Introduction

In Hugoesque 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." [1] 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.[6] This has resulted in the blurring or the outright abandonment of traditional or policy maintained demarcation lines with respect to markets, or institutions and some times 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.[8] 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 companies 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. [9] 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 it 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[18] 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.[19] 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"[20] a corporation to which the Act applies, to declare it a corporation "at risk".[21] 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.[22] 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. [23] 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."[24] 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."[25] (My italic). 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

business.

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.[26]

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. [27]

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."[28] 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.[29]

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.[34] 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."[35] 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.[36]

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.*

4. *NZ Herald*, 4/1/89, S4, p.3.

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

6. In this section I have drawn freely on a speech delivered by Mr David Walker, Executive Director of the Bank of England, as Kimber Fellow in Toronto in September 1987 and the discussion that speech engendered. An edited version of the speech appears in [1987-88] 13 C.B. L. J. 388. See also L.C.B. Gower, "'Big Bang' and City Regulation" (1988) 51 M.L.R. 1.

7. See Gower, note 6, *supra.*

8. Hadden, *Company Law and Capitalism*, 2nd ed., p. 352 ff.

9. For the Australian provisions, see Ford, *Principles of Company Law*, 4th ed., p.510 ff; for Canada see, Hadden, Forbes & Simmonds, *Canadian Business Organisations Law*, p.282 ff; for the United Kingdom see *Halsbury*, Vol 7, paras 970-976. The NZ *Commentary* thereon is in volume C, *Companies* at p.159 ff (Papps).

10. [1967] N.Z.L.R. 1054

11. *Re Automatic Phone Recorder Co. Inc.* (1955) 15 W.W.R. (N.S.) 666 (B.C.S.C); *Re Royal Trust Co Ltd* (1981) 14 B.L.R. 307 (Ont. H.C). In Canada there appears to have been some acceptance in the *Canadian Javelin* litigation that the rules of natural justice apply in this kind of proceeding. See (1978) 22 N.R. 465, and (1978) 89 D.L.R. (3d) 226, aff'd 106 D.L.R. (3d) 495 (F.C.A).

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

13. Hadden, "Fraud in the City : Enforcing the Rules" (1980) 1 Company Lawyer 16.

14. [1971] Ch. 388; see also *Maxwell* v *Department of Trade and Industry* [1974] Q. B. 523.

15. S.3(4)

16. *Id.*

17. *Id.*

18. *Hansard*, 13 September 1988, p.6493.

19. Cls. 4 & 7.

20. Cl. 29

21. *Id.*

22. Cl. 8

23. Cl. 7

24. *Hansard*, note 18 *supra* , p. 6499

25. Cl.2(1).

26. Cls.10,11,13.

27. Cls. 42, 69.

28. An unidentified lawyer, as reported in, McManus, " Lawyers, accountants fired up over registrar's new armoury", N.B.R., Oct. 4, 1988.

29. *Id.*

30. Cl.2 (1)

31. Cited in Comment, " A Confidence Trick" (1988) 9 The Company Lawyer 1, p.2

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.

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