. Section 8.30 (b) seems like an updated version of Romer J's third proposition.

Another point to be noticed is that the Revised Business Corporation Act does not attempt a codification of the Business Judgment Rule. The draftsman of the revised act thought that in view of the continuing judicial development the matter should not be codified but left to the courts and possibly to a later revision of the model act.

The US courts have developed the Business Judgment Rule to a much greater extent than the Commonwealth countries and it will be useful if we pause a moment to consider the nature of the rule and its relationship to the duty of care of directors.

First, one can distinguish between the Business Judgment Rule and the Business Judgment Doctrine. The Business Judgment Rule immunizes individual directors from liability for damages stemming from particular decisions while the Business Judgment Doctrine protects the decision making itself. It recognises the legitimacy of the board as a decision maker and the judicial deference to be accorded to it.

From the 18th century onwards it was recognised that directors were subject to equitable obligations of good faith and reasonable diligence. On the other hand since the 19th century Anglo-American courts have recognised the Business Judgment Doctrine in some shape or form. The rationale of the doctrine is three fold. First, it is a recognition of human fallibility. Second, it is a recognition of the role of risk taking in business decisions. Thirdly, it keeps the courts from becoming bogged down in complex corporate decision making and second guessing management decisions which they are ill equipped to do. In Commonwealth systems the doctrine has featured in alteration of articles, adequacy of consideration for shares, reduction of capital, refusal to register
transfers, schemes of arrangement and takeover cases. It has been similarly pervasive in U.S. Corporation laws which have worked out a clearer formulation of the Business Judgment Rule and have attempted recently to construct a coherent doctrine applicable to takeovers. In doing so they have exposed some weaknesses of both the doctrine and the rule.

Originally the Business Judgment Rule was formulated in connection with the diligence obligation of directors and in its terms it is more appropriate to this kind of question. However, it has since been applied in the more distinctly fiduciary context, where its application is less appropriate. The courts have attempted to deal with this inappropriateness by talking of the Rule in evidential terms. The Rule is sometimes described as a presumption of regularity. This has been reaffirmed by the Delaware Supreme Court in a number of recent cases. Such an analysis has also been adopted in other U.S. jurisdictions. The Business Judgment Rule as such applies where after reasonable investigation disinterested directors adopt a course of action which in good faith they honestly and reasonably believe will benefit the company. There are thus arguably five elements in the rule - a business decision, disinterestedness, due care, good faith and no abuse of discretion.

Let us look at the five ingredients of the rule -
(a) A business decision - the rule only applies to action, not inaction.
(b) Disinterestedness. This is axiomatic. In the U.S. corporation laws where a party challenging transactions establishes personal interest or self-dealing by a majority of the directors the burden shifts to the directors to prove the fairness of the transaction. At first sight it is difficult to avoid the assumption that a target company’s directors are inevitably involved in a
conflict of interest in a hostile bid. For this reason the courts have sometimes equivocated as to the application of the Business Judgment Rule in this context and its scope.

(c) Due care. Although there is a duty of due care the standard by which it is assessed is low.

(d) Good Faith. This is closely linked with 2 and 5. It predicates the absence of a collateral purpose.

(e) No abuse of discretion. Again this is linked very closely with the other aspects of the Rule.

In the reform of directors' obligations to care and skill there is much to be said for including some coverage of the Business Judgment Rule. I set out below paragraph 4.10 of the ALI tentative draft which attempts to do so:

4.01 Duty of Care of Directors and Officers; the Business Judgment Rule
(a) A director or officer has a duty to his corporation to perform his functions in good faith, in a manner that he reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.

(1) This duty includes the obligation to make, or cause to be made, such inquiry as the director or officer reasonably believes to be appropriate under the circumstances.

(2) In performing any of his functions (including his oversight functions), a director or officer is entitled to rely on materials and persons in accordance with 4.02-.03.
(b) Except as otherwise provided by statute or by a standard of the corporation [1.27] and subject to the board’s ultimate responsibility for oversight, in performing its functions (including oversight functions), the board may delegate, formally or informally by course of conduct, any function (including the function of identifying matters requiring the attention of the board) to committees of the board or to directors, officers, employees, experts, or other persons; a director may rely on such committees and persons in fulfilling his duty under this Section with respect to any delegated function if his reliance is in accordance with 4.02-.03.

(c) A director or officer who makes a business judgment in good faith fulfills his duty under this Section if:

(1) he is not interested [1.15] in the subject of his business judgment;

(2) he is informed with respect to the subject of his business judgment to the extent he reasonably believes to be appropriate under the circumstances; and

(3) he rationally believes that his business judgment is in the best interests of the corporation.

It should be noted that the ALI’s draft does not articulate a presumption of regularity. It merely states that by placing the burden of proof on persons challenging conduct it has provided directors with some protection. However, this is questionable.

Many of these sections refer to "the best interests of the company." Professor Gower’s draft Ghana Companies Code which relied heavily on the old text of the U.S. Model Business Corporations Code contained the following
In considering whether a particular transaction or course of action is in the best interests of the company as a whole, a director may have regard to the interests of the employees, as well as the members, of the company, and, when appointed by, or as representative of, a special class of members, employees, or creditors may give special, but not exclusive, consideration to the interests of that class.

This provision is radical in New Zealand in that it expressly authorises consideration of the interests of employees, something which has now been adopted by statute in the United Kingdom. Conversely it legitimates the existing practice of nominee directors giving attention to the interests of their nominator. At the same time it provides practical guidance - the director may give special, but not exclusive, consideration to the interests of that particular class.

Conclusion

In my opinion these materials represent useful precedents for reform of New Zealand law. If New Zealand adopted reforms along these lines they would be more in tune with what company directors themselves expect. The problem with the law at the moment is that it is remote from business reality. The problem with the Australian provisions in section 228-229 of the Companies Code is that they are too complex, not particularly well thought out and too draconian. This is tempered by erratic enforcement by the states but this is unsatisfactory for its own reasons. The advantage of the North American models is that they are more in tune with the market place. At the end of the day it must be recognised that fiduciary duties represent a compromise between efficiency and fairness. In devising satisfactory fiduciary duties it is necessary to strike a balance between these two objectives. Some New Zealand company directors have provided appalling examples of stewardship in recent years and this has occasioned bad
publicity for the local stock market which has fared worst in the aftermath of the October 1987 crash. While the October 1987 crash was not caused by this the consequent demise of a number of New Zealand listed companies has been due in part to this poor stewardship. The reform and codification of directors' duties would receive widespread support from the general public. In the aftermath of the stock market crash there is a natural tendency to cry out for more regulation. However, we must guard against overzealous regulation and maintain the precarious balance of efficiency and fairness. Efficiency is predicated because the company in an economic sense is a firm. Fairness is predicated because the company is also an association of persons in the real world linked together by a common purpose.
APPENDIX

A. Sections 228-229 of the Australian Companies Code

SECTION 228 Disclosure of Interests in Contracts
Property, Offices &c.

228(1) Subject to this section, a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company shall, as soon as practicable after the relevant facts have come to his knowledge, declare the nature of his interest at a meeting of the directors of the company. Penalty: $1,000 or imprisonment for 3 months, or both.

228(2) The requirements of sub-section (1) do not apply in any case where the interest of a director of a company consists only of being a member or creditor of a corporation that is interested in a contract or proposed contract with the first-mentioned company if the interest of the director may properly be regarded as not being a material interest.

228(3) A director of a company shall not be taken to be interested or to have been at any time interested in any contract or proposed contract by reason only -

(a) in a case where the contract or proposed contract relates to any loan to the company - that he has guaranteed or joined in guaranteeing the repayment of the loan or any part of the loan; or

(b) in a case where the contract or proposed contract has been or will be made with or for the benefit of or on behalf of a corporation that is related to the company.
- that he is a director of that corporation,
and this sub-section has effect not only for the purposes of this Code¹ but also for the purposes of any rule of law, but does not affect the operation of any provision in the articles of the company.

228(4) For the purposes of subsection (1), a general notice given to the directors of a company by a director to the effect that he is an officer or member of a specified corporation or a member of a specified firm and is to be regarded as interested in any contract that may, after the date of the notice, be made with that corporation or firm shall be deemed to be a sufficient declaration of interest in relation to any contract so made or proposed to be made if -

(a) the notice states the nature and extent of the interest of the director in the corporation or firm;

(b) when the question of confirming or entering into the contract is first taken into consideration, the extent of his interest in the corporation or firm is not greater than is stated in the notice; and

(c) the notice is given at a meeting of the directors or the director takes reasonable steps to ensure that it is brought up and read at the next meeting of the directors after it is given.

228(5) A director of a company who holds any office or possesses any property whereby, whether directly or indirectly, duties or interests might be created in conflict with his duties or interests as director shall, in accordance with sub-section (6), declare at a meeting of the directors of the company the fact and the nature, character and
extent of the conflict.
Penalty: $1,000 ir imprisonment for 3
months, or both.

228(6) A declaration required by sub-section (5) in
relation to the holding of an office or the
possession of any property shall be made by a
person -
(a) where the person holds the office or
possesses the property as mentioned in
sub-section (5) when he becomes a director
- at the first meeting of directors held
after -
(i) he becomes a director; or
(ii) the relevant facts as to the holding
of the office or the possession of
the property come to his knowledge,
whichever is later; or
(b) where the person commences to hold the
office or comes into possession of the property
as mentioned in sub-section (5) after he becomes
a director - at the first meeting of directors
held after the relevant facts as to the holding
of the office or the possession of the property
come to his knowledge.

228(7) A secretary of a company shall record every
declaration under this section in the minutes of
the meeting at which it was made.

228(8) Except as provided in sub-section (3), this
section is in addition to, and not in derogation
of, the operation of any rule of law or any
provision in the articles restricting a director
from having any interest in contracts with the
company or from holding offices or possessing
properties involving duties or interests in
conflict with his duties or interests as a
director.
SECTION 229  Duty and Liability of Officers

229(1) An officer of a corporation shall at all times act honestly in the exercise of his powers and the discharge of the duties of his office.

   Penalty -
   (a) in a case to which paragraph (b) does not apply - $5,000; or
   (b) where the offence was committed with intent to deceive or defraud the company, members or creditors of the company or creditors of any other person or for any other fraudulent purpose - $20,000 or imprisonment for 5 years, or both.

229(2) An officer of a corporation shall at all times exercise a reasonable degree of care and diligence in the exercise of his powers and the discharge of his duties.

   Penalty: $5,000.

229(3) An officer or employee of a corporation, or a former officer or employee of a corporation, shall not make improper use of information acquired by virtue of his position as such an officer or employee to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the corporation.

   Penalty: $20,000 or imprisonment for 5 years, or both.

229(4) An officer or employee of a corporation shall not make improper use of his position as such an officer or employee, to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the corporation.
Penalty: $20,000 or imprisonment for 5 years, or both.

229(5) For the purposes of this section, "officer", in relation to a corporation, means -

(a) a director, secretary or executive officer of the corporation;
(b) a receiver, or receiver and manager, of property of the corporation, or any other authorized person who enters into possession or assumes control of property of the corporation for the purpose of enforcing any charge;
(c) an official manager or a deputy official manager of the corporation;
(d) a liquidator of the corporation; and
(e) a trustee or other person administering a compromise or arrangement made between the corporation and another person or other persons.

229(6) Where -

(a) a person is convicted of an offence under this section; and
(b) the court is satisfied that the corporation has suffered loss or damage as a result of the act or omission that constituted the offence,

the court by which he is convicted may, in addition to imposing a penalty, order the convicted person to pay compensation to the corporation of such amount as that court specifies, and any such order may be enforced as if it were a judgment of that court.

229(7) Where a person contravenes or fails to comply with a provision of this section in relation to a corporation, the corporation may, whether or not the person has been convicted of an offence under
this section in relation to that contravention or failure to comply, recover from the person as a debt due to the corporation by action in any court of competent jurisdiction -

(a) if that person or any other person made a profit as a result of the contravention or failure - an amount equal to that profit; and

(b) if the corporation has suffered loss or damage as a result of the contravention or failure - an amount equal to that loss or damage.

229(8) Where a person who contravenes or fails to comply with this section has been found by a court to be liable to pay to a person an amount by reason of a contravention of Part X of the Securities Industry [name of State] Code\(^1\) that arose out of or was constituted by the same act or transaction as the contravention of or failure to comply with this section, the amount of the liability of the person under this section shall be reduced by the first-mentioned amount.

229(9) For the purposes of sub-section (8), the onus of proving that the liability of a person to pay an amount to another person arose from the same act or transaction as that from which another liability arose lies on the person liable to pay the amount.

229(10) This section has effect in addition to, and not in derogation of, any rule of law relating to the duty or liability of a person by reason of his office or employment in relation to a corporation and does not prevent the institution of any civil proceedings in respect of a breach of such a duty or in respect of such a liability.
Disclosure:  

B. Sections 132-4 of the Ontario Business Corporations Act 1982

Disclosure: conflict of interest  

132. (1) A director or officer of a corporation who,

(a) is a party to a material contract or transaction or proposed material contract or transaction with the corporation; or

(b) is a director or an officer of, or has a material interest in, any person who is a party to a material contract or transaction or proposed material contract or transaction with the corporation,

shall disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of his interest.

by director  

(2) The disclosure required by subsection (1) shall be made, in the case of a director,

(a) at the meeting at which a proposed contract or transaction is first considered;

(b) if the director was not then interested in a proposed contract or transaction, at the first meeting after he becomes so interested;

(c) if the director becomes interested after a contract is made or a transaction is entered into, at the first meeting after he becomes so interested; or

(d) if a person who is interested in a contract or transaction later becomes a director, at the first meeting after he becomes a director.
by officer (3) The disclosure required by subsection (1) shall be made, in the case of an officer who is not a director,
(a) forthwith after he becomes aware that the contract or transaction or proposed contract or transaction is to be considered or has been considered at a meeting of directors;
(b) if the officer becomes interested after a contract is made or a transaction is entered into, forthwith after he becomes so interested; or
(c) if a person who is interested in a contract or transaction later becomes an officer, forthwith after he becomes an officer.

Where contract or transaction does not require approval

(4) Notwithstanding subsections (2) and (3), where subsection (1) applies to a director or officer in respect of a material contract or transaction or proposed material contract or transaction that, in the ordinary course of the corporation’s business, would not require approval by the directors or shareholders, the director or officer shall disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of his interest forthwith after the director or officer becomes aware of the contract or transaction or proposed contract or transaction.
Director not to vote

(5) A director referred to in subsection (1) shall not vote on any resolution to approve the contract or transaction unless the contract or transaction is,

(a) an arrangement by way of security for money lent to or obligations undertaken by him for the benefit of the corporation or an affiliate;

(b) one relating primarily to his remuneration as a director, officer, employee or agent of the corporation or an affiliate;

(c) one for indemnity or insurance under section 136; or

(d) one with an affiliate.

General notice of interest

(6) For the purposes of this section, a general notice to the directors by a director or officer disclosing that he is a director or officer of or has a material interest in a person and is to be regarded as interested in any contract made or any transaction entered into with that person, is a sufficient disclosure of interest in relation to any contract so made or transaction so entered into.

Effect of disclosure

(7) Where a material contract is made or a material transaction is entered into between a corporation and a director or officer of the corporation, or between a corporation and another person of which a director or officer of the corporation is a director or officer or in which he has a material interest,

(a) the director or officer is not accountable to the corporation or its shareholders for any profit or gain realized from the
contract or transaction; and
(b) the contract or transaction is neither void nor voidable,
by reason only of that relationship or by reason only that the director is present at or is counted to determine the presence of a quorum at the meeting of directors that authorized the contract or transaction, if the director or officer disclosed his interest in accordance with subsection (2), (3), (4) or (6), as the case may be, and the contract or transaction was reasonable and fair to the corporation at the time it was so approved.

Confirmation by shareholders

(8) Notwithstanding anything in this section, a director or officer, acting honestly and in good faith, is not accountable to the corporation or to its shareholders for any profit or gain realized from any such contract or transaction by reason only of his holding the office of director or officer, and the contract or transaction, if it was reasonable and fair to the corporation at the time it was approved, is not by reason only of the director’s or officer’s interest therein void or voidable, where,
(a) the contract or transaction is confirmed or approved by special resolution at a meeting of the shareholders duly called for that purpose; and
(b) the nature and extent of the director’s or officer’s interest in the contract or transaction are disclosed in reasonable detail in the notice calling the meeting or in the information circular required by section 112.

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Court setting aside contract

(9) Subject to subsections (7) and (8), where a director or officer of a corporation fails to disclose his interest in a material contract or transaction in accordance with this section or otherwise fails to comply with this section, the corporation or a shareholder of the corporation, or, in the case of an offering corporation, the Commission may apply to the court for an order setting aside the contract or transaction and directing that the director or officer account to the corporation for any profit or gain realized and upon such application the court may so order or make such other order as it thinks fit. 1982, c.4, s.132.

Subject to the articles, the by-laws or any unanimous shareholder agreement,

(a) the directors may designate the offices of the corporation, appoint officers, specify their duties and delegate to them powers to manage the business and affairs of the corporation, except, subject to section 183, powers to do anything referred to in subsection 127(3);

(b) a director may be appointed to any office of the corporation; and

(c) two or more offices of the corporation may be held by the same person. 1982, c.4, s.133.

Standards of care, etc. of directors, etc.

134. (1) Every director and officer of a corporation in exercising his powers and discharging his duties shall,
Duty to Act, etc.

(a) act honestly and in good faith with a view to the best interests of the corporation; and

(b) exercise the care, diligence and skill that a reasonable prudent person would exercise in comparable circumstances.

Can not contract out of liability

(2) Every director and officer of a corporation shall comply with this Act, the regulations, articles, by-laws and any unanimous shareholder agreement.

(3) Subject to subsection 108 (5), no provision in a contract, the articles, the by-laws or a resolution relieves a director or officer from the duty to act in accordance with this Act and the regulations or relieves him from liability for a breach thereof. 1982, c.4, s.134.


5. Legal Systems and Lawyers' Reasonings.


7. See generally Ashburner's Principles of Equity 2nd ed by D Browne, pp 129-130. The law shows greater latitude to directors because of the element of risk. See Ashburner op cit p 131; Leeds Estate Co v Shepherd (1887) 36 ChD 787, 798.

8. See Gower op.cit., pp 584-591; R Clark Corporate Law Chapter 5.

9. (1854) 1 Macq HL 461.


11. Gower op cit 584.

12. Ibid, 585; Benson v Heathorn (1842) 1 Y & CCC 326, 341-2; Imperial Credit Association v Coleman (1871) LR 6 Ch App. 558, 567-8.


14. Ibid.


16. Hely-Hutchinson v Brayhead Ltd [1968] 1 QB 549 (CA); Castlereagh Hotels Ltd v Davies-Roe [1966] 2 NSWR 79 (NSW CA); Guinness Plc v Saunders (1988) 4 BCC 377 at 382. Where the articles allowed voting only if there had been prior disclosure of the conflict of interest failure to disclose rendered the votes invalid and made the resolution a nullity - Rolled Steel Products (Holdings) Ltd v British Steel Corp. [1986] Ch 246 at 275E (CA).
17. Gower op. cit. 587. Cf, however, Hely-Hutchinson v Brayhead Ltd [1968] 1 QB 549 where the English Court of Appeal assumed that s 199 of the UK 1948 Act applied to a contract in favour of a director made outside a board meeting by the chairman and de facto managing director without the director declaring his interest.

18. Guinness v Saunders (1988) 4 BCC 377 (CA). Another problem is that section 199 does not work sensibly where there is only one director or all the directors share a conflict of interest. See Re Woodware Products Ltd (1982) 1 BCR 378. Re David Neil and Company Ltd v Neil (1986) 3 NZCLC 99,658 and Movitex Ltd v Bulfield (1986) 2 BCC 99,403 discussed by Peter Watts in "Some Aspects of the Operation of the Conflict of Interest Principle in Company Law" [1987] 3 Canta L R 239. This article examines some fundamental problems concerning the relationship of s 199 and reg 84 of Table A to the basic equitable principle and repays close study. Peter Watts argues convincingly (1) that s 199 is characterised by a lack of clear headedness by the draftsman, (2) that dicta in Re Woodware Products Ltd, Re David Neil and Movitex are incorrect, (3) that self disclosure is possible under s 199 and reg 84, (4) that article 84(3) excludes absolutely the conflict of interest principle and substitutes its own code, (5) that s 204 should be interpreted to apply to other breaches of duty.


21. Cmnd 1749 paras 95, 99 (e) and (m).

22. The main New Zealand provisions are ss 190 (loans to directors), 191 (loss of office payments), 192 (compensation for loss of office on transfer of assets), 193 (compensation for loss of office on sale of shares).

23. See Companies Act 1985 Part X.

24. Clark op cit (footnote 8).

25. Ibid 160.


27. Clark, ibid.


32. See eg Hahlo op cit p 375; Gower op cit p 602.


34. See Charitable Corporation v Sutton (1742) 2 Atk 400 at 406.


36. Ibid p 5.

37. See for instance Shuttleworth v Cox Brothers & Co Ltd [1927] 2 KB 9 (CA).

38. Re Wragg Ltd [1897] 1 Ch 796 (C.A.); Brownlie & Ors, Practitioners 1898 6 SLT 249 at 251.


40. Re Smith and Fawcett Ltd [1942] Ch 304.

41. Re Alabama etc Railway Co [1891] 1 Ch 213.

43. See Block, Barton and Radin, supra, ch III. The literature on this subject is immense and one must be selective. See too Martin Lipton, "Takeover Bids in the Target's Boardroom" 35 Bus Law 101 (1979); "Takeover Responses and Directors' Responsibilities - An Update" 40 Bus Law 1403 (1985); Victor M Rosenzweig and M Orens, "Tipping the Scales - The Business Judgment Rule in the Anti-takeover Context" 14 Sec Reg LJ 23 (1986-87); Gary P Kreider, "Corporate Takeovers and the Business Judgment Rule: An Update" 11 J of Corp L 633 (1985-86).


45. See Block, Barton and Radin, op.cit. p 7 for the Delaware authorities.

46. Ibid, pp 7-8.

47. Ibid, p 7.


49. Ibid.

50. Ibid.


52. Companies Act 1985, sections 309 and 719.


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