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Company purchase of own shares under the Companies Bill 1990 - A sheep in wolf's clothing?

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New Zealand is one of the few remaining jurisdictions prohibiting companies from purchasing their own shares. The Companies Bill will change this and permit repurchase. This article examines five typical repurchase transactions currently in use in the United States, and considers how they will be dealt with under the Bill. The author concludes that the enabling provisions of the Bill are problematic particularly in the case of closely held companies, where buyouts will most commonly occur.

I INTRODUCTION

> The capital may, no doubt, be diminished by expenditure on and reasonably incidental to all the objects specified. A part of it may be lost in carrying on the business operations authorised. Of all this persons trusting the company are aware and take the risk. But I think they have a right to rely, and were intended by the legislature to have a right to rely, on the capital remaining undiminished by any expenditure outside these limits or by the return of any part of it to the shareholders.[1]

These words uttered by Lord Herschell, over 100 years ago, laid down a rule which has stood unchallenged in the Commonwealth ever since. The rule, known as the rule in *Trevor* v *Whitworth*, prohibits a company from acquiring its own shares. Despite being quickly rejected in the United States[2] as incompatible with that country's dynamic economy, the rule has only recently been overturned by statute in several Commonwealth jurisdictions.[3] New Zealand is poised to follow these countries.[4]

In the United States, repurchase is carried out in a number of ways. The repurchases which attract the most criticism from minority shareholders are discriminatory, or non pro rata repurchases, as these necessarily involve a wealth transfer from one group of shareholders to another. Some of these, such as buyout agreements for shareholders in closely held corporations, are relatively uncontroversial; others, like greenmail, are seen as an abuse of the repurchase power. Simply abolishing the rule in *Trevor* is, by itself, not enough. Any legislative change to the existing common law governing share repurchase must deal with a wide variety of acquisition methods, ranging from selective

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1 *Trevor* v *Whitworth* (1887) 12 App Cas 409, 415 (HL), per Lord Herschell.

2 See for example *In re Castle Braid Co Ltd* 145 Fed 224 (DC SD NY) (1906) 231-3.

3 Companies Act 1981 (UK), Close Corporations Act 1989 (Australia), Canadian Business Corporations Act 1975, C 33, and RSO 1970, C 53, s 39(2) (Ontario).

4 It is now proposed that the Bill will become law in January 1993.

repurchases to tender offers, and the varying degree of investor protection required in each transaction. The Bill relies primarily on disclosure for investor protection, although it is also substantive in effect.[5] The Bill reinforces this pro-shareholder approach with more effective enforcement provisions for director misfeasance than were previously available under the common law.

This paper considers five common repurchase transactions in the United States, and how these will be dealt with under the provisions of the Bill. The writer concludes that the repurchase provisions of the Bill cannot accommodate the most common repurchase scenario of all, the close corporation buy-back agreement, and provide an as yet untested protection from the more abusive repurchases in the area of widely held corporations. The paper is subject to several qualifications. Firstly, the Law Commission never intended the new legislation to be anything more than a core Companies Act. Secondly, by the time the Bill comes into force, there may well be taxation implications associated with repurchase. Finally, the Securities Commission, in its submission on the Law Commission's draft, did not make any major criticisms of the repurchase provisions or recommend reform of the Securities Act.[6] As it stands, the provisions of the Bill will have to provide the bulwark against any abuse.

II TYPICAL REPURCHASE SITUATIONS IN THE UNITED STATES

A *Close Corporations*

In the United States, close corporations consisting of only a few shareholders often have some sort of buyout agreement (either in the constitution or as a separate agreement) for the repurchase of the shares of an outgoing member. The agreement usually consists of three core elements: a triggering event (such as death or a desire by a retiring shareholder to sell), which activates the agreement, a pricing provision (such as book value, a formula or a third party valuation) and a provision stating whether the company is required to buy the shares on the occurrence of the triggering event (a put) or whether it simply has a right of first refusal (a call).

B *Going Private*

Going private consists of:[7]

> a transaction or series of transactions instituted by controlling shareholders of a publicly held corporation, designed to eliminate or substantially reduce the

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5 See cl 53(1)(a).

6 It is anticipated that securities law will be reformed following the 1988 report to the Minister of Justice. However in this report the Commission did not recommend any specific provisions dealing with takeover defences, with which this paper is largely concerned.

7 Iselin "Regulating Going Private Transactions: SEC Rule 13e-3" (1980) 80 Colum LR 782.

corporation's outstanding equity, thereby returning the corporation to private ownership.

Some companies in the United States, such as Levi Strauss[8] have achieved spectacular success on being taken private, and yet this form of share repurchase remains extremely controversial. The controversy stems from two factors. First of all, majority shareholders control both the timing and terms of the repurchase. Going private usually occurs with these insiders taking advantage of a depressed market to have the company repurchase its shares at a fraction of the price they had previously been sold at to the public.[9] The second reason going private is so widely criticised is the perceived coercion of the transaction: the most common means of going private is a two-step acquisition consisting of a tender offer, or a series of discrete repurchases, followed by a contrived merger, or a sale of assets to, a dummy corporation. This has the effect of "freezing out" the remaining public stockholders.[10]

C Poison Pills

The decision of the Delaware Supreme Court in *Moran* v *Household International*[11] in 1984 heralded the arrival of a new takeover defence: the poison pill. Poison pills operate by making acquisition of the "target"[12] company prohibitively expensive, encouraging instead a negotiated takeover with the target's board. In the United States, poison pills are usually implemented[13] by issuing to common shareholders a pro rata dividend of either rights or a special class of stock. The pill is only activated on the

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8 The Economist, London, England, June 22 1991, 67.

9 It is no coincidence that going private first emerged in the bear market of 1974. In *Kaufmann* v *Lawrence* (386 F Supp 12 (SDNY 1974) *aff'd per curiam* 514 F 2d 283 (2nd Cir 1975)), the District Judge noted:

> The issue raised is undeniably serious and troublesome. The public has invested some $14 million in the company. The decision to buy out the public during the current depressed market will enable the public shares to be repossessed at a fraction of the original cost to the public shareholders. Moreover if the exchange offer is successful i.e., if the number of shareholders is reduced to fewer than 300, the company will be able to operate as a private company free from public regulation and oversight.

Kaufmann concerned an advertising agency (Wells, Rich, Greene Inc.) that sought to go private at the time its share value had dropped from $27 7/8 to $5 1/2. The company offered to purchase common stock from the shareholders for $3 cash and $8 in securities. Similarly, in *SEC* v *Parklane Hosiery* 558 F 2d 1083 (1977), the company had previously gone public at $9 per share, and was seeking to go private at $2 per share.

10 Above n7, 782-3.

11 500 A 2d 1346 (Del 1985).

12 "Target" refers to the company sought to be acquired.

13 A large part of the popularity of poison pills can be attributed to their ease of adoption. Generally they can be adopted by simple resolution without the approval of the issuer's shareholders.

occurrence of a specified "triggering event", such as an acquiring person[14] obtaining control of the target, making a tender offer for the target, or acquiring a certain quantity of the target's stock. If the pill consists of a rights issue, the rights will redeemable by the target board before the triggering event, for a nominal sum, and do not trade separately from the underlying common stock before this. Poison pills come in five different flavours.[15] Two of these involve purchase of own shares.

1 The different poison pill provisions

(a) Back-end or note purchase plans

Pills with back-end provisions allow the target's common stockholders, except the acquiring person, to put their stock to the company for a package of cash and securities, on the occurrence of a specified triggering event. The effect of a back-end provision is to force the acquiring person to buy out the remaining shareholders at a price established by the target's management.[16]

(b) Convertible preferred stock

This type of pill is implemented by issuing a pro rata dividend of convertible preferred stock. If an acquiring person makes a partial tender offer[17] but there is no resulting business combination, the pill, like the back-end provision, allows the target's shareholders to redeem their common stock for cash and securities of the target. In the event the acquiring person does gain control of the target, the second feature of the pill, the conversion right, comes into play. This permits the target's shareholders to convert their preferred stock into voting stock of the acquiring person, effecting a sudden and massive dilution of the acquiring person's stock. The advantage of convertible preferred stock is that it allows target shareholders to obtain a fair price for their shares if there is only a partial tender offer, or to retain their interest in the target following a takeover.

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14 An Acquiring Person is a person or group seeking a business combination with the target.

15 Flip-over provisions, flip-in provisions, voting provisions, back-end provisions and convertible preferred stock. See Dawson, Pence and Stone "Poison Pill Defensive Measures" (1987) 42 Bus Law 425.

16 Thompson "Shareholder Rights Plans: Shields or Gavels ?" (1989) 42 Vanderbilt LR 173, 186.

17 A partial tender offer is an offer for less than 100% of the target's stock.

D Greenmail

A takeover defence which has created great interest in the North American financial press is greenmail. Greenmail is:[18]

> the purchase of a substantial block of the target company's stock by an unfriendly suitor with the primary purpose of coercing the target into repurchasing the block at a premium.

Greenmail is so called because it is seen as corporate blackmail, with the greenmailer threatening to take the target company over and expel incumbent management, unless the target buys it out.[19] Greenmail usually occurs in the context of a threatened takeover offer but it can also occur in other situations. Probably the most common example of this is a payment to silence (and remove) a dissenting shareholder.[20]

E Price Manipulation

In an imperfect market, or by using inside information in a market which is only semi-strong form efficient, a company may be able to manipulate[21] the price of its stock. Corporate environments characterised by myopic investors, such as North America or New Zealand, may provide management with an incentive to boost sagging share prices. One way of doing this it to create an illusion of demand for the company's stock, through having the company conduct a repurchase program and not disclosing the buyer's identity to the public. Driving up the price by means of secret repurchases is a useful management tool for several reasons.[22]

Price manipulation is also a useful takeover defence. If another company makes a hostile tender offer for the target company, the target's management can use purchase of own shares as a defence, by conducting a repurchase program and driving the price above what the raider has offered, defeating the tender offer.[23]

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18 Loss and Seligman *Securities Regulation* (3ed, Little, Brown & Co, Boston, 1990) 2140.

19 In 1984 US companies spent over $3.5bn to repurchase their own securities from unwanted shareholders, at premiums totalling over $600m above market prices. In this year, the Bass group extracted over $400 in greenmail from Texaco. Texaco was engaged in a buyout of Getty Oil. It became concerned that the Bass group (who had acquired about 10% of Texaco stock) might make a takeover bid while it was financially vulnerable. It therefore bought out the Bass group's holding at a premium over market.

20 See for example *In re General Motors Class E Stock Buyout Litigation* 694 F Supp 1119 (D Del 1988).

21 Manipulation in this context refers to action taken either to inflate the price of a stock, or to peg it at its current level.

22 See Getz "Some aspects of Corporate Share Repurchases" (1974) 9 UBCLR 9, 33.

23 See for example *Crane* v *Westinghouse Air Brake* 419 F 2d 787 (1969). Crane sought a merger between itself and Air Brake. The Air Brake directors decided instead on a merger with a white knight (a friendly company prepared to assist the target in

III THE RULE IN *TREVOR* V *WHITWORTH*

The facts in *Trevor* involved what is the most common occurrence of share repurchase in the jurisdictions permitting it and the most commonly called for exception to the rule in those jurisdictions still forbidding the practice, such as New Zealand. A company purchased shares from one of its shareholders, who subsequently died. The debt was partially satisfied by the issuing of a promissory note. In winding up proceedings, the executors of the deceased shareholder sought to enforce the note. The House of Lords resolved the case on the widest of the three issues presented to it: that a company could not repurchase its shares. Their Lordships propounded four separate bases for this decision. If the repurchased shares were not intended to be resold, then their acquisition would constitute a circumvention of the strict capital maintenance provisions of the Companies Act 1862 (UK). If, on the other hand, the shares were intended to be resold at a later date, this would amount to trafficking in shares. In any case, to allow repurchase would prejudice the position of creditors (especially unsecured creditors) whose only protection was the paid up capital of the company, whatever the company's reasons for repurchasing the shares. Their Lordships were also concerned that to allow repurchase would undermine corporate governance; if the majority wished to remove troublesome shareholders, they should do so with their own funds and not from those of the company.

Capital maintenance and creditor protection are admirable but unrealistic reasons for retention of the rule in *Trevor*. In theory the rule allows creditors to protect themselves by relying on the external reports of the company. Even supposing unsecured creditors actually read these, the protection afforded by the reports is illusory. Not only are they subject to manipulation by management, but they are also substantively flawed as non cash consideration does not have to approximate the value of the shares.[24] Whatever danger the surplus of shareholders funds may face from share repurchase is dwarfed by the threat of poor management and over-indebtedness.

A *Circumvention of the Rule in* Trevor

The same results that share repurchase is used to achieve in the United States have been achieved through different means in New Zealand. Often the only difference is that the alternatives are more circuitous than those favoured by our North American corporate counterparts.

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fighting a hostile takeover bid), American Standard. Crane made a tender offer to all Air Brake shareholders at $50 per share. On the day the tender offer was to expire, Air Brake stock was trading at $49. During that day, Standard purchased 170,000 Air Brake shares on the New York Stock Exchange, and drove the price over $50, defeating the tender offer. Standard secretly onsold the Air Brake stock, off the market, creating the appearance of significant demand for the stock.

24 Cl 40 of the Bill seems to address the problem by requiring directors to certify that the consideration for an issue is fair and reasonable to all existing shareholders.

The primary takeover defence in New Zealand is that of the white knight. Poison pill defences have so far been confined to new issues of shares.[25] However there are numerous possibilities for pills which do not involve the repurchase of shares. Flip-in, flip-over and super majority voting provisions all function in this way.

Greenmail is unknown in New Zealand, due to the repurchase prohibition. Financially assisting a third party to purchase shares is also barred.[26] However the same result can be achieved if directors acquire the shares themselves, or arrange for acquisition by a friendly third party. This can be financed internally by a dividend distribution[27] or by means of a sale of assets by or to the company.[28]

It is possible to facilitate a buyout and circumvent the rule in *Trevor* in several ways. Firstly there is the section 62(1)(b) exception to financial prohibition. A cross-purchase arrangement can be financed with company funds if the purchasing shareholder is an employee or (in a private company) a director. Alternatively, an equivalent financial result can be achieved by means of a capital reduction at a premium or by redemption of preference shares. The terms of the redemption can be constructed so that (at least for closely held companies) the shares avoid the rule in *Trevor*.

Going private appears to fall outside the Companies Amendment Act 1963.[29] It cannot be conducted by repurchase, but an insider group (usually linked to management) can repurchase the shares,[30] or internally finance the transaction by a sale of assets or a dividend. If the owners wish to retain control of the assets, they may be sold to a newly formed subsidiary.

Price manipulation (to whatever extent is possible in a semi-strong efficient market) is possible in New Zealand; but company purchase of own shares cannot be used for this.

IV AN OVERVIEW OF SHARE REPURCHASE UNDER THE BILL

The Bill sweeps away the rule in *Trevor* v *Whitworth*, by permitting repurchase. The repurchase provisions with which this paper is primarily concerned are clauses 51

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25 The usual takeover defence in New Zealand, involving share issue, is simply for the offeree to make a bonus issue to all members in an effort to induce them to retain their holdings. These issues have so far not achieved the sophistication of the US poison pill. The Securities Commission *Company Takeovers: Report to the Minister of Justice* (Wellington, 1988) 210, para G55.

26 Section 62 of the Companies Act 1955.

27 *Re Wellington Publishing Ltd* [1973] 1 NZLR 133.

28 *Belmont Finance Corporation* v *Williams Furniture Ltd (No 2)* [1980] 1 All ER 393.

29 Dugan and Keef *Company Purchase of Own Shares: The Case for New Zealand* (Victoria University Press for the Institute of Policy Studies, Wellington, 1989) 57.

30 A management buyout. This is facilitiated in the US by first having the company purchase some of the outstanding stock to reduce the control threshold and pressure other shareholders to sell or face an illiquid market.

to 55.[31] Subject to clause 44 (the solvency test) a company can repurchase its shares, if permitted to do so expressly by its constitution.[32] Such an enabling provision will only be valid for three years,[33] and shareholders must approve its continuance by special resolution before or after expiry. After revalidation, it appears to be valid indefinitely. All repurchases must be made in accordance with clause 52.[34] The Bill addresses two different types of repurchase: pro rata,[35] and non pro rata, or selective repurchases.[36]

A A Pro Rata Repurchase Under Clause 52(1)(a)

A clause 52(1)(a) repurchase is subject to the least amount of regulation under the draft Act. To fall within paragraph (a), the offer must be one made to all shareholders, to acquire the same proportion of their shares. It must give the shareholders a reasonable opportunity to accept,[37] and if accepted in full, it must leave relative voting and distribution rights unaffected.[38] Repurchases under subclause (1)(a) are limited to 10% of outstanding stock per annum.[39] Clause 52(1)(a) repurchases must also satisfy the remainder of clause 52. The use of clause 52(1)(a) is limited because of the 10% ceiling. Its chief function will be as a preliminary step in a two-stage transaction, to reduce the number of shares that must be acquired by selective repurchase in the second stage, for example in preparation for going private, or a management buy out. It may also be used in situations where management may not need to acquire a large quantity of stock, and is not particular where it comes from. Purchases to increase the company's debt/equity ratio, increase the net asset backing and EPS of remaining shares or absorb excess corporate case all fall within this category.

B Selective Repurchases Under Clause 52(1)(b)

Clause 52(1)(b) covers two kinds of selective repurchase. The first is an offer to one or more shareholders to which all shareholders have consented in writing. This will rarely, if ever, be used in a widely held company.[40] It may be used in a closely held company where all shareholders agree to the repurchase but do not wish to contract out of the Act's substantive protections under a clause 86 agreement. The second type of selective repurchase under subclause (1)(b) is one expressly permitted by the constitution, and made in accordance with clause 53.[41]

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31 In some circumstances a shareholder can require the company to purchase its shares under cls 88-90.

32 Clause 51(1).

33 Clause 51(3).

34 Clause 51(2).

35 Clause 52(1)(a).

36 Clause 52(1)(b).

37 Clause 52(1)(a)(ii).

38 Clause 52(1)(a)(ii).

39 Clause 52(2).

40 Clause 52(1)(b)(i). In practice this is highly unlikely ever to be satisfied, as it is impossible to obtain unanimous shareholder approval in a widely held public company. Shareholders will have changed address, moved overseas etc.

41 Clause 52(1)(b)(ii).

All repurchases must comply with the remainder of clause 52. Before repurchase, the directors must have resolved, given reasons for, and certified[42] that the acquisition is in the best interests of the company,[43] and that the terms of the offer and consideration are fair and reasonable to the company,[44] and that they are not aware of any information:

(i) which is material to an assessment of the value of the shares;
(ii) as a result of which the terms of the offer and the consideration offered for the shares are unfair to the shareholders accepting the offer.[45]

In addition, selective repurchases must comply with clause 53. The directors must resolve, give reasons for, and certify that, the acquisition is of benefit to the remaining shareholders and that the terms of the offer and consideration offered are fair and reasonable to the remaining shareholders.[46] Before an offer is made, the directors must send a disclosure document to all shareholders,[47] detailing the nature and terms of the offer, to whom it will be made (if to specific shareholders) and the text of the resolution, with such additional information that a reasonable shareholder would require.[48] The offer cannot be made within 10 working days of sending the disclosure document.[49]

There is no concept of treasury stock under the Bill. Shares are deemed to be cancelled immediately on acquisition, and can only be reissued in accordance with Part V of the Bill.[50]

The Bill declares contracts with a company for the repurchase of shares to be subordinated to the rights of other creditors.[51] The Bill also defines redeemable shares in clause 57, as shares which are redeemable either at the option of the company or the shareholder, or on a date fixed in the constitution. Shares redeemable at the option of the company are subject to the same restrictions as any other share repurchase. Shares redeemable at the option of the shareholder, or on a fixed date, however are not subject to these restrictions.

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42 Clause 52(5). This only applies to directors who vote in favour of the resolution.
43 Clause 52(3)(a).
44 Clause 52(3)(b).
45 Clause 52(3)(c). There are two typographical errors in cl 52. The words "Subsection (2)" in cl 52(5) should read "subsection (3)" and "subsection (3)" in cl 52(6) should read "subsection (5)".
46 Clause 53(1), (2) and (3).
47 Clause 53(4).
48 Clause 54.
49 Clause 53(5). It must be made no later than 30 working days after the disclosure document has been sent.
50 Clause 55(1).
51 Clause 56(3).

V REPURCHASE TRANSACTIONS UNDER THE BILL

A *Greenmail Under the Bill*

1 *Satisfying the certification requirements*

Greenmail is by definition a targeted repurchase. As such, unless authorised by unanimous shareholder agreement[52] or a contracting out provision, it will be an acquisition subject to clause 52(1)(b)(ii). Target directors must comply with a number of certification requirements. Clause 52 requires them to certify that the acquisition is in the best interests of the company, and the terms and consideration of the offer are fair and reasonable to the company. Secondly, clause 53 requires them to certify that the terms and consideration of the offer are fair and reasonable to remaining shareholders, and that the acquisition is of benefit to remaining shareholders. As the repurchase is subject to clause 52(1)(b)(ii), it will also require the company to send a disclosure document to each shareholder. The proposed repurchase may not be made within 10 days of, or more than 30 days after, the document has been sent. This disclosure, coupled with the mandatory wait period, makes any proposed greenmail vulnerable to injunctive action by aggrieved shareholders.

2 *Shareholder remedies for director misfeasance*

There are a number of options open to a disaffected shareholder both before and after a greenmail payment. Most suits will presumably be brought under the Bill rather than the common law,[53] although in some cases common law remedies may be more attractive.

(a) A suit prior to payment

The Bill enables shareholders to take action before the payment. On receipt of the disclosure document, a plaintiff shareholder could seek to restrain the acquisition under clause 53(6), on the grounds that it was not in the best interests of the company or of benefit to remaining shareholders. An injunction could be sought under clause 138 for the same reason. The third possibility would be a clause 148 action, pleading that the shareholder was about to be unfairly prejudiced. This is assisted by clause 149, which deems the signing by directors of a certificate, without reasonable grounds for the opinion set out in it, to be unfairly prejudicial for the purposes of clause 148.[54]

This is a good example of where the statutory protection may not be carried over into practice. Shareholders may not be able to utilise these protections because of

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52 Even ignoring the practical impossibilities of obtaining this, it is highly unlikely, given the antipathy with which greenmail is regarded in the United States.

53 Clause 116 states that the duties imposed on directors by the Bill are in addition to any duty imposed on a director by any rule of law, except to the extent that the duty imposed is inconsistent with or modified by the Bill.

54 Unfair prejudice actions are discussed in more detail below.

institutional problems; there is no system of contingency fees in New Zealand, and if the company moves quickly, the shareholders will only have just over a week to act. Most actions are therefore likely to occur after the greenmail payment.

(b) A suit after the payment

(i) An unfair prejudice claim under clause 148

Clause 148 of the draft Act is very similar to section 209 of the 1955 Act, with two minor changes.[55] The Law Commission regards this provision as important[56]. Section 209 was generally invoked only by shareholders of closely held companies, and the focus in the reported cases was on the meaning of unfair prejudice.[57] This could well change under the Bill. The broad focus will still be on unfair prejudice, but now certain conduct is deemed to constitute unfair prejudice. Either a complete omission[58] to sign a certificate in respect of the greenmail payment[59] or the absence of reasonable grounds[60] for an opinion set out in a certificate (false certification) required by the Bill is *deemed* to be unfair prejudice for the purposes of clause 148. Clearly this is just as applicable to shareholders of widely held companies as it is to their counterparts in closely held companies. The mere fact that the greenmail payment discriminates against other shareholders will not amount to unfair prejudice within clause 148, as discriminatory repurchases are expressly permitted under clause 52. Something else is required.

(1) The reasonable grounds requirement

Most greenmail cases under the Bill will turn on what constitutes reasonable grounds for an opinion in the certificate. Although the common law contains no explicit business judgment rule, New Zealand and English courts have shown the same

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55 The modifications are twofold and not material:
(1) The new clause removes the present ability of a shareholder to seek relief for prejudice suffered other than as a shareholder.
(2) It also emphasises the diversity of orders available to the court where it finds that shareholders have been prejudiced. See The Law Commission *Company Law: Reform and Restatement - Report No 9* (Wellington, 1989) 132-133, at para 573.

56 Above n 55.

57 See for example: *Re Waitikiri Links Ltd* (1981) 4 NZCLC 64,922, *Vujnovich* v *Vujnovich* (1989) 4 NZCLC 65,186, *Re Ashby Bergh & Company Ltd* (1988) 4 NZCLC 64,131, *Metropolitan Life Assurance Co of New Zealand Ltd* v *Triple M Ltd.* (1989) 4 NZCLC 64,821, *Tullamore Holdings Ltd* v *The Selby Shoe Co Ltd* (1986) 3 NZCLC 99,759, *Re The Great Outdoors Co Ltd* (1984) 2 NZCLC 99,260, *In re Federated Fashions (NZ) Ltd* (1981) 1 NZCLC 95,011, *Lusk* v *Archive Security Ltd,* (1991) 5 NZCLC 66,979, *Thomas* v *H W Thomas Ltd* [1984] 1 NZLR 686 (CA), *Willems & Davidson* v *Stars Corporation Ltd, Dickie & Macerata Management Ltd (No 1)* (1990) 5 NZCLC 66,113.

58 Non compliance renders the director liable to fines of up to $5000 under cl 320(1).

59 Clause 149(1) deems failure to comply with cl 52 to be unfairly prejudicial.

60 Clause 149(2).

reluctance to second guess directors on matters of business judgment[61] as their United States counterparts. This aversion is likely to extend to deciding what constitutes the best interests of the company, under clause 148, and the decision of directors to pay greenmail may prove difficult to assail on this basis. Taking their cue from United States practice, directors will have sought outside advice from investment bankers, and will only have resolved to pay the greenmail after full board discussion.[62] The resolution that the payment is in the best interests of the company will no doubt contain numerous reasons in support of this conclusion[63] even if in reality it is being employed solely to perpetuate the status of incumbent management.[64] Decisions concerning what is or is not in the best interests of the company are likely to be protected by the same sort of implicit business judgment rule that prevailed under the 1955 Act.

Greenmail necessarily depletes the assets of the target, leaving shareholders unambiguously worse off.[65] To defend themselves against an unfair prejudice claim, target directors must show they reasonably believed there would be an offsetting benefit to the remaining shareholders. The question is what will satisfy this requirement. Logically, "of benefit to the remaining shareholders" under clause 53 should mean something different to "in the best interests of the company" under clause 52. It is submitted that directors should be required to demonstrate that they reasonably believed there would be some kind of tangible advantage to shareholders and not simply point to business judgment.[66] Resolution of this issue therefore lends itself more readily to judicial intervention, as the expression "of benefit to remaining shareholders" is not inherently a part of directors' business judgment in the same way that the best interests of the company is.

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61 See *Hogg* v *Cramphorn* [1967] Ch 257 and *Thomas* v *H W Thomas Ltd* [1984] 1 NZLR 686 (CA).

62 "Full board discussion" will entail having a shrewd attorney guide discussion in the board meeting so that directors reach a preordained conclusion.

63 These are required by cl 52(4). Examples would be: a raider bent on asset stripping (*Baigent* v *DMcL Wallace* (1984) 2 NZCLC 99,122), an offeror with a policy incompatible with that of the target (*Polk* v *Good* n Del Supr 507 A2d 531 (1986)), or even the presence of a dissident shareholder-director (*In re General Motors Class E Stock Buyout Securities Litigation* above n 20).

64 Lynch & Steinberg "The Legitimacy of Defensive Tactics in Tender Offers" (1979) 64 Cornell LR 901, 936.

65 Assuming that the drop in price is greater than the initial rise that occurred when the greenmailer first acquired a stock position. See discussion of greenmail studies in "Greenmail: Targeted Stock repurchases and the Management Entrenchment Hypothesis" (1984/85) 98 Harv L Rev 1045, 1051-1054.

66 Although not necessarily. In *Polk* v *Good* 507 A2d 531 Del Supr (1986), the court stated that

> the payment of a premium of approximately 3% over market seems reasonable in relation to the immediate disruptive effect and the potential long term threat which was posed. *Clearly, that was a benefit to the company and most of its shareholders.*

Economically, "of benefit to the remaining shareholders" should require an increase in net shareholder wealth. Under this approach, greenmail would benefit remaining shareholders if it lead to an auction[67] of the company to a higher bidder.[68] Empirically, if directors pay greenmail and the company is not quickly taken over by a third party,[69] there will usually be a net fall in the share price. It is difficult to see how this can be said to be of benefit to remaining shareholders. Consequently, if directors pay greenmail without reasonable grounds for believing an auction will occur, they will be vulnerable to an unfair prejudice suit. Under this analysis, greenmail in other situations, such as the removal of a troublesome minority shareholder, could not be said to be a benefit to remaining shareholders, even if it was arguably in the best interests of the company. It is questionable, to say the least, whether New Zealand courts, with no experience of greenmail, and no history of closely scrutinising business decisions[70] under section 209 of the previous Act, will adopt this kind of rigorous approach. If the courts continue to give directors the benefit of the doubt under the new Act, it is possible the two requirements may more or less merge and be subsumed under the rubric of business judgment, relegating them to rubber stamping provisions for perpetuating the control of incumbent directors.

Even if a plaintiff shareholder can demonstrate unfair prejudice, it may be difficult to demonstrate sufficient loss in a clause 148 suit. As the provisions are for the most part procedural, the court is likely to require the shareholder to show loss or damage before granting substantive relief.[71] Probably the only damage a shareholder will be able to show is a diminution in share value. This is insufficient to ground a personal claim;[72] however at common law it was sufficient to ground a derivative action.[73] It is submitted that this should suffice for an unfair prejudice action.[74]

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67 Empirical studies in the US have shown that companies which are rapidly taken over by other bidders may be benefited by greenmail. See above n 65.

68 Any greenmail payment that was not made to enable an auction of the company at a higher price would be vulnerable under this test. Depending on one's views of the level of efficiency of the market, other greenmail payments may also be acceptable. If the payment is made to avoid an asset stripper acquiring the company for a price below the "intrinsic" or true value of the company greenmail may be an acceptable "get lost" solution. However, if one is an efficient market devotee, then these companies cannot be underpriced by the market; only companies underutilised by management will be underpriced by the market.

69 See for example the *GM* case; the substantial fall in stock prices was one of the reasons that shareholders sued. Above n 20.

70 See above n 61.

71 Above n 55, 133 at para 573.

72 Clause 143(1)(b).

73 *Prudential Assurance Co Ltd* v *Newman Industries Ltd* [1982] 1 All ER 354, 367.

74 In *Thomas* v *H W Thomas*, above n 57, it was held that the three expressions in s 209: "oppressive, unfairly prejudicial and unfairly discriminatory" taken together were directed towards conduct amounting to unjust detriment to the interests of a member or members of the company. See above n 61, 693. In *Mellon* v *Alliance Textiles Ltd & Anor* (1987) 3 NZCLC 100,092, one of the few cases to consider s 209 in the context of a widely held company, it was held that: "no doubt detriment, in terms of s 209, can arise in a number of ways but when the subject matter is a holding in a large public

If the court finds that the shareholders were unfairly prejudiced by the greenmail payment it can require the company to purchase their shares.[75] If this is at the same premium paid to the greenmailer it will serve both as an effective remedy and also as a good deterrent to future greenmail.

(ii) A claim for breach of fiduciary duty to the company

Claims for breach of fiduciary duty[76] may have less chance of success than either personal or unfair prejudice claims, as they concern the directors' relationship with the company which may be shielded to some extent by business judgment presumptions.

It is arguable that, if greenmail was not reasonably paid to facilitate an auction of the company, it will not have been paid for a proper purpose[77] and a reasonable director would[78] not have made the payment. As in the case of unfair prejudice, the outcome of this will depend on whether the courts are prepared look beyond assertions of business judgment and examine the directors' decisions more closely. Under the common law, a diminution in share value[79] is sufficient to ground a derivative action.

(iii) A personal action

As with the case of unfair prejudice, if directors have made a false certification or omitted to sign at all, they will be vulnerable. The duty to comply with the constitution and the Bill is a duty owed to shareholders.[80] Likewise the duty to certify that the acquisition is of benefit to remaining shareholders and that the terms and consideration of the offer are fair and reasonable to remaining shareholders. The same comments made in respect of an unfair prejudice suit apply here. However, like the

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company, the share can only be regarded as an investment, *and the detriment can relevantly apply only to the value of the investment*" (emphasis added). This comment clearly implies that a diminution in share value will ground such a complaint; indeed, in a widely held company, it is the only loss that will ground such a complaint. Similarly, in *Willems v Stars Corporation*, a claim under s 209 was denied because the difference in the value of the shares based on the proposal, compared with the values otherwise was almost "de minimis", above n 57, 66,121. This also clearly implies that if the drop in share value had been significant enough, the claim would have been allowed.

75 Clause 148(2)(a).

76 Possible breaches include breaches of cls 109 and 115 (the duties to act bona fide in what the director believes to be the best interests of the company and for a corporate purpose). Clause 143(3) deems these to be duties owed solely to the company.

77 A breach of cl 111. Shareholders will contend that it was paid to entrench existing management.

78 A breach of cl 115.

79 Above n 73.

80 Clause 143(2)(b).

common law, there is no breach of duty if the only loss is a diminution in share value.[81] A representative action is also available under clause 147.[82]

The statutory protection afforded by clause 143 may simply not be carried into practice. It will be expensive for a shareholder to get to court and there is no system of contingency fees. The Act only provides for costs to be advanced in respect of derivative suits, while unfair prejudice suits look the most attractive for plaintiff shareholders.

(c) New Zealand Stock Exchange requirements[83]

Section 9.5 of the NZSE listing requirements 1991[84] forbids the offerees' directors from taking action to thwart an offer, unless they personally believe that acceptance is not in the best interests of the company. This is a subjective requirement which adds nothing to the Bill.[85] The Securities Commission's 1988 report[86] did not recommend any specific measures against take-over defences.[87]

3 Drafting a greenmail prohibition

Drafting a greenmail prohibition may not as important in New Zealand as in the US, because of the stricter requirements.[88] It will only be necessary if it is possible for "bad"[89] greenmail to slip through the statutory net.[90]

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81 Clause 143(1)(b). This severely limits the chances of recovery, as it is the only loss a plaintiff shareholder will be able to show. A derivative suit does not suffer from this limitation.

82 This is a multiple personal action, enabling one shareholder to sue on behalf of other shareholders who have suffered the same damage to their personal rights.

83 The Stock Exchange is still waiting for action to be taken on the Securities Commission report to the Minister of Justice. The requirements for offeree directors are unchanged, pending new takeover legislation.

84 These are contractually binding, see *NZSE* v *Listed Companies Assn Inc* [1984] 1 NZLR 699 (CA).

85 If the directors consider the offer to be too low or believe on reasonable grounds that a higher offer is in prospect, they should advise shareholders. Seeking of a higher offer is to be confined to one reasonably in prospect and is not to be unduly prolonged or used to thwart or delay unwelcome bids. See NZSE listing requirements, section 9.5.3.

86 Above n 25, para 12.21.

87 It did however recommend, (as is required by the City Code on Take Overs and Mergers in London) that a person who acquired 30% or more of the voting stock in a company should be required to make a mandatory offer for the remaining shares. Above n 25, recommendation 12.17 at 83-84. This would effectively eliminate the two tiered tender offer as a means of taking the offeror's holding from 30 to 50%, and would substantially reduce greenmail.

88 Specifically the requirement that it must be of benefit to remaining shareholders, if this is interpreted meaningfully.

89 In other words if it is possible for directors to pay greenmail simply to entrench themselves (and not to deter one bidder and attract a subsequent offeror), and yet not be adequately caught by the statutory protection.

B Going Private Under the Bill

Going private appears to fall outside the Companies Amendment Act 1963.[91] Once the Bill is law, share repurchases may be substituted for the more expensive and circuitous methods currently used to go private with company assets. Purchase of own shares is used in the two-step methods of going private.

1 The mechanics of going private under the Bill

By itself, clause 52(1)(a) is insufficient to take a company private, due to the 10% ceiling.[92] Management will use it to acquire the first 10% of outstanding shares, with clause 52(1)(b)(ii) repurchases being used to acquire the rest. Clause 52(1)(b)(ii) allows management to make offers to one or more shareholders to acquire shares. Management will use this provision firstly to pick off the big institutional investors and then make a bundled offer[93] to the remaining shareholders.

The Bill appears to impose stricter substantive requirements on going private than do the Security and Exchange Commission rules in the United States.[94] To comply with clauses 52(3)(a) and 53(1)(a) respectively, repurchase must be in the best interests of the company, and of benefit to the remaining shareholders.[95]

2 Shareholder remedies for director misfeasance

(a) A claim under clause 148 for unfair prejudice

The effective coercion of the tender offer in a going private situation, despite its apparent lack of formal coercion, has already been noted. Shareholders faced with either a freezeout or at least a drop in liquidity for their shares are not in a position to make a completely free choice. It is important that the courts recognise this, and do not assume that shareholders are faced with a simple voluntary "to sell or not to sell" problem when

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90 For drafting a greenmail prohibition see Gilson "Drafting an effective greenmail prohibition" (1988) 88 Colum LR 329.

91 Above n 29, 57-58.

92 Clause 52(2).

93 A bundled offer is a single offer to multiple shareholders to purchase their shares on the same terms.

94 The SEC rules primarily regualte going private by means of disclosure; the only substantive regulation being Item 8 (a) of the Schedule 13E-3 transaction statement, which requires the directors to give their opinion as to whether or not the transaction is fair to unaffiliated shareholders.

95 The terms and consideration of the offer must also be fair and reasonable to the company (cl 52(3)(b) and to the remaining shareholders (cl 53(1)(b). These two requirements seem similar to the standards Delaware courts applied to going private transactions following *Singer* v *Magnavox* 380 A2d 969 (Del Supr) (1977) ie that the going private transaction serves some valid business purpose, and that it satisfies an "entire fairness" standard.

what is really at issue is a "do I sell now or later" dilemma. However, at least in theory, shareholders are protected from the coercive nature of going private by the requirement directors certify that the repurchase is of benefit to the remaining shareholders. The Bill gives standing to former shareholders, under the unfair prejudice provision.[96] If the directors have omitted to sign a certificate, or have signed one without reasonable grounds for the opinion set out in it, this is deemed to be unfairly prejudicial conduct.[97]

The most often advanced reason for going private, a reduction in transaction costs, does not satisfy the certification requirements. The benefit accrues only to insiders, as the company must be delisted to realise these savings. Therefore the mechanics used to achieve the eventual savings, selective acquisitions from large institutions, will also not be of benefit to the remaining (small) investors, who face at least a drop in liquidity, and probably a freezeout later on. Unless the insiders make only one offer[98] to all outside shareholders it is difficult to see how they can meet the certification requirements in respect of the remaining shareholders. The requirement that the acquisitions be of benefit to remaining shareholders does appear to be a more stringent test than that contended for by Brudney.[99] Even if a company were to go private in order to revalue its shares, say to retain key executives through stock option plans[100] (a valid corporate purpose), the mechanics used to do this would still not appear to benefit remaining shareholders.[101]

The difficulty for plaintiff shareholders may not be so much in showing unfair prejudice, but in demonstrating a quantifiable loss. The true loss is probably the loss of an opportunity to participate in taking the enterprise public again at some time in the future, but this is so uncertain that it would almost certainly not be justiciable.[102] The same kinds of arguments can be made in respect of a personal action, as the duty to certify that the acquisitions are of benefit to remaining shareholders is a duty owed personally to the shareholders.

(b) A derivative suit

Directors will argue that going private is in the best interests of the company. Weighing up the pros and cons will be a hazardous business. How does one value having a public market for shares for example ? Directors may be largely protected from derivative suits by a presumption in favour of their business judgment.

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96 Clause 148(1). Ex-shareholders are of course the ones who wish to sue.

97 Clause 149(2).

98 In which case the only remaining shareholders, who the insiders will have to certify the repurchases are of benefit to, will be themselves!

99 Brudney advocates stringent controls for companies seeking to go private, arguing that they should be required to show a "valid corporate purpose" in doing so. See Brudney "Note: Going Private" (1974/75) 84 Yale LJ 903, 922.

100 See discussion of Wells, Rich Prospectus. Above n 99, 924.

101 In addition, if there is no corporate purpose, a suit will lie for a breach of cl 111.

102 Above n 99, 927-928.

(c) *Going private as a self-interest transaction*

If a director holds stock in the company, she will be materially interested in the going private transaction, and it will therefore fall within the definition of a self-interest transaction, in clause 117(1). An interested director must disclose this fact to the board and enter on the interests register the nature and extent of her interest. Under clause 119, a transaction in which a director was interested can be avoided within three months of it being disclosed to all shareholders. However it cannot be avoided if the company receives fair value.[103] It will be difficult to prove that the company did not receive fair value, especially as the true loss to shareholders is the chance to participate in going public at some time in the future, which may be unquantifiable.[104]

(d) *New Zealand Stock Exchange requirements*

The New Zealand Stock Exchange requirements may impinge on going private in two ways. Firstly if the transaction disposes of over 50% of the issuer's assets, it will require majority shareholder approval.[105] Secondly there are the actual listing requirements. Under clause 7 a company can be, but is generally not, removed once it ceases to satisfy[106] the spread requirements. [107]

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103 Clause 119(2).

104 And this dynamic loss seems to be ruled out by cl 119(3). Clause 119(3) states that the question of whether a company receives is to be determined on the basis of the information known to the company and the interested director *at the time the transaction is entered into.*

105 This appears to be superseded by cl 107 of the Bill which requires any major transaction (being one that disposes of the greater part of the company's assets) to be sanctioned by shareholder approval in a special resolution.

106 Delisting will occur (or Non-Standard Listing) if the Exchange considers, taking into account any other considerations it thinks fit:
(a) Trading in the market in those shares is limited and/or
 (i) Quotation for the Securities; and/or
 (ii) Prices at which sales are reported to occur; and/or
 (iii) Any pattern of transactions
gives or appears to give a false indication of proper arms' length market prices; and
(b) Continuation of Listing without Non-Standard designation, or at all, as the case may be, is likely in the opinion of the Exchange to give rise to an unacceptable risk of damage to the reputation of the Exchange.

107 These are:
> 3.1.2(a) At least 200 Members of the Public hold in total a minimum of 25% of the number of securities of that class issued or
> 3.1.2(b) At least 500 Members of the Public hold in total a minimum of 15% of the number of Equity Securities of that class issued.

C *Poison Pills Under the Bill*

1 *A rights issue*

One option for a New Zealand company considering a poison pill involving share repurchase is make a pro rata rights[108] dividend to all existing shareholders of common stock. This will allow shareholders (except the acquiring person), on the occurrence of a specified triggering event,[109] to redeem their common stock at a premium. Before this, the rights will trade as a part of the shares and will be redeemable by the company for a nominal sum. The rationale behind this is to encourage the potential tender offeror to negotiate with the target board, or risk acquiring a company which has been effectively stripped of all its free assets.

Under the Bill, shares confer certain rights and powers on the shareholder, subject to the company's constitution.[110] When the rights are triggered (on the occurrence of the specified event), the common stock will effectively be converted into redeemable stock. This requires an alteration to the constitution,[111] which in turn requires a special resolution.[112] A special resolution is also required from the interest group (common stockholders) who have the shares in respect of which rights are being altered.[113] The beauty of this scheme is that repurchase of the now redeemable shares, if they are redeemable at the option of the shareholder, will not be subject to the provisions of clauses 52-56.[114]

2 *An issue of redeemable shares*

Instead of issuing rights, the directors could resolve to make a bonus issue of redeemable shares to all shareholders, except the acquiring person, triggered by the same events as the rights in the above situation. To issue this class of stock it must either be

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108 Rights in this particular context mean the right to redeem common stock at a premium. These rights do not appear to fall within the definition of "share" in cl 27, and are therefore not subject to the issuing requirements of the Act; in particular cl 40, which would otherwise require directors to certify that the issue was fair to all existing shareholders (including the acquiring person).

109 Such as any person acquiring a specified level of stock in the company, or making a hostile takeover offer.

110 Clauses 27 and 28.

111 Above n 110.

112 Clause 85. This will require a 75% majority.

113 Clause 95. This will probably also be forthcoming, if it is in financial interests of the majority of common shareholders to do so.

114 Under the new Act shares can be redeemable at the option of the company or the shareholder. Shares redeemable at the option of the company are subject to cls 52-56 ie the same protections as any other share repurchase by the company. Shares redeemable at the option of the shareholder, on the other hand are not subject to these sections.

authorised by the constitution,[115] or the directors must obtain shareholder approval for the issue in the same manner as they would need to in order to alter the constitution and make such a issue valid.[116] This would require a special resolution.[117] The issuing of these shares is not an alteration of shareholder rights under clause 95, if the constitution expressly permits the issuing of shares ranking equally with or in priority to existing shares.[118] The Bill also has a preemption requirement, but this can be overridden by the constitution.[119]

A bigger stumbling block to a non pro rata bonus issue is clause 40. Before the company issues shares under clauses 35 or 37, the directors must resolve and certify that the consideration and terms of the issue are fair and reasonable to the company and to all existing shareholders.[120] However the issue cannot be fair to all shareholders if it is made to all shareholders except the acquiring person (unless the pill is adopted in advance of a specific threat). To satisfy clause 40(1)(c) the bonus issue will have to be made to all shareholders, including the raider, giving the raider the same opportunity to sell her shares back to the company at a premium as other shareholders. This is similar to the case of greenmail where company wealth is also traded off for retention of control by incumbent directors.

The interesting question is which one of these two options would be adopted in practice. Both will be issued by way of a short form prospectus.[121] If a large quantity of shares has already been issued to the public, a rights issue may provide the best deterrent; if there are insufficient shares issued, directors may have to issue redeemable shares to provide a sufficient deterrent effect.

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115 Clause 35(a). An effective authorising provision in the constitution would be one permitting the issuing of blank cheque stock. This is stock in which the terms are fixed by the board at the time of issuing . It is therefore ideally suited for poison pills. In Delaware the issuing of blank cheque stock is permitted by statute. It can be issued pursuant to ss 102(a)(4), 151(a) of the Delaware Corporation statute DEL CODE ANN tit 8 (1982). These sections allow a corporation's board to issue blank cheque stock on any terms it fixes by resolution at the time of issuance, as long as the power to do so is contained in the corporate charter. The statute itself does not place any limitations on the board. See also Anon "Protecting Shareholders Against Partial and Two-tiered Takeovers: The Poison Pill Preferred" (1984) 97 Harv LR 1964.

116 Clause 37(1).

117 Clause 85.

118 It is questionable whether or not cl 95 in fact applies. It is only relevant if the issuing of these shares affects the rights of shares already in existence. The only rights that could be affected are distribution rights, and the shares do not appear to affect these rights. They will only rank ahead of other shares already issued on the occurrence of the specified triggering event.

119 Clause 38.

120 Clause 40(1)(c).

121 See Reg 4, Securities Regulations, 1981 (SR 1983/121). Companies can take advantage of the short form prospectus because, inter alia, they are issuing equity securities (either the rights or the redeemable shares) to persons who already hold equity securities of the issuer.

3 *A suit by the tender offeror*

Obviously an offeror would wish to enjoin either the issue of rights or redeemable shares. Even if the pill is not invalid per se, and directors do not breach their fiduciary duty in adopting it, implementation may constitute unfair prejudice under clause 148. This is more likely in the case of a rights issue, than a pro rata issue of redeemable shares, which is at least formally equal to all shareholders.[122]

(a) *Unfair prejudice - the rights issue*

As directors will not have signed a certificate in respect of the rights issue, arguments on unfair prejudice will not centre on the deeming provision, but rather, as was previously the case under the 1955 Act, on what unfair prejudice itself means.[123] The offeror will contend that she has been unfairly prejudiced because the rights issue discriminates between shareholders of the same class.[124] Almost all the cases brought under the predecessor section to clause 148 concerned closely held companies.[125] It is clear from the clause 149(2) deeming provision however, that unfair prejudice can be equally be invoked in the context of widely held companies.

In the leading case on section 209, Richardson J interpreted the section expansively. The focus of the section is on unjust detriment to the complainant. It is not necessary to show any want of good faith or lack of probity on the part of the board or actual invasion of the complainant's legal rights. Section 209 is a remedial provision designed to allow the court to intervene where there is a visible departure from the standards of fair dealing. [126]

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122 If the raider has a national reputation as a greenmailer however, discrimination by the target board may be allowed. A greenmail payment discrimates against all target shareholders, in favour of the acquiring person. The rights issue discrimates *against* the acquiring person in favour of all target shareholders', and it is precisely this point, that management are faced with the choice of discriminating against all target shareholders, or the raider, that persuaded the court in *Unocal* v *Mesa Petroleum Co* 493 A2d 946 (Del Supr) (1985) to permit a discriminatory self-tender, to all shareholders except the acquiring to permit a discriminatory self-tender, to all shareholders except the acquiring person, because of Mesa's reputation as a greenmailer.

123 Clause 149(2) cannot be invoked as the directors will not have signed a certificate.

124 Some courts in the US have overturned poison pills on this ground. See *Minstar Acquiring Corp* v *AMF Inc* 621 F Supp. 1252 (DCNY 1985), *Asarco, Inc* v *MRH Holmes A Court* 611 F Supp 468 (DNJ 1985), *Amalgamated Sugar Co* v *NL Industries* 644 F Supp 1229 (SDNY 1986), and *Bank of New York* v *Irving Bank Corp* 536 NYS 2d (Sup 1988). However Delaware courts have taken a different line, holding that discrimination does not render the pill invalid per se, but is simply one factor to take into account. See *Unocal Corp* v *Mesa Petroleum Co*, above n 122, and *Dynamics* v CTS 637 F Supp 406 (ND 111) (Illinois court following Delaware law).

125 Above n 57.

126 See *Thomas* v *HW Thomas Ltd* above n 61, 693-694. It is submitted that these considerations apply equally to cl 148, as it is in *pari materia*.

Section 209 has been used to successfully enjoin a "golden parachute"[127] takeover defence,[128] but this concerned a private company, and so the authority of the case is limited. The case of *Mellon* v *Alliance Textiles Ltd*[129] suggests a narrower interpretation of section 209 in the context of a widely held company. The judge held:[130]

> No doubt detriment, in terms of [section 109], can arise in a number of ways, but when the subject matter is a holding in a large public company, the share can only be regarded as an investment, and the detriment can relevantly apply only to the value of the investment.

In light of *Thomas* it is submitted that this is too narrow an interpretation. This is reinforced by recent English cases which have also interpreted "unfair prejudice" widely, holding that judges should be wary of placing a gloss on the ordinary meaning of the expression, and that the test is "whether a reasonable bystander would think the petitioner had been unfairly prejudiced."[131] It is submitted that clause 148 would enable New Zealand to invalidate shareholder rights plans which are discriminatory.[132]

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127 This involves an agreement between management and the company, providing for generous severance payments in the event of takeover.

128 See *Tullamore* v *Selby*, above n 57. The plaintiff shareholder was attempting to increase his shareholding to 50%. He brought a successful suit to restrain the company from entering into a golden parachute agreement with the incumbent manager, on the ground of unfair prejudice. It was held that there was an arguable case that entering into the contract would have been unfairly prejudicial to the shareholder, as it was designed to protect the position of the managing director, and the losses imposed by the contract would have been onerous. However the company had not deposed that the contract was in its interest, so its company, but to protect the position of the managing director.

129 (1987) 3 NZCLC 100,086.

130 Above n 57, 100,092.

131 In *Re Bovey Hotel Ventures Ltd* (unreported, 31 July 1981, Slade J) cited and approved in *Re R A Noble (clothing) Ltd* [1983] BCLC 273, 290-291, the judge stated:

> The test of unfairness must I think, be an objective, not a subjective one. In other words it is not necessary for the petitioner, or that they were acting in bad faith; the test is whether a reasonable bystander observing the consequences of their conduct would regard it as having unfairly prejudiced the petitioner's interests.

In *Re A company* [1986] BCLC 382, 388 the court stated "unfairness is a familiar concept employed in ordinary speech, often by way of contrast to infringements of legal right. It was intended to confer a very wide jurisdiction upon the court and I think it would be wrong to restrict that jurisdiction by adding any gloss to the ordinary meaning of the words."

132 It is also open to shareholders of the target, apart from the acquiring person, to sue for unfair prejudice. It was held in *Thomas* that unfair prejudice can exist even if all members are affected equally adversely.

(b) *Unfair prejudice - pro rata issue of redeemable shares*

It may even be open to a raider to argue unfair prejudice in the face of an apparently completely equal bonus issue as part of a pill.[133] This is supported by another English case[134] where it was held that a member could challenge the company's right to make a cash pro rata rights issue, even though it was at a price that clearly benefited all subscribers including himself and did not diminish his proportionate interest. Such an allotment could be unfairly prejudicial where, for example, it was known that the objecting member could not afford to take up the offer, or where he was (as was the case here) engaged in litigation against the majority shareholders and the offer was designed to deplete resources available to finance litigation. A pro rata bonus issue, while being fair in a formal sense, may therefore be held to unfairly prejudice a tender offeror, if its sole purpose is to discourage a tender offer, by inducing the existing shareholders to redeem their shares and dilute the company's wealth.

(c) *A derivative action*

The courts have already considered directors issuing shares in the face of a takeover offer.[135] The power to issue is a fiduciary power, and if exercised for an improper motive, the issue may be set aside.[136] Shares can be issued for reasons other than enabling capital to be raised, as long as these relate to a purpose benefiting the company as a whole.[137] If the shares are issued for an improper purpose, such as maintaining control in the hands of existing directors, it will be irrelevant that directors believed this was in the best interests of the company.[138] However, self interest is only one improper motive, and even if this is absent the issue can still be set aside if it is used solely to defeat a takeover offer by destroying an existing majority and creating a new one.[139] Unless directors are seeking to maintain control however, actions taken to defeat a takeover offer may be quite permissible.[140]

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133 It was recently held in the UK (*Re A Company (No 00370 of 1987)* [1988] 1 WLR 1068) that action of directors that affects all members equally could not be considered discriminatory to "some part of the members", as required by s 459 of the Companies Act 1985 (UK). However this part of the conclusion has no application in New Zealand, in view of the different wording of cl 148, and of the express words of the Court of Appeal on this point. (*Thomas* v *Thomas*, above n 61, 493). Furthermore, R*e A Company* was not followed in the later case of *Re Sam Weller* [1989] 3 WLR 923.

134 *Re A Company* [1985] BCLC 80.

135 It is submitted that the same considerations would apply to a rights issue.

136 *See Hogg* v *Cramphorn*, above n 61.

137 *Harlowe's Nominees Pty Ltd* v *Woodside (Lakes Entrance) Oil Company* (1969-70) 121 CLR 483.

138 *Howard Smith Ltd* v *Ampol Petroleum Ltd* [1974] AC 821 (PC); *Hogg* v *Cramphorn* [1967] Ch 254. This is preserved by the Bill; cl 111 requires directors' actions to be for a proper purpose.

139 Above n 138.

140 *Darvell* v *North Sydney Brick and Tile Company* (1988-89) 15 ACLR 230, 276 (CANSW).

The judicial approach to defensive stock issues is set out in the judgment of the Privy Council in *Howard Smith Ltd* v *Ampol Petroleum Ltd.*[141] The court will examine the power whose exercise is in question. Having ascertained its nature and the limits within which it may be exercised, the court will then examine the substantial purpose for which it was used and whether or not that purpose was proper.[142] A provision in the constitution permitting the directors to issue redeemable shares is likely to be extremely broad. In the absence of anything express, courts would probably construe the nature of the power as permitting directors to issue stock to defeat a hostile tender offer which they reasonably believe is not in the best interests of the company and the shareholders.[143] The court's aversion to interfering in matters of business judgment will work in favour of the target directors here.[144] In *Howard Smith Ltd* the sole purpose of issuing the shares was to destroy an existing majority, clearly an improper purpose. On the other hand, issuing redeemable shares pursuant to a clause in the constitution, solely to defeat a takeover offer (without changing voting rights) will not be an improper purpose per se.[145] It will be far more difficult for a plaintiff to show an improper purpose in these situations. The improper purpose that will presumably have to be shown, on a balance of probabilities, is an intention to perpetuate control. This is extremely difficult to show in the United States; there is nothing to suggest it will be any easier under the Bill.

In Delaware, a plaintiff must show that entrenchment was the primary motive for adopting the defensive tactic. The High Court of Australia adopted a causation test in *Whitehouse* v *Carlton Hotel Pty Ltd.*[146] Whether or not the impermissible purpose was dominant, an issue could be invalidated if the impermissible purpose was causative in the sense that, but for its presence, the power would not have been exercised.[147] However this begs the question; a plaintiff still has to show presence of the impermissible motive.

A sale of crown jewels may be a far more secure way of designing a poison pill, following the New Zealand case of *Baigent* v *DMcL Wallace.*[148] In this case the judge

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141 Above n 138, 835.

142 The constitution can be so framed to expressly or implied permit the exercise of the power of allotment of unissued shares for what would otherwise be an improper purpose. *Whitehouse* v *Carlton Pty Ltd* (1986-87) 162 CLR 285 (HCA). Under the Bill this is constrained by cl 40(2)(c) which compels the directors to certify that the terms of an issue are fair to all existing shareholders.

143 For example to prevent an asset stripping raid of the kind in *Baigent* v *DMcL Wallace Ltd*, above n 63.

144 See above n 61.

145 As of course the constitution will permit this subject to the (implied or express) qualification that it not be used capriciously.

146 Above n 142.

147 Above n 142, 294.

148 Above n 63.

distinguished the issue of shares from other takeover defences, such as the sale of an asset, stating:[149]

> it would be only in the most extreme case, if ever, that the Court would find the decision of directors to sell one of the company's assets was an abuse of power, unless of course the directors obtained some personal advantage from the sale.[150]

4 *New Zealand Stock Exchange listing requirements*

The listing requirements do not deal with specific defensive tactics. Section 9.5 of the 1991 New Zealand Stock Exchange listing requirements forbids directors of an offeree from taking action to thwart an offer unless they honestly believe that acceptance is not in the best interests of the company.[151] This is a subjective standard which adds nothing to the Bill.

D *Price Manipulation Under the Bill*

1 *Manipulation in a takeover situation*

Secret off-market purchases aside, the most effective way for a target company of the widely dispersed, publicly held variety to drive up the price of its stock quickly is through self tender.[152] Under clause 52(1) of the draft Act, repurchases are limited to 10% of the outstanding shares. This may not be sufficient to have a marked effect on prices. The alternative is to make an offer, or offers, under clause 52(1)(b)(ii). As this is an "offer to one or more shareholders", it could be made to a sufficient number of shareholders to alter the price. In New Zealand's thin market this may be quite easy to do. However, the cumbersome disclosure requirements relating to selective acquisition may frustrate any use of this mechanism to manipulate prices upwards, unless the defence can be limited to a few offers to large shareholders, or a single offer to a sufficient number of small investors.[153] As with the other takeover defences, price manipulation can only really be said to meaningfully benefit the remaining shareholders if it leads to an auction contest and higher prices for the target company. If clause

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149 Above n 63, 99,130.

150 However the scope of this dicta may be limited. Prichard J distinguished, at 99,128, between bona fide and non bona fide takeover offers. In *Baigent* the sale of crown jewels occurred in the face of a non bona fide takeover offer.

151 If the directors consider the offer too low, or believe on reasonable grounds a higher offer is in prospect, they should advise security holders. The seeking of a higher offer is to be confined to one reasonably in prospect, and is not to be unduly prolonged or used purely as a device to thwart or delay unwelcome bids.

152 Section 257 of the Crimes Act 1961 provides for up to 5 years imprisonment for "any person who conspires with any other person by ... fraudulent means.. to affect the public market price of shares". This provision is ill-defined to catch market manipulation. See above n 29, 48.

153 The target must wait at least 10 days after sending disclosure documents before it purchases shares, and in the meantime the offeror is likely to try and restrain the purchase under cl 53(6) or cl 148(1).

53(1)(a) is not interpreted this strictly, directors are likely to be able to shelter behind business judgment.

2 *Price manipulation outside a takeover situation*

The most potent form of price manipulation outside of a tender offer situation would be secret repurchases of the kind discussed in *Davis* v *Pennzoil*.[154] The disclosure requirements of clause 53 would certainly frustrate this. Manipulation is probably still possible as it is unlikely that stock prices incorporate all (including inside) information about the company. Management may be able to manipulate prices by selective repurchase if shareholders believe that management is acting on positive inside information in making the repurchases, or perhaps the thinness of the market will simply drive up prices. However this could just as easily backfire if shareholders get a different signal from the one management is trying to send.

The Bill is not designed to cope with issuer intervention on a regular basis. Such intervention under clause 52(1)(a) would require management, every time it intervened, to make an offer to all shareholders. Similarly, intervening under clause 52(1)(b)(ii) would require the sending of a disclosure document to all shareholders, and a ten day moratorium before repurchase. Both of these are impractical.

E *Closely Held Companies Under the Bill*

The Bill will have a large impact on closely held corporations, the predominant type of company in New Zealand. With companies being able to repurchase their own stock, there will be increasing interest in buyout agreements under which the company can, or must, repurchase the stock of one of the shareholders in a closely held corporation, on the occurrence of certain events. Buyouts are ideal for closely held corporations because they preserve the entity as a going concern and also give exiting shareholders a fair price for their shares, which might otherwise not find a ready market. The granting of a repurchase option to the company, rather than to other shareholders, is preferable for a number of reasons.[155]

1 *Shopping for buyout agreements - what to look for*

To be satisfactory to both the shareholder and the company the buyout agreement must be certain ex ante. The outcome of the specified triggering event or events, whether it be death, bankruptcy or a desire to sell, should be predictable in advance. The whole purpose of having this kind of agreement is to provide certainty in the present for an event which will occur at some time in the future. A related feature of any buyout agreement is that it should not be subject to majority manipulation. Any agreement which can be manipulated by the majority is necessarily uncertain.

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154 264 A2d 597 (Penn 1970).

155 O'Neal & Thompson *O'Neal Close Corporations* (3ed, Callaghan & Co, Illinois, 1990) S 7.01.

There are basically three ways to structure the buy-back.

(a) A special class of share.
(b) An agreement in the constitution.
(c) A side agreement, between the company and the shareholder.

(a) A special class of share

Under the Bill, shares are transferable, subject to any limitation or restriction on transfer in the constitution. One buyout option would therefore be to place a restriction on alienation (for example that the shares must be purchased by the company in some circumstances, and that it has a right of first refusal in others) in the constitution. However this is unsatisfactory. Under the Bill, shares in the company confer certain rights, subject to the constitution.[156] These rights can therefore be altered in the same way that the constitution can be altered (just as it was possible for directors in a widely held company to use a rights issue to convert common stock into redeemable stock in the poison pill), by special resolution.[157] The problem with majority manipulation rules out several other possibilities:

(A) Issuing a special class of share as provided for in clause 35 of the Bill.[158]
(B) The issuing of shares redeemable at the option of the company. Not only are the rights of these shares subject to alteration by special resolution, they also fail to provide ex ante certainty, as they are subject to the provisions of clauses 52-56.[159]
(C) Shares redeemable at the option of the shareholder. Because the company has no say in when these can be redeemed, they are not subject to the protections of clauses 52-56. However the rights attached to these can also be manipulated by the majority.

(b) An agreement in the constitution

This involves using clause 52(1)(b). The simplest option under this provision is unanimous consent to an offer, under clause 52(1)(b)(i). This is not particularly helpful. Simple consent now does not mean that an offer will actually satisfy the requirements

156 Clauses 27 and 28.

157 This would require a special resolution under cl 85, as well as possibly a special resolution by the affected interest group, under cl 95. Majority manipulation is only possible in a closely held company where the majority can muster the necessary 75% majority to force an alteration to the constitution. In a company with only three members, for example, the minority member would always have a right of veto. Alteration of the rights attached to shares does not appear to give the minority shareholder a buyout right under cl 88.

158 Or cl 37. Again any rights given pursuant to these shares will be subject to alteration by special resolution.

159 Clause 58.

of clause 52 later on.[160] Furthermore, if there is dissention later on, there is no guarantee that an offer will even be made. A more concrete ex ante solution is clearly desirable.

Similarly, even blanket consent in advance, with a declaration that the acquisition is in the best interests of the company, and that the terms and consideration of the offer are fair and reasonable to the company, will not satisfy the statutory requirements. It is impossible to determine, for example, during an economic boom that an offer will be in the best interests of the company five years later on.

A simple enabling provision, or a complete buyout agreement in the constitution, under clause 52(1)(b)(ii), both suffer from the same defects; both are subject to manipulation by the majority, and neither can satisfy the requirements of clauses 52 and 53 with any certainty ex ante. The statutory requirements produce some strange results. In the United States, the courts' focus is on whether a buyout restriction was fair and equitable when it was imposed.[161] Under the new Act this is irrelevant. Whether clauses 52[162] and 53[163] are satisfied falls to be decided at the time of the transaction, not when the enabling provision or buyout agreement is inserted in the constitution, and it is impossible, ex ante, to determine whether, when the repurchase actually occurs, it will be "in the best interests of the company" or "of benefit to remaining shareholders".[164] The repurchase option cited in O'Neal[165] as the most likely to receive judicial support in the United States (a right of first refusal triggered by the shareholder's desire to sell, and allowing the company and/or other shareholders to purchase shares at a price and on conditions determined by, a third party)[166] would only be upheld in New Zealand if by a quirk of fate, beyond the control of both parties, repurchase happened to satisfy the statutory requirements at the time it occurred.

In summary, any class of share is vulnerable to having its rights altered by special resolution and any agreement in the constitution under clause 52 can also be

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160 For example it is impossible to know in 1991 that an offer consented to in that year will be in the best interests of the company, and that the terms of the offer will be fair and reasonable five years later on, *even if it is fair and reasonable now.*

161 See for example *In re Estate of Weinsaft* 647 SW 2d 179, 182-183 (1983) (Mo App).

162 Whether the offer is in the best interests of the company and whether or not the terms of the offer and the consideration are fair and reasonable to the company.

163 Whether or not the offer is of benefit to the remaining shareholders, and whether or not the terms and consideration of the offer are fair and reasonable to remaining shareholders.

164 In a time of recession, like the 1987 crash, it may be that *no buyout* agreement would satisfy these criteria. It is also questionable whether repurchase is in the best interest of the company even during a period of relative prosperity. Perhaps the repurchase funds could be more profitably employed. Of course economic conditions are not always decisive; if not purchasing will lead to deadlock and corporate paralysis, repurchase may still be in the best interests of the company.

165 Above n 155, S7.09.

166 See for example *Fletcher* v *Kentucky Inns Inc* 276 NW 2d 619 (1979).

manipulated and/or will not satisfy the requirements of clauses 52 and 53 with any certainty ex ante.

(c) A clause 86 agreement

The only remaining option is to utilise clause 86 in some way, and contract out of the Bill. Action taken under clause 86 is not subject to clauses 50 to 54 of the Bill, nor to clause 35.[167] However the clause must be used in the form of a separate agreement, as a simple election in the constitution to adopt it would be subject to exactly the same defects as anything else in the constitution; the majority could alter it at will by special resolution.

(i) A separate agreement

A contract, unlike a regulation of the company, is subject only to the general provisions of the law of contract. Whereas a regulation in the constitution can always be altered or repealed by the company, a contract between the company and the shareholders may only be altered or cancelled with the consent of both parties. The contract will also provide ex ante certainty because it is not subject to clauses 50-54.

As the contract is purely personal, it binds only shareholders who are a party to it, and not subsequent transferees of the shares, unless there is novation. This difficulty could be overcome by including in the agreement a provision that it was binding on the heirs and assigns of the company and the shareholder. As a further precaution, a minority shareholder could apply to the company for a share certificate under clause 78(2), and state on the certificate that the shares are subject to the agreement. They can then only be transferred if accompanied by the certificate, giving the recipient notice of the agreement.

Even if part of the agreement provides for redemption at the option of the shareholder it does not seem to fall within the definition of a redeemable share, because under clause 57 a share is defined as being redeemable:[168]

> if the constitution of the company makes provision for the redemption or repurchase of that share by the company.

Here it is the clause 86 agreement, not the constitution of the company that provides for redemption. The only restriction on repurchase is that directors must be satisfied on

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167 Clause 86(2).

168 If it did fall within this definition, it would be subject to majority manipulation, and in order to effectuate an agreement immune from this defect, only a right of first refusal could be incorporated in the agreement, as this does not fall within the definition of redemption.

reasonable grounds that after the buyout (because it is a distribution[169]), the company will satisfy the solvency test.[170]

(ii) The validity of a clause 86 agreement

The key issue is whether a limitation on transfer can be imposed by means of a side agreement; under clause 32 a share is transferable, subject to any limitation on the transfer of shares in the constitution. If this means that any limitation on transfer must be in the constitution, it will not be possible to set up a watertight clause 86 repurchase agreement ex ante, as anything in the constitution is subject to manipulation.

(iii) The downside - Part I: strategic behaviour by the minority

The most obvious kind of strategic behaviour in a closely held company will be threats not to go along with the majority in matters requiring unanimous consent. Unanimity is required[171] to waive the audit requirement under the Bill.[172] Also requiring unanimous consent is an agreement to engage in clause 86 actions, such as making distributions and loans to directors.

The other kind of strategic behaviour will be the threat to exercise the buyout agreement. Although this may only require the company to buy the shares in the event of shareholder death or some other occasion the minority shareholder is unlikely to avail herself of, it is still a substantial threat; either the other shareholders, or the company may be compelled to purchase the shares, to keep competitors from acquiring them.[173]

(iv) The downside - Part II: strategic behaviour on the part of the majority

Strategic behaviour by the majority would consist of making the minority shareholder's buyout right, which the majority presumably cannot alter, as worthless as possible. A distribution to the minority shareholder will still be subject to clause 44(1) of the Act (the solvency test), even though the directors do not have sign a certificate in respect of the transaction. The majority may therefore engage in asset stripping the company. It seems that minority shareholders would be adequately protected from such discriminatory distributions by clause 148.[174]

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169 Share repurchases fall within the wide definition of distribution in cl 2.

170 See cl 4. However they do not have to sign a certificate in respect of this.

171 See Part X, cl 186(2)

172 As was required under s 354(3) of the Companies Act 1955.

173 And in an economic recession neither the company nor the shareholders may be in a position to purchase.

174 In a similar situation in *Re Waitikiri Links Ltd* (above n 57), it was held that majority shareholders who were running the company purely for their own benefit, and who had adopted a policy of paying low dividends and returning the profits to themselves as grants were acting oppressively. In *Willems & Davidson* v *Stars Corporation Ltd* (above n 57, 66,121), Tompkins J was in some doubt as to whether the sale of assets at an undervalue by directors was unfairly prejudicial or oppressive, as the difference in the value of the plaintiff's shares based on the proposed rule, as compared with the

The following is a buyout agreement utilising the contracting out provision of clause 86(1)(b).

BUYOUT AGREEMENT

Recitals

Agreement made this __________ day of ____________, 19___, between __________________ (hereafter referred to as the Shareholders), and __________________________ (hereafter referred to as the Company).

Whereas, the Shareholders are the owners of all the outstanding shares of the Company.

Whereas, the parties to this Agreement wish to provide for the purchase by the Company of the shares of any Shareholder who wishes to withdraw from the Company and to sell her shares during her lifetime.

Whereas, the parties to the agreement wish to provide for the purchase by the Company of the shares of any deceased Shareholder.

Therefore, in consideration of the mutual covenants contained herein, it is agreed between each of the parties to this Agreement, the following:

ARTICLE 1

By this agreement the Shareholders, as entitled persons within the meaning of that term under section 2 of the Companies Act 1992 (hereafter referred to as "the Act") unanimously assent under section 86(1)(b) of the Act, to the acquisition by the Company of their shares, in the circumstances and in the manner set out below.

ARTICLE 2

This agreement shall not be altered, amended or terminated, except in writing, signed by each Shareholder and by an officer duly authorized to act on behalf of the Company. This agreement shall be binding upon the heirs, administrators and executors of each of the Shareholders and upon the successors or assigns of the Company.

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asset values otherwise was almost "de minimis". The learned Judge eventually held that a s 209 action was not available, because of the limited consequences of the sale on the plaintiffs. However, asset sales which are clearly frustrating a buyout agreement and driving the company to insolvency are distinguishable from this case. If the directors sell off enough of the assets, the company will reach a state where it cannot repurchase the minority's shares without becoming insolvent. This is surely not de minimis.

ARTICLE 3

In the event any Shareholder ("the Seller") should desire to dispose of any of the Shareholder's shares in the Company, the Shareholder shall first offer to sell the shares to the Company.

The total purchase price shall be fixed by Article 5, except that "offer by Shareholder to sell" shall be substituted for "Shareholder's death", and "Shareholder" shall be substituted for "Deceased".

Any shares not purchased by the Company within thirty (30) days after receipt of such offer shall be offered to the other Shareholders, each of whom shall then have the right, for thirty (30) days, to purchase a portion of the shares offered based on the ratio of the shares the Shareholder then owns to the total number of shares owned by all the nonwithdrawing Shareholders. If any Shareholder does not purchase his or her portion of the shares offered, such portion shall then be available to the other Shareholders on a proportional basis. If the offer is not accepted by the Company or the other Shareholders within sixty (60) days of its receipt, the selling Shareholder may sell his or her shares to any other person but shall not do so without first giving the Company and the other Shareholders the right to purchase such shares at a price and on the terms offered by such other person.

The terms of payment shall be fixed by Article 6.

ARTICLE 4

Upon the death of any Shareholder the Company agrees to purchase all the shares owned by the deceased Shareholder at the date of the Shareholder's death. Each Shareholder agrees that any shares owned by the Shareholder at the time of the Shareholder's death shall be sold and transferred by the legal representative of Shareholder's estate to the Company. The purchase price shall be determined as provided in Article 5, and the terms of payment shall be determined by Article 6.

ARTICLE 5

The Shareholders and the Company will, concurrently with the execution of this agreement, agree in writing upon the value of each share of the Company. The value of each share of the Company will be redetermined, in writing, by the Company and the Shareholders, concurrently with the preparation of the company's accounts, which shall be prepared annually. If the Shareholders are unable to agree on a new value within thirty days after preparation of the annual accounts, then the value shall be fixed by an arbitrator appointed by the New Zealand Institute of Arbitrators.

Upon the date of any Shareholder's death, the purchase price of the deceased's share shall be the value fixed by the Shareholders and the Company in the agreed written valuation statement accompanying the last set of annual accounts immediately preceding the year in which death occurred.

ARTICLE 6

In the event of the death of a Shareholder under Article 4, ten percent of the purchase price shall be paid within sixty (60) days of the company receiving notice of the death. In the event of acceptance by the Company of the Shareholder's offer under Article 3, ten percent of the purchase price shall be paid within sixty (60) days of the company's acceptance. In both cases, the balance shall be paid in sixty (60) equal consecutive monthly instalments, the first falling due thirty days after initial ten percent has been paid. The obligation to pay these instalments shall be evidenced by promissory notes issued by the Company.

ARTICLE 7

Each of the parties shall do everything in their power, and shall execute all instruments necessary to facilitate the repurchase of the vendor Shareholder's shares, and make effective the provisions of this Agreement.

(v) Instalment payments and the solvency test

Because a clause 86 agreement is being used, the directors do not have to sign a certificate in respect of any distributions.[175] However the solvency test must still be satisfied for each instalment payment. This again raises the possibility for majority manipulation of distributions. No matter how the price is calculated, by formula, agreement, or book value, it will be subject to the solvency test. There is thus incentive for directors to strip the company of assets, so that distributions under the buyout agreement will not be able to be made as they will cause insolvency. As has already ben discussed, section 209 case law would appear to protect the minority shareholder from this abuse.[176]

VI CONCLUSION

The repurchase provisions of the Bill are a deliberate attempt to protect shareholders from the abuses associated with some these transactions in the United States. The Bill relies strongly on disclosure to implement this protection, particularly the certification requirements. This is all very well, but effective implementation of shareholder rights requires more than a pro-shareholder statute. The legislative protection will work only as long as it can be readily enforced, and the Bill assumes an institutional structure for enforcement which is simply not present in New Zealand. We have no system of contingency fees to encourage enforcement, nor, with our thin market, do shareholders possess the same degree of rights consciousness as in the United States. The Bill attempts to address this problem, by providing that costs may be advanced in litigation, but it does not go far enough. From a shareholder's point of view, an unfair prejudice suit is the most potent cause of action for director misfeasance, and yet costs may only

175 Clause 86(2).
176 See *Re Waitikiri Links*, above n 57.

be advanced in a derivative suit. Coincidentally, this is the situation most likely to be protected by any de facto business judgment rule.

Even if one ignores the problem of litigation costs, there are difficulties within the Bill itself. The bedrock of shareholder protection in a selective repurchase situation is the requirement that directors certify the acquisition is of benefit to remaining shareholders. This provision, unique to New Zealand, raises problems consonant with its uniqueness. The clause manages to simultaneously frustrate the desirable cases of repurchase, such as close corporation buyout agreements, while providing only uncertain protection in situations of potential abuse, such as greenmail. The protection is uncertain because it is wholly dependent on how the courts interpret the "benefit" requirement. If clause 53 is to provide any meaningful protection it will necessitate the courts looking long and hard at some of the decisions of big business, something they have been loath to do in the past.

In Australia, close corporations are dealt with under separate legislation. By adopting only one set of repurchase provisions for both widely and closely held companies, New Zealand has paid the price for compactness. The legislation does not bring out the fundamental difference between repurchases made by closely held companies on the one hand and their widely held counterparts on the other. Buyouts in closely held companies are usually agreements, made some time in advance, to provide a predictable ex ante solution to problems that may arise in the future. In contrast, when widely held companies repurchase their shares, it is often an ad hoc response to a specific event, such as a hostile takeover bid. The repurchase provisions of the Bill do not cater well for agreements formulated in advance, such as these close corporation buy-backs. The most reasonable buyout agreement in the world cannot guarantee compliance with the Bill. Somewhat ironically, this forces shareholders seeking protection from majority manipulation to contract out of an Act purportedly designed to protect them from just such conduct. Even contracting out may have validity problems.

Big business may discover that although the Bill does permit share repurchase, it will not allow them to purchase in the way they would have liked. A prime example is price manipulation, or stabilisation. To be sure, companies are free to acquire their shares in order to affect the price. But how are they to do it ? Must they make an offer to all shareholders, under clause 52(1)(a) ? If they decide on selective repurchase must the company send disclosure documents to all shareholders at least ten days before each repurchase ? This raises interesting problems when one considers that a company may wish to intervene regularly, perhaps even daily. This is only a minor quibble however; many would argue that companies should not be purchasing buying their own shares in a free and efficient share market anyway.

The big question is how the courts will deal with the issues that the Bill raises with respect to share repurchase. Perhaps the only comment that can be made with any degree of certainty is that the New Zealand law concerning share repurchase will develop in a manner very different to that of the United States.