THE SCOPE AND APPLICATION OF THE COMPANIES AMENDMENT ACT 1963

While the Courts may not be able to refer to the records of Parliamentary debates to ascertain the intention of an Act there is nothing to stop the inquisitive student from doing so, but to discover the intention of Parliament in enacting the Companies Amendment Act 1963, however, Hansard is helpful only up to a point; and to ascertain Parliament's intention as to the scope and application of the Act, Hansard is not helpful at all, because the particular problem which arose in *Multiplex Industries Limited v. Speer and Others* [1965] N.Z.L.R. 592 and [1966] N.Z.L.R. 122 (C.A.) had not occurred to the honourable members. Yet some of the statements made by the Attorney General in introducing the Bill are worth quoting. On the 24th September 1963 at p.2017 Hansard reports the Attorney General as saying about the Act:

> it prescribes the procedure to be followed in making takeover bids .... The first provision of the Bill dealing with takeovers is designed to lay down a set of requirements to which those making takeover bids must conform .... The Government wishes simply to ensure that shareholders are given certain information about the offer made and that they are given a certain time in which they can study the terms and obtain expert advice .... However, overseas experience has shown that the likelihood of some takeover bids being conducted less than fairly must not be ignored, and in using those terms I understate the case. Parliament should therefore legislate in anticipation of an abuse.

The provisions in the Act relating to the procedure to be adopted in making takeover offers seem clear and relatively straight forward. The major difficulty in the *Multiplex* case, however, did not concern the procedural provisions but when they were to apply – in other words the scope and application of the Act. The decision of the Court of Appeal,on this aspect of the case was important and somewhat unexpected, particularly as it reversed the view which had hitherto been taken generally by practising solicitors. Three of the respondents in *Multiplex* had apparently been independently advised on the point in a sense contrary to the decision of the Court

of Appeal.

The simple question for decision on the facts of the case was the true ownership of 250 shares. But these 250 shares meant the crucial difference between controlling or not controlling a majority of the shares in the company.

There were 60,000 shares in S.E. Ltd and for present purposes it is sufficient to note that there were three groups of shareholders who held shares totalling 29,580. These groups had been anxious to sell for some time as the company had not been doing well financially. The first group comprising A. & S. Ltd held 9,796 shares, of which 250 were in the name of the first respondent, Speer, who was manager of A. & S. Ltd. The second group comprised shareholders in A. & S. Co., holding 4,004 shares. The third group comprising the remaining members of the family founders of S.E. Ltd. held 15,780 shares. Various attempts by the first respondent to effect a merger of S.E. Ltd with other companies had not been successful. Eventually however, negotiations began which envisaged M.I. Ltd buying the shares of these groups so long as it was able to acquire additional shares to bring its total holding in S.E. Ltd to over 50%. The arrangement was that the shares would be bought at 30/- per share, paid over a period of five years with interest payable on the outstanding amount at 6% with quarterly rests. The M.I. Ltd obtained options on the shares of the first and third groups exercisable by 5 p.m. on 1 July 1964. These, together with the shares of the second group totalled 29,580. M.I. Ltd. already controlled 300 shares. The balance required to reach more than 30,000 was obtained by a cash purchase of 150 shares from a client of the solicitor for A. & S. Ltd.

Considerable importance attaches to how these options were obtained. The members of each of the two groups executed options prepared by M.I. Ltd which stated that the shareholder granted an option to M.I. Ltd to be exercisable as stated above. There was no written invitation to these shareholders to sign the options, which were simply handed over with an oral invitation to sign. Options were also obtained over the shares held by the second group. These were obtained by the first respondent writing to each of the five shareholders in this group, advising them of what had been agreed, and asking them to fall in line with the plan. The options were exercised on 14 July. In the Supreme Court the point was not taken that they had not been executed by the time stipulated, i.e. 1 July. In the Court of Appeal it was held that non-fulfilment of the condition could not then be pleaded to avoid the contract.

On 19 August Z.H. Ltd gave notice to S.E. Ltd under the Companies Amendment Act 1963, giving particulars of a takeover offer for all 60,000 shares in S.E. Ltd

for 30/- each. This offer was accepted by all the shareholders of S.E. Ltd who had not given options to M.I. Ltd. These totalled 29,950. On 21 September after receiving legal advice, Speer transferred the 250 shares he held on behalf of A. & S. Ltd to Z.H. Ltd thus apparently giving it a controlling interest. About a month earlier when it had become known that Z.H. Ltd was interested in taking over S.E. Ltd the legal advisers to the latter company had advised that the contracts held by M.I. Ltd were illegal and unenforceable, having resulted from offers which were made in beach of the Act.

At the time of the hearing therefore, the success of either takeover depended upon whether the contracts obtained by M.I. Ltd upon exercising the options were illegal and unenforceable, i.e. whether the activities of M.I. Ltd came within the scope of the Act, and consequently on whether M.I. Ltd had an equitable title to the 250 shares which made all the difference. In the Supreme Court, Tompkins J. held that the Act did apply, that M.I. Ltd was in breach, that the contracts it held were illegal and unenforceable and that M.I. Ltd had no equitable title to the 250 shares which had been transferred to Z.H. Ltd by Speer.

The judgment of Tompkins J. together with the arguments of Counsel before the Court of Appeal and the judgments of the members of the Court of Appeal open up a number of interesting points on application of the 1963 Act. It is intended in this note to pick up these points and in the light of the judgments, endeavour to assess the effectiveness of the Act in its present form.

The first and major question to be answered was whether the activities of M.I. Ltd fell within the scope of the Act. Tompkins J. considered that this could only be determined by first considering its scope and purposes. He concluded from an analysis of the provisions that the main purpose was to protect shareholders of an offeree company when takeover offers were made. To ensure the attainment of this purpose he considered that the Act should be construed in accordance with the principles set out in s5 (j) of the Acts Interpretation Act 1924. He concluded that the fact that M.I. Ltd handed to the shareholders in the first and third groups an offer to M.I. Ltd of an option over their shares constituted a takeover offer in writing for the acquisition of shares under a takeover scheme.[1] He also considered the letters written by Speer to the members of the second group of shareholders in S.E. Ltd to be invitations to make offers to M.I. Ltd.

In argument before the Court of Appeal, Counsel for the Appellant (M.I. Ltd.) argued that the scheme of the Act was simply to regulate the making of takeover offers and the procedure in respect of them. The most important point in the argument

1. Companies Amendment Act 1963 S.2 (1)

was that the Act defined a takeover offer as meaning an offer *in writing*. Consequently any offer made otherwise than in writing, whether pursuant to a takeover scheme or not was not a takeover offer for the purposes of the Act.

Counsel for Speer and A. & S. Ltd argued that the Act was intended to control takeover schemes rather than takeover offers. He contended that once there was a takeover scheme in existence the only way that the scheme could be carried out was by the offeror giving the notice to the offeree company and then presenting to the offerees an offer in writing complying with the requirements contained in the Act. Only in this way could a takeover scheme be effected. (It is interesting that *prima facie* this interpretation accords with the Attorney General's statement in Parliament quoted at the beginning of this note.)

Counsel for Z.H. Ltd argued that the intention of the Act ascribed to it by Tompkins J. was correct, and that having regard to the purposes of the Act, the context in s.4 (1)[2] required a meaning to be placed on the words "take-over offer" different from that contained in the definition section. The point of this argument was that a wider meaning in this section could exclude the necessity for the takeover offer to be in writing.

The learned judges in the Court of Appeal each thought that the appeal could be decided on the short point (which they said was not taken in the lower Court) that takeover offers were defined in the Act as being offers or invitations to make an offer, *in writing*. There had been no such invitations in this case; the handing of a draft offer for signature to the first and third parties did not constitute an offer in writing; the letters written by Speer to the shareholders in the second group did not constitute a written invitation by M.I. Ltd to these shareholders, and that M.I. Ltd had not acted in contravention of the Act. Two of the judges explicitly agreed with the interpretation of the objective of the Act put forward by Counsel for the Appellant – that it was to regulate the making of takeover offers and the procedure in respect to them[3] basing their conclusion on the ground that in "plain words, the statute restricts its prohibition to offers in writing".

North P. commented [1966] N.Z.L.R. at 132–133:

> It may be that this result does not fully give effect to the legislative intention; on the other hand it is possible the Legislature was really only concerned with large takeover schemes which,

2. providing for the procedure in respect of takeover offers.

3. North P. and McCarthy J., Turner J. did not consider the point.

> in their very nature would have to be carried out by the offeror communicating with the shareholders in writing. However it is my duty to interpret the Act as it stands.

The contention by Counsel for Speer and A. & S. Ltd that the object of the Act was to control takeover schemes was dismissed with the observation at page 133 that the Act "has not been built on these lines"; and the suggestion that in s.3 (1) the Court should depart from the definition of takeover offer could not be accepted "for one moment".

That several interpretations of the scope of the Act could have been seriously entertained suggests that the matter may not have been as straight forward as the decision of the Court of Appeal would make it appear. The trouble arose from differing opinions about the intention of the Act.

Those Counsel and Tompkins J. who argued that the intention was to protect the interests of shareholders in the offeree company by *inter alia* preventing a surreptitious change of control can point to much in the Act to support their contention. Undoubtedly once it applies, the Act provides for all the shareholders to receive adequate information about all aspects of the proposed takeover. Moreovėr, there is the example of the Supreme Court of Victoria to point to in *Colortone Holdings Limited v. Calsil Limited* [1965] V.R. 129. There Gillard J. accepted the submission that s.184 of the Uniform Companies Act 1961 (Commonwealth of Australia) was enacted to protect shareholders from becoming vulnerable to takeover bidders and having their rights coaxed away from them upon inadequate information and advice.

S.184 of the Companies Act 1961 (Commonwealth) is couched in terms similar to that of the Companies Amendment Act 1963, and it doubtless provided the starting point for the New Zealand draftsman. Nevertheless it does differ from the New Zealand Act in several important respects:

(a) it defines a takeover scheme as a scheme intended to obtain control of at least one third of the voting power at any general meeting of the offeree company, compared with one half required by the New Zealand Act.

(b) any offer or proposed offer pursuant to a takeover scheme is a takeover offer within the scope of the Act, not just an offer "in writing."

(c) it does not provide for exceptions relating to private companies where all shareholders have agreed in writing to waive the

requirements of the Act, and to offers to no more than six shareholders which are contained in s.3 of the New Zealand Act.

Thus clearly the scope of the New Zealand legislation is much more restricted than its Australian counterpart. In view of this, it is important to consider whether the New Zealand legislation is adequate to prevent abuses in regard to takeover offers in cases where abuses are most likely to occur.

To say, as did the Court of Appeal, that the purpose of the Act is simply to regulate takeover bids and their procedure, leaves much unsaid about the intention of the Act. For what purposes are takeover offers to be regulated? The schedules, as pointed out above, confirm that when it applies, the Act ensures that adequate information relating to the takeover scheme, the standing of the offerors and the relations between the offerors and the directors of the offeree company are made available to the shareholders in the offeree company. A more meaningful statement of the intention of the Act would therefore be that when it applies, it regulates takeover offers and their procedure to the intent that shareholders are given sufficient information to enable them to act to protect their interests.

There are two vital questions to be considered in assessing the adequacy of the Act: first, are the procedures it prescribes sufficient to protect the shareholders' interests, and secondly, does the Act apply to all cases where shareholders' interests need to be protected. Only the second is considered here.

All takeovers involving large public companies with very many shareholders which could be effected only by notifying shareholders by circular letters and with much attendant publicity would necessarily come under the Act. On the other hand, takeovers of small companies are not necessarily excluded, and in fact are only excluded when offers are made to not more than six members, or, in the case of private companies, where all members have waived in writing the requirements of the Act. Further, it is clear after *Multiplex* that all takeovers where the offers are made orally are excluded.

The reason for providing for the exclusion of small takeover schemes from the scope of the Act is understandable. For practical purposes compliance with the Act in such cases would be onerous and unnecessary and out of proportion with the shareholders' interests being protected.

The decision in *Multiplex* now makes it apparent that there is a large class of takeover schemes which could affect the interests of numerous shareholders, but which could avoid the Act. These are obviously the cases with most opportunity for abuse. The takeover arrangements described in *Multiplex* were such a case.

There it was possible for the offeror to acquire over 30,000 shares worth more than £45,000 without coming within the scope of the Act. The reasons for protecting the shareholders in such a case from surreptitious change in control of a company are as valid as if the company had an issued capital of £600,000. A shareholder would be affected just as much as if he held shares of the same value in a much larger company.

There are probably a considerable number of private and public companies with an issued capital of between £25,000 to £200,000 which could come into the category under discussion. These are the companies of which it would be possible for one party to obtain a controlling interest and avoid having the operation come under the Act by using some of the devices open to him under it as, for example, approaching shareholders with oral invitations to offer, or by making offers to no more than six persons or by employing subtler if more devious means such as voting agreements, or by having shares held on trust. To a large extent, these procedures would depend for their feasibility upon the distribution of the shareholding. They would be possible, for example, where a relatively few shareholders held between them 40%-50% of the total shares; or where the total shareholding was distributed equally between a relatively small number of people. As a result of such manipulations many shareholders could find their interests had been prejudiced without their being aware of it.

The possibility of abuses resulting from large concentrations of shares in the hands of relatively few shareholders, has been recognised for purposes other than domestic takeover legislation. The News Media Ownership Act 1965 for example restricts the total overseas ownership of shares in a "news company" to 20 per cent of the total voting power. Moreover it provides that any one member domiciled outside New Zealand shall not exercise more than 15 per cent of total voting power.

The Australian takeover legislation also shows awareness of these dangers. First, it recognises that for practical purposes control of a company may be gained with considerably less than 50 per cent of voting power, in that it defines a takeover scheme as one involving the acquisition of one third of the voting power, and a takeover offer as any offer pursuant to a takeover scheme. It is interesting to note that both these points have been taken up in the Overseas Takeovers Regulations 1964 (made pursuant to the Reserve Bank of New Zealand Act 1964). In particular in the definition of a takeover scheme the proportion of shares aimed at is reduced to 25 per cent of the voting power. No doubt the regulations were given a wider scope to prevent mischiefs other than those the Act was intended to remedy. Nevertheless, if the application of the Act were so extended, it would provide a more comprehensive protection of shareholders' interests.

Secondly the Australian legislation recognises that if the control of a company is likely to be affected by a takeover scheme, all members of the company are entitled to know about it. This legislation does not allow a takeover scheme to avoid its procedures simply because offers are made to a few persons only, whether few is defined as being not more than six or as all those shareholders to whom the offer may be made orally. It could be objected that this complete coverage would create unnecessary hardship in the case of genuine takeovers of small companies. Doubtless it was to meet this objection that the application of the 1963 Act was restricted. Nevertheless it is submitted, that, to achieve complete protection for shareholders in a company subject to a takeover offer, all transactions should be subject to the provision of the Act except where all shareholders have agreed in writing to waive the application of the Act.

While the Court of Appeal has pointed to the proper interpretation of the scope of the Act in its present form *Multiplex* raises a number of points which have not been settled, and which may arise in the future. Only two of these will be discussed here.

The first of these was the distinction drawn by Counsel for the Appellant before the Court of Appeal. He argued that an invitation to an offeree to grant an option over his shares was different from an invitation to an offeree to sell his shares. It appears from the judgment of North P. that Counsel later decided not to pursue the argument, and consequently no more was said about it. There is internal evidence in the Act that shares which could be acquired under an option are not necessarily shares acquired under a takeover offer: s2 (2) (a). In any event, it is to be regretted that the Court of Appeal did not comment on the matter while they had the chance so that the remaining element of doubt could have been cleared away. As matters stand it appears arguable that an offeror could send out written invitations to offeree shareholders to grant options over their shares in favour of the offeror, in this way avoiding the application of the Act. If this were the case then the category of companies of which takeovers could be effected without reference to the Act would be greatly increased, and the possibility of abuse would be likewise enhanced.

Again, no light was thrown on the question of whether and under what circumstances a contract resulting from a takeover offer made in breach of the Act would be illegal and unenforceable. S.13 provides for a fine of not more than £500 where such an offer is made, but it is not stated in the Act whether such an offer is, in the words of Chitty on Contracts 22ed. at 371 "forbidden as illegal or whether it is merely rendered expensive". The words of Lord Wright in *Vita Food Products Inc. v. Unus Shipping Co. Ltd.* [1939] A.C. 277,293 are in point:

> Each case has to be considered on its merits. Nor must it be

> forgotten that the rule by which contracts not expressly forbidden by statute or declared to be void are in proper cases nullified for disobedience to a statute is a rule of public policy only, and public policy understood in a wider sense may at times be better served by refusing to nullify a bargain save on serious and sufficient grounds.

Tompkins J. at page 605 thought that on its true construction the Act rendered takeover offers in contravention illegal and unenforceable. On the other hand, however, Gillard J., in the *Colortone* case (supra) accepted as valid contracts made pursuant to takeover offers which were technically in breach of s.184 of the Companies Act 1961 (Commonwealth). However it should be noted that in this case Counsel for both parties were agreed on the point that the interests of the shareholders had been protected by subsequent actions of the offeror and offeree companies. It remains to be seen what approach the Court will take to this question.

It is of interest in this connexion that regulation 15 of the Overseas Takeovers Regulations 1964 sets out two conditions under which contracts resulting from takeover offers made by overseas persons shall be unlawful and void. They are when notice in writing has not been given to the Registrar that the offers are being made, and when the offeror has received notice in writing, in accordance with the provisions of the regulations that the Minister's consent has been refused. The regulation does not say that contracts resulting from offers which are in breach of some technical point required by the Act or the Regulations will not be unlawful or void, but the particularization of two major breaches for which such contracts may be void, at least raises an implication that minor breaches would not necessarily result in unenforceable contracts.

The conclusion of this note is that the Companies Amendment Act 1963, as interpreted by the Court of Appeal, is far too restricted in its scope and equivocal in its application. Moreover, the Act is inconsistent; it contains detailed instructions for the protection of shareholders' interests, but it allows avoidance of these provisions in those situations where perhaps they are most required. It was enacted in anticipation of an abuse, but its doubtful effectiveness in crucial areas is a strong argument in favour of its early revision; it should be made more thoroughgoing in its application along the lines of its Australian counterpart.